PALIARE ROLAND
BARRISTERS

Andrew Lokan
T 416.646.4324 Asst 416.646.7411
F 416.646.4323
E andrew.lokan@paliareroland.com
www.paliareroland.com

File 16035

August 18, 2008

Via Courier and Email

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor, 2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Walli:

Re: Hydro One Networks Inc. 2008 Distribution Rate Application
EB-2007-0681

Enclosed please find the Power Workers' Union final argument in this proceeding.

Three hard copies have been forwarded to the Board via courier delivery.

We trust this is satisfactory.

Yours very truly,
PALIARE ROLAND ROSENBERG ROTHSTEIN LLP

"A. Lokan"

Andrew Lokan
AL/sb

cc: All Participants (*via email/regular mail*)
Hydro One Networks Inc. *(via email/regular mail)*

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EB-2007-0681

IN THE MATTER OF the *Ontario Energy Board Act 1998*, S.O. 1998, c.15, (Schedule B);

AND IN THE MATTER OF an application by Hydro One Networks Inc. for an order approving or fixing just and reasonable rates and other charges for the distribution of electricity.

SUBMISSIONS OF THE POWER WORKERS' UNION

The Power Workers' Union ("PWU") makes the submissions below on issues 1.5, 3.1, 3.2, 3.3, 3.6, 4.2, 7.1, 7.2, and 7.7.

1. ADMINISTRATION

1.5. Have the impact of Conservation and Demand Management initiatives been suitably reflected in the load forecast?

1. The PWU notes that two of the main issues that were raised in this proceeding with respect to the level of CDM impact on Hydro One's load forecast for 2008 were: first, Hydro One's use of the OPA's assumptions and numbers with respect to the provincial CDM savings target to be achieved in 2008; and second, whether Hydro One should be required to make an adjustment for naturally occurring conservation and demand response in line with the Board's EB-2006-0501 decision on Hydro One's 2007/08 transmission rates application. This decision resulted in a 350 MW adjustment of the OPA's 2007 target of 1350MW.

2. Hydro One filed a report that details bottom-up analysis of the CDM savings achieved to the end of 2007. For 2008, Hydro One used the OPA's IPSP forecast of 800 GWh of CDM savings for the province to derive its forecast

of 126 GWh based on its share of the provincial load. The PWU submits that this is appropriate and that there is no basis to require Hydro One to further adjust its forecast for naturally occurring conservation and demand response, for the reasons set out below.

Exhibit H, Tab 1, Schedule 105, Attachment A

3. First, as noted in the OPA's *Conservation Bureau 2007 Annual Report, Supplement: Conservation Results, June 2008* ("Annual Report"), and as noted by Hydro One's expert witness Mr. But in cross-examination, Ontario has achieved a demand reduction of 1462MW for the period 2005-2007. Page 8 of the Annual Report makes it clear that the 1462MW demand reduction, which has exceeded the 1350MW provincial target, is net of naturally occurring conservation:

> In 2004, the Ontario government set a target for 2007 to reduce Ontario's peak electricity demand by five percent from the Independent Electricity System Operator's 2007 forecast peak electricity demand of 27,000 megawatts. This meant a reduction of 1,350 megawatts. Since 2004, the 2007 peak demand forecast was revised downward to 26,282 megawatts (reference forecast) as a result of various factors, including some naturally occurring conservation.

4. As can be seen from the following Table 3.1 of Page 8 of the Annual Report, it is the 26,282 MW reference forecast, which is net of natural conservation, that is in turn adjusted for weather and used to derive the 1462MW demand reduction.

Table 3.1: Comparison of 2007 peak demand to forecast (megawatts)

Forecasted 2007 peak demand	**Weather-adjusted 2007 peak demand**	**Demand reduction including conservation and other factors**	**Percent below forecast**
26,282	24,820	1,462	5.6

5. It is clear, therefore, that the lack of accurate information on the part of the OPA with respect to the level of natural conservation and the Board's decision to require Hydro One to adjust its CDM forecast for 2007 in EB-2006-0501 by 350MW has resulted in an underestimation of CDM achieved savings for 2007.

6. Second, the OPA's understanding of the Government's directive with respect to the IPSP CDM targets beyond 2007 is that they are net of natural conservation. This is noted in EB-2007-0707 (IPSP), Exhibit D, Tab 4, Schedule 1, Attachment 2, Page 2:

> The Directive established further conservation targets of an additional 1,350 MW of demand reduction by 2010 and a further 3,600 MW by 2025. This Directive provided clear instruction that the targets were to be met through the implementation and delivery of effective new conservation programs. It was understood that natural conservation would not play a role in the achievement of these goals.

7. The PWU therefore submits that without a proper analysis and accounting of conservation results and the appropriate evaluation, monitoring and verification system in place, any assumptions about natural conservation are prone to subjectivity and any attempt by the Board to require Hydro One to adjust CDM forecasts under such circumstances would be arbitrary and could cause a significant variance to the Company's load forecast.

8. The PWU also believes that it is appropriate for Hydro One to include demand response programs as part of the forecast CDM savings for 2008. As the evidence indicates, this approach is consistent with that of the OPA's IPSP CDM savings.

Exhibit K, Tab 6, Schedule 13

3. COST OF SERVICE

3.1 Are the overall levels of the 2008 Operation, Maintenance and Administration budget appropriate?

3.3 Is the proposed level of 2008 Shared Services and Other OM&A spending appropriate?

9. The PWU submits that subject to the comments under Issue 3.2 below, the overall levels of the 2008 OM&A budgets and proposed level of shared services and other OM&A spending are appropriate.

