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August 18, 2008

**VIA MAIL & E-MAIL**

MS Kirsten Walli  
Board Secretary  
P.O. Box 2319  
2300 Yonge St.  
Toronto, ON  
M4P 1E4

Dear Ms. Walli:

**Re: Vulnerable Energy Consumers Coalition (VECC)**  
**EB-2007-0681**  
**Hydro One Networks Inc. – 2008 Electricity Distribution Rate**  
**Application**

Please find enclosed the Final Submissions of the Vulnerable Energy Consumers Coalition (VECC) in the above-noted proceeding.

Thank you.

Yours truly,

Michael Buonaguro  
Counsel for VECC  
Encl.

**ONTARIO ENERGY BOARD**

**IN THE MATTER OF *the Ontario Energy Board Act, 1998*;  
AND IN THE MATTER OF an Application by Hydro One Networks Inc.  
For an Order or Orders approving rates for the distribution of electricity.**

**Final Submissions of  
The Vulnerable Energy Consumers Coalition (VECC)**

**August 18, 2008**

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## **EB-2007-0681 Hydro One Distribution Inc. 2008 rates**

### **Executive Summary**

1. VECC represents vulnerable ratepayers who are least able to bear the burden of the rate increase sought by Hydro One in its 2008 Rate Application.
2. The regulatory principles of prudence, fairness and the burden of proof on Hydro One to prove the proposed cost increases are warranted in order to maintain an acceptable level of service to customers have guided VECC and its consultants in the review of the Application and its final submissions.
3. VECC is an “all issues” intervenor but has focused its attention on certain issues and as much as possible it has coordinated its activities with other intervenors of similar interests.
4. In the part of the Application dealing with the 2008 Revenue Requirement VECC’s primary concerns are the proposed increases in OM&A Expense above 2006 Board Approved levels; accordingly much of VECC’s argument is focused on that topic.
5. In the area of Rate Base and Capital Expenditures VECC has concerns primarily with the regulatory treatment of Smart Meter Capital and regulatory treatment of the benefits realization for the Cornerstone Project.
6. VECC supports the submissions of CME and others regarding an envelope approach to establish the appropriate OM&A Expense for 2008. This results in a recommended level of \$428 million, excluding Smart Meter OM&A, based on a reasonable escalation from Hydro One’s 2006 actual spending.
7. Alternatively using a “line by line approach” to the 2008 OM&A Expense, then the following Table shows the lines where VECC has identified costs that are not reasonable and where the Hydro One’s 2008 OM&A claim of \$478 million should be reduced:

<b>OM&amp;A Line Item</b>	<b>Hydro One Claim</b>	<b>Reduction</b>	<b>Recommended</b>
<b>SUSTAINING</b>			
<b>Vegetation Management</b>	<b>\$119.4 M</b>	<b>-\$13.3 M</b>	<b>\$105.7 M</b>
<b>SHARED SERVICES</b>			
<b>Telecom Services</b>	<b>\$8.7 M</b>	<b>-\$1.7M</b>	<b>\$7.0 M</b>
<b>Inergi Fees</b>	<b>\$114.4 M</b>	<b>-\$6.1M</b>	<b>\$108.3 M</b>
<b>Pension Costs</b>	<b>\$33.0 M</b>	<b>- \$1.5 M</b>	<b>\$31.5 M</b>
<b>Regulatory Costs</b>	<b>\$2.9 M</b>	<b>-\$2.2 M</b>	<b>\$0.7 M</b>

<b>OTHER</b>			
<b>Smart Meters</b>	<b>\$9.7 M</b>	<b>-9.7 M</b>	<b>\$0.0 M</b>
<b>LT Load Transfer</b>	<b>5.2 M</b>	<b>- \$0.8 M</b>	<b>\$4.4 M</b>
<b>SUBTOTAL</b>	<b>288.1 M</b>	<b>-36.1 M</b>	<b>252.0 M</b>
<b>REMAINING OM&amp;A</b>	<b>189.7 M</b>	<b>\$0.0 M</b>	<b>189.7 M</b>
<b>TOTALS OM&amp;A</b>	<b>477.8M</b>	<b>-36.1 M</b>	<b>\$441.7 M</b>

8. It should be noted that while the envelope approach is based on escalation from 2006 actuals, VECC's line by line analysis, detailed later on in these submissions, references 2006 board approved figures, which in Hydro One's case, for many line items, was in excess of their actual spending for 2006.
9. With regard to the 2008 Ratebase and CAPEX VECC has three financial issues affecting the 2008 Revenue Requirement -the regulatory treatment of Smart Meter Capital, recalculation of the Working Capital Allowance with a GST rate of 5% and incorporation of the Board's findings and update of the 2008 ROE using the Board's latest forecast.
10. With respect to Hydro One's proposed cost allocation and revenue to cost ratio proposals, VECC has detailed submissions objecting to the proposals and proposing an alternate proposal which it submits is more appropriate.
11. With respect to Hydro One's harmonization proposal, it is VECC's submission that Board should reject the Hydro One Networks harmonization plan and direct the Company to come back (for May 1, 2009 implementation) with a plan that includes a full assessment of customer impacts, proposed impact criteria for individual customers as well as the "average customer" and proposals on how to deal with unacceptable outliers.
12. With regard to 2008 Smart Meters, VECC requests the Board to direct Hydro One to use the Rate Adder/ Deferral Account regulatory treatment similar to that approved for Toronto Hydro. In addition, VECC submits that no recovery of costs above minimum functionality be allowed pending generic Board direction on eligible costs. As shown in Exhibit J2.2 this treatment would reduce 2008 OM&A by \$9.7 million and CAPEX by \$164.8 million.
13. If the Board accepts these submissions on the 2008 cost of service, the adjusted revenue requirement can be calculated by Hydro One, reflecting changes to the Working Capital Allowance using a 5% GST rate and to the Weighted Average Cost of Capital using the Board's allowed 2008 ROE of 8.57%.
14. With regard to Rate Implementation, VECC is concerned that the 2008 Rate year may be more than half over before new rates can be implemented.