10. Hydro One clearly established in evidence that its OM&A budgets were driven by an assessment of its work needs. External factors such as system expansion, the need to improve vegetation management, asset replacement needs, conservation, and the introduction of smart meters, are the major drivers of Hydro One's work requirements.

Applicant's Pre-Filed Evidence, Exhibit C1, Tab 4, Sched. 2, p. 7

11. As indicated in Exhibit C1-T2-S1, page 2 (see Table below), total OM&A expenditures have increased by 38% or $132 million over the 2004 to 2008 period and $74 million or 18% over the 2006 to 2008 period.

Table 1

Summary of Distribution OM&A Budget ($ Million)

Description	**Historic (Actual)**			**Bridge**	**Test**
	2004	**2005**	**2006**	**2007**	**2008**
Sustaining	207.9	222.0	255.6	278.8	280.0
Development	5.5	4.8	4.2	8.0	9.1
Operations	16.3	11.2	14.9	12.6	13.4
Customer Care	103.0	96.3	103.7	97.1	103.8
Shared Services and Other OM&A	9.3	23.3	21.2	91.9	66.9
Taxes Other Than Income Tax	4.0	4.6	4.5	4.2	4.5
TOTAL	346.0	362.1	404.1	492.6	477.7

12. The PWU understands that some intervenors have expressed concerns over the proposed increase of the 2008 OM&A budget over the 2006 amount, suggesting that it amounts to a “significant increase”. The PWU disagrees with any suggestion that the proposed increase is unnecessary and unreasonable. The PWU submits that no evidence has been adduced to demonstrate that the proposed OM&A budget is not reasonable or prudent in any respect; either in relation to the number of units of work encompassed in the proposed work program, or in respect of the cost associated with any of those units of work. The PWU submits that the Board should approve the proposed OM&A budget for the following reasons:

(a) The proposed OM&A expenditures should be examined in terms of the necessary work programs identified in Hydro One’s evidence, which are a result of a rigorous need assessment. The PWU submits that these forecasts are based on the Company’s business planning process described in detail in the evidence which includes needs identification and work program prioritization that are designed to identify needs that are absolute requirements.

(b) Any assessment of the reasonableness of the proposed work program must take into account the potential consequences of not undertaking the proposed work. It is imperative that the Board be aware of the impacts of any decision that disallows amounts of the proposed budgets on service quality, reliability and safety.

(c) As the evidence shows, the requested OM&A expense for 2008 of $477.7 million is actually $14.9 million less than the $492.6 million OM&A expense incurred by the company in 2007. As Hydro One submitted in its Argument-in-Chief (Transcript, Volume 7, pages 15-16), the Board should consider the fact that the expenditures in 2007 took place in a year when the revenue requirement was determined by the 2nd generation Incentive Regulation Mechanism (IRM) and was therefore not based on cost of service. The 2008

rates that are the matter for this proceeding are based on a cost of service regulatory review.

(d) It is clear from the evidence that $70 million of the $74 million increase in the total OM&A in 2008 over the 2006 amount is driven by two elements of OM&A expenditures, i.e., Shared Services and Other OM&A ($46 million) and Sustainment Expenditures ($24 million). Here again, it is important to note that both 2008 Sustainment Expenditures and Shared Services and Other OM&A costs have decreased from the 2007 levels: $280.3 million and $91.9 million in 2007 to $280 million and $66.9 million in 2008, respectively.

13. With respect to Shared Services and Other OM&A, the PWU submits that Hydro One has followed the appropriate methodology to determine the level of expenditures attributable to the distribution arm of its business; moreover, the proposed amounts are reasonable and appropriate. The PWU notes that a number of factors contribute to the forecast $46 million increase in Shared Services and Other OM&A in 2008 over the 2006 amounts, including an increase in the shared services workload that is required to support core work programs and comply with regulatory activities. The PWU also notes that the largest single contributor to the increase in Shared Services and Other OM&A is actually the reduction in credit relating to the Other Shared services category from $106.3 million in 2006 to $78.3 million in 2008, a reduction of $28 million which has the net effect of increasing OM&A by the same amount.

14. With respect to sustainment Expenditures, Hydro One's evidence indicates that these expenditures are required to ensure the safe and reliable operation of the distribution system, and include increased vegetation management costs, increased maintenance costs associated with aging assets, and an increase in costs associated with smart meters. However, it is important to note that, as the table below indicates, the $24 million increase in sustainment

Expenditures in 2008 over the 2006 amounts is, almost solely attributable (but for the $3.6 million increase in spending associated with smart meters) to the $30.3 million increase in spending on vegetation management offset by a combined reduction in spending of $9.5 million on maintenance of stations and lines.

Table 1
Sustaining OM&A
($ Million)

Description	**Historic**			**Bridge**	**Test**
	2004	**2005**	**2006**	**2007**	**2008**
Stations	18.4	19.9	26.0	25.0	24.9
Lines	92.4	105.3	126.5	124.6	118.1
Meters	8.2	10.3	14.0	15.7	17.6
Vegetation Management	88.9	86.4	89.1	115.0	119.4
Total	**207.9**	**222.0**	**255.6**	**278.8**	**280.0**

Exhibit C1-T2-S2 Page 3

15. The main issue for consideration by the Board, therefore, is whether or not the proposed spending on vegetation management is justified

3.2 Is the 2008 vegetation management budget appropriate?

16. The PWU respectfully submits that the vegetation management budget is appropriate to the extent that it partially recognizes the pressing need to shorten the cycle for line clearing and brush clearing from the current 10 to 11 years to eight years. However, there is compelling evidence that Hydro One should go further and move to a six-year cycle.

17. As seen in Exhibit C1-T2-S2 (see Table 9 below), Hydro One spent $89.1 million on vegetation management in 2006, $115 million in 2007 and plans to spend $119 million in 2008.

Table 9
Vegetation Management
($ Millions)

Description	Historic			Bridge	Test
	2004	2005	2006	2007	2008
Unplanned Maintenance (d)	6.2	5.3	6.1	6.9	6.0
Customer Notification	6.9	6.8	6.8	6.5	7.9
Asset Condition Assessment	0.5	0.2	0.5	0.5	0.5
Line Clearing	55.6	52.9	50.6	74.1	76.8
Brush Control	19.6	21.1	25.2	26.9	28.2
Total	**88.9**	**86.4**	**89.1**	**115.0**	**119.4**

Exhibit C1-T2-S2, p. 30

18. The evidence in Exhibit C1-T2-S2, page 30 also indicates that the reason for the increase in spending on vegetation management is primarily attributable to increased levels of accomplishment in line clearing (accomplishment increased by 35%) and brush control (accomplishment increased by 25%).

19. The PWU submits that the Board ought to approve the requested budget for vegetation management for the following reasons:

(a) Vegetation management, which constitutes the largest work program managed by Hydro One, has the greatest impact on system reliability, an objective that is of overarching importance to the PWU. In this respect, the Board should consider in its decision, as noted in Exhibit C1-T2-S2, Page 35, the considerable reliability impacts of trees on Hydro One Distribution's system. Trees on average account for about 57% of SAIDI and during force majeure events the impacts increase to an average of 78% with a high of 84%. Similarly, Exhibit A-T3-S1 shows that tree-related contacts accounted for 28% of SAIFI between 2003 and 2006. Indeed, as

confirmed in a recent (August 14th) Press Release by NERC, the major August 2003 Blackout affecting large sections of the U.S. and Canada was caused by multiple transmission outages due to vegetation, and NERC now has in place a zero-tolerance policy for breach of vegetation management standards. It is clear that the Board's approval of the requested spending will allow Hydro One to improve its reliability performance.

(b) As PA Consulting Group ("PA")'s Hydro One Distribution Benchmarking Study ("PA Study") filed in this application indicates, while Hydro One's reliability performance adjusted for line length is in line with the norms of the group of companies considered by the PA Study, Hydro One has comparatively poor reliability within the panel group, when measured by SAIDI and SAIFI on a "customer experience" basis. While the PA Study's finding is not unexpected given the rural nature of Hydro One's service territory, there is no doubt that the requested budget for line clearing and brush control will contribute to the improvement of Hydro One's reliability performance. In this respect, the PWU also notes that the PA Study indicates that the optimum tree trimming cycle length is nearer to 5-6 years than to the 11 years currently in practice at Hydro One. The PWU, while understanding Hydro One's proposal to move to an eight-year cycle and to monitor the costs and reliability benefits before moving to a 6-year cycle, is of the view that a shorter trimming cycle would, in the long-term, benefit ratepayers both in terms of improved reliability and reduced cost.

P.A. Consulting Group Distribution Benchmarking Study, dated October 24, 2007, Exhibit A, Tab 15, Schedule 2A, p. 4-21

20. In addition to the PA Study, Hydro One filed two specific studies into vegetation management practices in response to interrogatories: the 2008 Vegetation Management Program Review, prepared by M. Higgins and E. Lybrogiannis, and the 2003 Vegetation Management Study.

2008 Vegetation Management Program Review, Exhibit H1, Schedule 14, Attachment C

2003 Vegetation Management Study, Exhibit H1, Schedule 49, Attachment A

21. The 2008 Study sets out the following rationales for shortening the cycle in vegetation management:

- It leads to measurable and significant increases in reliability;
- It leads to lower annual operating costs; and
- There are various other unquantified benefits, such as improved customer relations, and public and worker safety.

22. The 2008 Study points out that most utilities manage vegetation according to a four to six year cycle. This is also supported by the PA Study's report that a 5-6 year cycle is standard.

2008 Vegetation Management Program Review, Exhibit H1, Schedule 14, Attachment C, p. 3

P.A. Consulting Group Distribution Benchmarking Study, dated October 24, 2007, Exhibit A, Tab 15, Schedule 2A, p. 4-21

23. Each of the three rationales put forward in the 2008 Study for a shorter cycle not only supports Hydro One's planned move to an eight-year cycle, but supports going further to a six-year cycle. In particular:

- The expected improvements in SAIDI and SAIFI arising from tree-related incidents would be almost twice as much if Hydro One moved to a six-year cycle as opposed to an eight-year cycle;
- The projected annual cost savings would increase from $14 million to $21 million if Hydro One moved to a six-year cycle rather than an eight-year cycle; and
- Hydro One would gain additional benefits in the areas of customer satisfaction, corporate reputation, public and worker safety, and ability to respond to the challenge of the Emerald Ash Borer infestation. While these benefits are not quantified, they are nonetheless real and may translate into cost savings.

2008 Vegetation Management Program Review, Exhibit H1, Schedule 14, Attachment C, p. 7-8, 11, 17

24. Indeed, the 2008 Study indicates that a six-year cycle will produce optimum “steady state” financial benefits. This is because costs of tree trimming and line clearing tend to rise as the cycle length increases, because the task of clearing vegetation while working around power lines becomes more complex.

25. The 2003 Study provides a graphic illustration of this phenomenon in Chart 2 at page 8. The most cost effective way to clear brush is by spraying, which in 2003 cost 50¢ per tree. However, spraying only works until trees grow to three metres tall. As they grow further, costs escalate dramatically as follows (in 2003 terms):

- Brush over three metres but outside limit of approach to energized conductor - $5 per tree;
- Brush within limit of safe approach to conductor - $10 per tree;
- Trees more than 10cm in diameter measured at breast height - $100 per tree.

2003 Vegetation Management Study, Exhibit H1, Schedule 49, Attachment A, p. 8

26. The amount of time that it takes trees to grow to three metres varies according to the type of forest and climate conditions, but in all three vegetation zones in Hydro One’s service area (Boreal, Great Lakes, and Carolinian), the most common brush species reach this height in six to seven years, as detailed in Table 7 of the 2003 Study. In the Boreal or Northern zone, poplar is the dominant species of brush, and reaches this height in seven years. In the Great Lakes and Carolinian zones, many species reach three metres in six years. It is therefore not surprising that the 2003 Study recommended a brush clearing cycle of 5.8 years. Indeed, in light of this evidence, it defies logic that Hydro One would recommend an eight-year cycle for both line clearing and brush clearing.

2003 Vegetation Management Study, Exhibit H1, Schedule 49, Attachment A, Appendix D, p. 18 - 19

27. The reasons offered by Hydro One for choosing an eight-year cycle over a six-year cycle were (a) a concern that moving from a 10 to 11-year cycle to a six-year cycle over the space of five years would be too costly, and (b) that such a move would impose too great a burden on current rate payers. Hydro One estimated the one-time costs of moving to an eight-year cycle as being $60 million over five years, and the comparable cost of moving to a six-year cycle as being $125 million over five years.

2008 Vegetation Management Program Review, Exhibit H1, Schedule 14, Attachment C, p. 19

28. However, Hydro One's own witness George Juhn admitted under questioning from the Panel Chair, Mr. Gordon Kaiser, that he would "feel better" with a six-year cycle, except for the practicalities of making the transition. The PWU respectfully submits that the financial implications of moving to an optimum cycle, consistent with other utility practice, are better addressed through lengthening the transition period. The benefits of the six-year cycle, not just in lower annual operational costs, but also in significant increases in reliability and unquantified but nonetheless real increases in customer satisfaction, corporate reputation, public and worker safety, and the like, will be enjoyed in perpetuity. The PWU submits that it is high time that Hydro One brought its vegetation management practices in line with those of other utilities.

Transcript, Volume 2, p. 167, lines 13-25

29. In its Response to Undertaking J2.7, Hydro One suggested that it could move to a six-year cycle over a five year period and ensure intergenerational equity by establishing a regulatory deferral account that it estimated would take 17 years to clear. The PWU submits that this analysis likely understates the benefits of the six-year cycle – for example, there are additional unquantified benefits in the areas of corporate reputation, customer satisfaction, and public and worker safety that may well have financial implications. But in any event, no analysis is presented in J2.7 that would address the benefits of moving to a six-

year cycle over a longer transition period (as noted also by Board Staff). The PWU submits that a longer transition period would likely mitigate the strain on staffing and organizational resources that Hydro One cites as the major practical impediment to achieving a six-year cycle. Alternatively, Hydro One should at the very least implement a six-year cycle for brush clearing, where the benefits of a cycle that avoids brush growth over 3 meters are overwhelming.

Transcript, Volume 2, p. 114, line 19 – p. 115, line 20

Response to Undertaking J2.7

3.6 Are the 2008 Human Resources related costs (wages, salaries, benefits, incentive payments, labour productivity and pension costs) including employee levels, appropriate?

30. The PWU notes that concerns relating to allegedly "high' levels of compensation at Hydro One have been raised in recent rate hearings involving Hydro One. In EB-2005-0378 on Hydro One's 2006 Distribution Rates application, for example, the Board indicated that it was "particularly concerned about the apparently high labour rates," and that it expected Hydro One to identify what steps it had taken or would take to reduce labour rates. In its Decision dated April 12, 2006, the Board directed Hydro One to engage an independent party to develop a list of comparable North American companies with similar business models, and submit a report on high level comparative performance and cost information for Hydro One and the comparable companies as part of its next rate application. The Board also directed the submission of a comparison of labour rates and overtime policies amongst Hydro One, other comparative Ontario electricity distributors and other Canadian utilities as identified in the high level benchmarking study. As part of its 2007/08 Transmission rates application (EB-2006-0501) Hydro One filed a benchmarking study, prepared by PA Consulting in September 2006, which compared 21 of Hydro One's business performance metrics with those of 13 North American utilities. In its decision in EB-2006-0501, the Board accepted the forecast compensation costs for 2007 and 2008; however, the Board noted that the PA Consulting study suffered from various deficiencies and shortcomings, and

therefore, directed Hydro One to prepare a more comprehensive study of its compensation costs and how they compare with the costs of comparable utilities, and to file the results with its 2008 Distribution rate filing, or its 2009 transmission application.

31. The PWU understands that, after extensive consultation with stakeholders, Hydro One engaged the PA Consulting Group and Hay Group to undertake the Benchmarking and Comparison of Labour Rates and Overtime Policy studies, respectively, and that partial results of these studies have been filed with the current application. Full results are anticipated to be filed with Hydro One's 2009 transmission rates application.

32. The PWU understands that some intervenors have expressed concerns with Hydro One's forecast labour costs in the current application, largely citing the level of increases in compensation cost over the 2006-2008 period. However, the PWU submits that compensation levels for Hydro One's full time staff and the reasonableness of Hydro One's total labour costs cannot be considered in isolation from Hydro One's overall staffing strategy. Hydro One's staffing strategy in turn should be considered in the context of the challenge that Hydro One is facing in hiring and retaining a skilled workforce, given the expected high retirement rate of its labour force in the near term, the ever increasing work programs, and the competition from the rest of the industry for skilled workers. The Ontario electricity sector is undergoing changes in both the transmission and distribution businesses, due to the significant planned replacement or refurbishment of generation resources that have implications on the transmission and distribution infrastructure.

33. Moreover, due consideration should be given to the significant initiatives taken by Hydro One which have resulted in efficiency gains and labour cost savings, notwithstanding the fact that Hydro One operates in an environment

where compensation levels for 90% of its staff are determined through collective bargaining.

No Evidence that Compensation Levels at Hydro One are "Too High"

34. The PWU submits that no party has presented any evidence that shows compensation levels at Hydro One to be unreasonable compared to those at similar utilities. In fact, the only such evidence before the Board, in so far as such comparisons are of any relevance, is the Hay Group Comparison of Labour Rates and Overtime Policy Study ("Hay Group Study") filed by Hydro One with this application. This study illustrates that, for the sample jobs studied, Hydro One's rates are generally within market rates, and overtime policies for comparable positions are also comparable with those of other organizations considered in the study. The study shows, among other things that:

- For the Field Operations Manager class, Hydro One's hourly wage rate minimum is 24% below market; the hourly wage rate maximum is 10% below the market average. For the Designer Engineer class, Hydro One's hourly wage rate minimum is comparable with the market and the hourly wage rate maximum is 4% above the market. For the Powerline Maintainer class, Hydro One's hourly wage rate minimum is 30% below the market and the hourly wage rate maximum is 12% above the market.
- Progression from the hourly wage rate minimum to hourly wage rate maximum at Hydro One takes significantly longer time and more steps compared to the market average (Exhibit A-15-2, Attachment B, Page 9: 2007).

Table 1:

Standard Length of Time from Minimum to Maximum Wage Rate (Months)

Survey Position	**Market Average**	**Median (P50)**	**Hydro One**
Design Engineer	68	54	**96**

Powerline Maintainer	41	54	**72**

Table 2:

Number of Wage Rate Steps before Reaching Maximum Wage Rate (Months)

Survey Position	**Market Average**	**Median (P50)**	**Hydro One**
Design Engineer	5	4	**9**
Powerline Maintainer	5	5	**9**

Hay Group Comparison of Labour Rates and Overtime Policy Study, Exhibit A-15-2, Attachment B

35. Hydro One's hourly wage rate minimum is below the market for the Design Engineer position, and considerably so for the Powerline Maintainer position. Moreover, progression from the minimum hourly wage rate to the maximum hourly wage rate not only takes longer but also involves a larger number of steps at Hydro One compared to the market average.

36. The PWU submits that this should, in fact, raise a concern in terms of attracting, motivating and retaining skilled staff, a concern that Hydro One has itself acknowledged:

> In an industry with aging demographics and a highly competitive labour market, the Corporation needs to be positioned as an attractive employer if it is to succeed in recruiting and retaining staff with the requisite skills. To do so, it must provide a competitive compensation package and challenging and rewarding job opportunities.
>
> Exhibit C1-3-1, Page 8

37. The PWU notes that the companies surveyed in the Hay Group Study are companies that Hydro One competes with for skilled labour, and to whom Hydro One could lose its skilled workforce (or conversely attract skilled workforce from). In this context, the PWU submits that, for example, with respect to the Powerline

Maintainer position, a minimum hourly wage rate that is 30% below the market, and 9 steps between the minimum and maximum hourly wage rate compared to the average 5 steps for the market, and a 6-year wait to reach the maximum wage rate compared to less than 3.4 years for the market, should be a source of concern in terms of Hydro One's ability to compete for urgently-needed skilled workers.

38. The PWU notes the following with respect to comparisons of compensation with other companies. First, high skilled labour costs are not unique to Hydro One. They reflect the shortage and competition for skilled labour related to the workforce demographics facing the industry as a whole. Second, there is no evidence to suggest that Hydro One is unique in terms of overtime policies and union representation, as noted in the Hay Group Study:

> Hydro One's overtime eligibility, overtime policies and union representation seem generally similar to the norms of the market survey participants.
>
> Hay Group Study, Exhibit A-15-2, Attachment B, page 14

Hydro One's Work-Based Approach to Staffing is the Major Driver of Compensation Costs

39. Hydro One takes a work-based approach to staffing, whereby Hydro One resources according to work programs rather than planning the work around the number of internal resources available. Hydro One considers the amount of work to be done, the nature of the work and the skills required, and uses cost saving strategies to recruit, train and reward its skilled workforce. The evidence also indicates that demographic and skills analyses are conducted annually to ensure that Hydro One attracts and retains the required level of skilled workforce. Instead of hiring or using regular staff for all types of work, Hydro One uses a variety of labour resources, including regular, temporary, hiring hall and contract staff, to provide the necessary flexibility to manage in a cost-effective manner.

40. Hydro One first establishes the need for work programs, and then determines the number and type of workers required and forecasts the associated labour cost. In addition to tight competition for labour and power system professionals, Hydro One faces challenges resulting from the significant increases in its work programs. As described by Hydro One, the major growth in work programs requiring increased staffing resources and support systems is caused by changes in conservation initiatives, installation of smart meters, vegetation management, increased demand in specific geographic areas, the need to replace aging assets, system expansion and generation mix.

Exhibit C1-T4-S2, Page 7

41. The PWU submits that what is relevant to the Board is whether Hydro One has established the need to justify its forecast of workforce and compensation level for 2008, as opposed to the percentage increases in forecast amounts over historical levels. Percentage increases or decreases treated in isolation of the drivers underlying them are not informative and are not a prudent basis for the Board's consideration of Hydro One's requested revenue requirement.

42. In this respect, the PWU notes that some intervenors have raised concerns with percentage increases with respect to number of employees and total wages referenced in the evidence. According to a table provided in Exhibit H-12-20, Attachment A, that breaks out employee count and total wages by employee representation, there has been an increase in the total number of employees from 5,301 in 2006 to a forecast of 7,079 in 2008, and of total wages from $459,324,903 in 2006 to a forecast of $580,700,000 in 2008. This amounts to increases of 34% and 26% respectively. However, at least as far as PWU-represented employees are concerned, these increases are primarily attributable to the increased work program and the demographic challenge facing Hydro One, rather than wage escalation.

Exhibit H-12-10, Attachment A, p.1

Transcript, Volume 3, p. 42, lines 17-28

The Demographic Challenge of Hydro One's Aging Workforce

43. Hydro One has identified its aging work force as one of the many challenges it faces, and notes that it is bound to see a critical loss of skill sets in the coming years:

> Hydro One's greatest corporate risk with respect to its human resources continues to be an aging workforce and, with a world-wide scarcity of core skills in the industry, a highly competitive labour market. By December 31, 2008, approximately 1,000 Networks staff, representing 24% of the current population, are eligible for an undiscounted retirement. This is a trend which is expected to continue through the next decade and is consistent with challenges faced by other utilities in the electricity sector throughout the world. Recent studies suggest that up to half the workforce in the North American electricity industry will be eligible for retirement in the next five years.
>
> Exhibit C1-T3-S1, page 1

44. This is consistent with testimony by Hydro One's witness Judith McKellar, who, during cross examination by School Energy Coalition ("SEC") testified that 60% of the total number of staff Hydro One plans to hire in 2008 are needed due to increase in work load and the remaining 40% are needed due to expected retirement levels over the next few years, starting in 2008:

> MR. DeVELLIS: The other theme, I guess, that is in your evidence is your demographic challenges. So what I am trying to get at is what proportion of your total hires -- the additional 1,186 employees you're going to be hiring in 2008, what proportion of that is due to the work program and what proportion is due to your demographic issues?
>
> MS. McKELLAR: If I was going to give you based on my knowledge of the demographics and the number of people that have retired, I would probably say it was a 60-40 split. Sixty would be for new work program growth and 40 would be for attrition, the demographics term.
>
> Transcript, Volume 3, page 52

45. Ms. McKellar further testified that by 2012, 40 % of Hydro One's work force will be eligible for undiscounted retirement.

Transcript, Volume 3, page 53

46. While Hydro One is taking a number of measures to address the problem, including hiring through apprenticeship programs, the skill shortage Hydro One is facing is likely to continue in the future. Hydro One needs to compete for skilled workers not only with other distribution and transmission companies in Canada and the U.S., but also faces competition from non-distribution/transmission companies such as generators.

47. In light of the above, the Board should not expect there to be any material reductions in the foreseeable future, at least in terms of compensation per employee, notwithstanding Hydro One's best efforts. In other words, per employee compensation should not be looked at in isolation; the context in which it operates is critical, including the increase in the overall work programs, the resulting competition for labour, and the changing demographics of Hydro One's work force. By the same token, neither should the Board rely on per-employee compensation as a reliable and valid indicator of Hydro One's efficiency or cost effectiveness.

Cost Savings Have been Gained

48. Hydro One's evidence indicates that it has taken a variety of cost efficiency measures, including some that have resulted in reduced compensation costs compared to the volume of work its work force have been carrying out:

> Despite a projected 40% increase in Hydro One Networks Distribution and Transmission businesses' work program expenditures between 2006 and 2008, whereas over this same time period the regular staff count is expected to only have grown by 23% and total staff resources (regular and non-regular) by 34%. This is an indication that Hydro One is getting more work done without a corresponding increase in resource levels.

Exhibit C1-T1-S4, page 2

49. The evidence also indicates that the cost savings realized and expected to be realized are the result not only of Hydro One's staffing strategy but also of its efforts to reduce compensation costs through joint participation between management and the unions on work efficiency improvements, as well as collective agreements.

a. From Collective Agreements

50. Compensation levels at Hydro One are determined through binding collective agreements which apply to approximately 90% of its staff. Wage rates, benefits and pension entitlements for unionized employees can only be changed through collective bargaining. However, it is important to note the cost savings which Hydro One achieved in the last rounds of bargaining. With respect to the PWU, for example, the following gains have been achieved:

A. PWU Incentive Plan non-renewal
B. Lower meter reader B rate negotiated
C. Modified duty hours
D. Switching agents for stations
E. Winter meal reduction
F. Temporary headquarters established

Exhibit C1-T3-S2, page 4

51. Hydro One has achieved costs savings relating to the PWU represented staff through its focus on achieving increased management flexibility to run operations:

> "…The key focus with respect to the PWU has been to achieve increased management flexibility to run the operations, as opposed to wide scale reductions in wages, benefits and pensions."

Exhibit C1-T3-S2, page 4

52. The PWU submits that the reality of the labour market that Hydro One operates in means that it is neither realistic nor prudent to expect future cost reductions to be achieved through decreases to per employee cash compensation. In a highly competitive labour market, where Hydro One, other utilities and many other companies will be facing shortages of skilled labour, downward pressure on compensation rates will simply undermine Hydro One's ability to recruit and maintain the skilled staff it requires in order to meet its future operational needs.

b. The Use of Overtime

53. The PWU understands that Hydro One's management has the prerogative to meet its human resources needs through the assignment of overtime. While the rate of pay for overtime worked by unionized staff is prescribed by the provisions of the applicable collective agreement, the decision on whether any overtime is to be worked lies with management. The PWU understands that management has determined that, notwithstanding the premium rates which are payable in respect of overtime, it is generally less expensive to the company to have overtime worked than it is to add additional complement to the regular staff. As cited earlier, the Hay Group Study indicates that Hydro One has overtime policies and eligibility criteria that are similar to other utilities. The Hay Group study also shows that for the Powerline Maintainer position, all of the thirteen market survey participants that matched to the Powerline Maintainer are eligible for overtime.

Hay Group Study, Exhibit A-T15-S2, Attachment B, pages 14, 2

54. Extensive use of overtime pushes up Hydro One's average cost per employee, but results in overall cost efficiency. If Hydro One were to hire more permanent staff instead of using overtime, it would have to incur additional costs on pension, health and other benefits. Moreover, as Ms. McKellar testified, Hydro

One's use of overtime helps meet variable staffing needs and provides flexibility which ultimately allows the Company to reduce its overall compensation cost:

> MR. LOKAN: Okay. Overtime, is it fair to say that overtime is another mechanism to provide flexibility in meeting your workplace needs?
> MS. McKELLAR: Absolutely. In the evidence, we talk about overtime, and it's important to realize that given the essential nature of our business and the fact that it is a 24-7 operation and a lot of our overtime has to do with storm restoration, it is a necessary part of the business. We work often in remote locations where it does not make good business sense to send in another crew. It's more cost efficient and customer focussed to complete the work and have the crew complete it on overtime.
> MR. LOKAN: Right. And I take it when you use overtime, you don't need to increase the complement. You have the work force already there, so there is that advantage?
>
> MS. McKELLAR: Correct.
>
> MR. LOKAN: You have existing employees who are fully trained. You don't need to train anybody up, and it permits you to deal with fluctuations up and down in the day-to-day workplace needs?
>
> MS. McKELLAR: Correct.
>
> Transcript, Volume 3, pages 28-29

c. The Use of the Hiring Hall

55. The hiring hall has been a very important component of Hydro One's strategy in reducing the overall compensation costs. Cost savings are gained by allocating work that requires less skill to the Hiring Hall rather than using more skilled permanent staff who could be assigned to higher-skilled work. Finally, the Hiring Hall saves time and money since it provides flexibility in terms of deployment.

Pension Plan Costs

56. One factor in the increased compensation costs is the increase in funding to the pension plan required under Hydro One's recently-filed actuarial valuation report. These were estimated at $23 million per year at the time of the filing of the application. The evidence is uncontradicted that the drivers for the increased funding requirement are actuarial assumption changes, and an increase in

current service cost reflecting staff growth (in turn related to Hydro One's work-based approach to staffing.) Hydro One confirmed in cross-examination that these costs were not driven by any increase in benefits.

> Exhibit C1-3-2, Appendix A, p.3
>
> Hydro One Inc. Pension Plan and Fund – Report on the Actuarial Valuation for Funding Purposes as a December 31, 2006 (dated September 5, 2007), Exhibit H-1-76
>
> Transcript, Volume 3, p. 39-40

57. Pension plan funding is a complex and technical area governed by actuarial standards and subject to the oversight of the Financial Services Commission of Ontario ("FSCO"). No party adduced any evidence that challenged or called into question the actuarial need for this funding, and there is no basis in the evidence for doing so.

58. The PWU notes that Board Staff, in their submissions, have indirectly challenged the need for increased pension plan funding by questioning the need for a variance account to track the difference between estimated and actual pension costs. In this context, Board Staff appears to suggest that introducing a defined contribution plan might avoid such costs. However, with respect, this suggestion must be rejected for the following reasons:

- There is absolutely no basis in the evidence to suggest that introducing a defined contribution plan, even if possible, would be any less costly;
- No party even explored this issue in cross-examination;
- In fact, pension regulatory standards administered by FSCO require funding on a prescribed basis for all benefits accrued to date, and the actuarially-required funding of such benefits (and concomitant differences between projected and actual costs) must continue into the future regardless of any future changes to the pension plan; and

- The pension plan is incorporated into the PWU collective agreement, and any changes to the plan must be collectively bargained.

59. The PWU submits that in this context, a deferral account is appropriate because it protects the ratepayers by ensuring that there is no risk of over recovery or under recovery. This is appropriate because the cost variances arise in circumstances where there is no ability to either control or forecast the variances.

4. RATE BASE

4.2 Are the amounts proposed for 2008 Capital Expenditures Appropriate?

60. The PWU submits that, as in the case of the OM&A budgets, the proposed distribution capital budgets should be considered in the context of the asset replacement and refurbishment needs of Hydro One's aging system, the Government's directive with respect to smart meters, the need to expand the system to meet forecast load growth, distributed generation connection, and also in terms of cost escalation related to the high increase in the price of materials and equipment.

61. The PWU notes that Hydro One has proposed a capital budget of $566 million for 2008, an increase of $173.6 million (44%) over the 2006 expenditures and $89.6 million (18%) over the 2007 amounts. Here again, the PWU notes that some intervenors have raised questions with respect to the size of the proposed increase in capital expenditures between the 2006-2008 period. Hydro One's evidence indicates that about $131 million of the $173.6 million increase (about 75%) is attributable to the proposed increase in sustaining capital. It is also of interest that the proposed $131 million increase in sustaining capital in turn is due to a $151.6 million increase in metering capital ($150.7 million in smart

meters; about $1 million in customer retail meters) offset by a decrease in Lines Sustaining Capital of over $23 million. Similarly, compared to actual spending in 2007, about $88 million, almost all of the increase in the 2008 proposed sustaining capital, and therefore almost all of the increase in the proposed total capital spending, is attributable to smart meters. It is clear from the evidence that, while other components of the proposed capital expenditure such as development capital associated with customer growth and other capital programs such as the Cornerstone IT initiatives have contributed to the overall increase in the proposed capital spending in 2008 over the 2006 amounts, the growth in capital spending is primarily due to increases in sustaining capital related to smart meters and associated systems.

Exhibit D1-T3-S1, page 2, Table 1

62. This is consistent with Exhibit J2.2 which shows the impact of removing the smart meter program from capital spending. When increases in capital spending related to smart meters are removed, Hydro One's proposed capital expenditures represents an increase from a 2006 level of $378.5 million to $399.9 million in 2007 (6%), and then to $401.4 million in the 2008 test year (an increase of $1.5 million over the 2007 expenditures, a relatively insignificant increase of 0.37%).

Exhibit J2.2

63. Hydro One has submitted that the forecast increase in spending on smart meters in turn is attributable to its plan to install 370,000 smart meters by 2008 (compared to 222, 831 in 2007) and that approximately 700,000 smart meters will have to be installed in 2009 and 2010. The PWU submits that the proposed level of spending is needed to implement Hydro One's plan to install 1.2 million smart meters by 2010 and thereby help realize the June 23, 2004 Minister of Energy's Directive to the Board that establishes targets for the installation of smart meters for all Ontario consumers by 2010.

Exhibit H-T10-S31

64. The PWU notes that there have been questions posed on spending levels on what Hydro One identified as incremental (exceeding minimum) functionalities. Hydro One's evidence shows that $136.5 million (83%) of the $164.8 million smart meter capital spending forecast for 2008 relates to minimum functionality and the remaining $28.3 million (17%) is for activities which Hydro One submits are associated with incremental functionalities. The incremental functionalities identified in the evidence fall into four categories: meter outage detection capability, collectors outage detection capability, time-of-use capability, and integration and meter-base repair and replacement costs. As per Ontario Regulation 425/06, a distributor may recover costs relating to functionality that exceeds minimum functionality provided that they are approved by the Board. In the absence of a clear definition that enables the Board to accurately distinguish between minimum and "exceeding minimum" functionalities, the Board is expected to use its good judgment in its consideration of the eligibility of any equipment, systems and technologies procured by distributors for cost recovery. Hydro One has submitted, and the PWU agrees, that the proposed Smart Meter-related expenditures under the "Exceeding Minimum Functionalities" category either support the government's policy of adopting time-of-use rates and the integration of systems and technology with the IESO systems, or support systems that in the long-term benefit rate payers by improving efficiency and reliability. The PWU, therefore, submits that the Board should approve the proposed capital expenditure relating to smart meters.

Exhibit D1-T3-S2, page 27

7.0 COST ALLOCATION AND RATE DESIGN

7.1. Are Hydro One's proposed new Customer Rate Classes appropriate?

7.2. Is Hydro One's cost allocation appropriate?

7.7. Is the proposal for harmonization of rates appropriate?

65. The PWU notes that Hydro One is proposing to simplify its rate structure by harmonizing (consolidating) the rates for its 88 acquired utilities and its

existing legacy rates, over a four year period. Hydro One has proposed to adopt 12 common rate classes for all customers at the end of four years, instead of the approximately 280 rate classes presently in place. Hydro One has submitted that consolidating the existing rate classes would better reflect utilization of assets and services which impact cost causality. Hydro One also has submitted that the simplified rate classes are partly designed to be more consistent with the number, and categorization of rate classes typically used in other Ontario distribution companies ("LDCs"), and are expected to reduce customer confusion and be significantly easier to manage from an administrative perspective.

Exhibit G1, Tab 2, Schedule 1, Pages 1-2

66. While the PWU is cognizant of the varying rate/bill impact of the proposed cost allocation and rate design on the different rate classes, the PWU's position is that the Board must ensure that its decision on this issue is fair to all rate payers to the extent feasible in line with the principle of cost causality, and that Hydro One is kept financially whole.

Conclusion

67. For all the above reasons, the PWU respectfully submits that Hydro One's proposed 2008 revenue requirement is prudent and cost effective, and therefore merits Board approval.