15. Nonetheless, given the reduced revenue requirement resulting from these submissions, VECC opposes any retroactivity and submits that the new rates, reflecting the Board-Approved 2008 revenue requirement be implemented on a prospective basis for the balance of the 2008 rate year.

### **Submissions on Confidentiality**

16. With respect to the various requests for confidentiality made by Hydro One, VECC has reviewed and adopts the submissions of the School Energy Coalition with respect to the requests related to Exhibit J2.5 (the CN Utility Study), J3.10 (Quarterly Management Reports), and with respect to the general restrictions that should be placed on access to information the Board has allowed to be filed in confidence. Specifically, VECC submits that Exhibits J2.5 and J3.10 should be placed on the public record.
17. With respect to Exhibit J3.3, VECC does not have any submissions with respect to whether that information should be deemed confidential, however if the Board does deem it confidential access should be made to all participants, whether lawyer or consultant, in accordance with SEC's submissions.

### **Overview of the Application**

18. Hydro One is seeking the following:
- a. A revenue requirement of \$1,067 million for the 2008 test year, as set out in Exhibit E2, Tab 1, Schedule 1 on the basis of the methodology described in Exhibit E1, Tab 1, Schedule 1.
  - b. An OM&A cost expenditure level of \$478 million in 2008 for the Distribution Business, as summarized in Exhibit C1, Tab 2, Schedule 1. Hydro One's request for this approval is supported by evidence in various schedules in Exhibit C.
  - c. Other components of the "Cost of Service", as summarized in Exhibit C1, Tab 6, Schedule 1 and Exhibit C1, Tab 7, Schedule 1. These include Hydro One's depreciation and amortization rates and Payments in Lieu of corporate income taxes ("PILs") for the Distribution Business for 2008.
  - d. A Distribution business rate base of \$4,382 million in 2008 as summarized in Exhibit D1, Tab 1, Schedule 1. Hydro One's request for this approval is supported by a discussion of the assets and the capital expenditures forecast of \$566.2 million for 2008 as found in Exhibit D1, Tab 3, Schedule 1, page 2, Table 1.
  - e. Regulatory assets with a total balance of \$(49) million to April 30, 2008, which would be refunded over a four-year period, as summarized in

Exhibits F1, Tab 1, Schedule 1 and F1, Tab 2, Schedule 1 (amended to \$65.5 million).

- f. Proposals for cost allocation, rate design and rate harmonization. Hydro One's mitigation plan is to limit increases to 10% based on total bill impacts for average use customers. This ignores the much higher impacts on vulnerable consumers, including low and fixed income customers.
- g. Approval of three new deferral accounts, as detailed at Exhibit F1, Tab 3, Schedule 1:
  - an account to track the impact of incremental OEB costs,
  - an account to record the sum of \$2.5 million per year of revenue deficiency resulting from the impact mitigation proposals, and
  - a variance account to track variations in pension costs.

### ***Discussion on Increase in Revenue Requirement***

19. The magnitude of the increase in revenue requirement and the associated impact on rates can be best assessed by reference to the corresponding Board-Approved 2006 amounts, since 2007 rates were indexed using the second generation IRM Formula.
20. Relative to 2006 Board Approved Revenue Requirement and rates, the applicable comparison is shown below from Exhibit E1, Tab 1, Schedule 1, page 4, tables 2 and 3:

**Table 2**  
**Comparison of Revenue Requirements: 2006 vs. 2008 (\$ Millions)**

<b>Line No</b>	<b>Description</b>	<b>Year 2006 OEB Approved</b>	<b>Year 2008</b>	<b>Difference</b>
1	OM&A	423	478	55
2	Depreciation	202	239	37
3	Capital Taxes	10	11	1
4	Income Taxes	69	39	(30)
5	Return	261	300	39
	<b>Total Revenue Requirement</b>	<b>965</b>	<b>1,067</b>	<b>102</b>



**Table 3**  
**Components of Change to Revenue Requirement**  
**Previously OEB-Approved (2006) vs. Proposed (2008)**

Description	Amount (\$ millions)
Impact of increased rate base	63
Increase in OM&A	45
Impact of Smart Meters	22
Change in Common Equity	8
Impact of lower statutory tax rate	(9)
Decrease in asset removal costs	(9)
Lower ROE as per OEB formula	(8)
Decrease in cost of debt	(6)
Other	(4)
<b>Total Change</b>	<b>102</b>

21. Without offsets due to lower tax and financing costs, there would have been an increase in the Revenue Requirement of \$138 million or 14.3% from 2006-2008.

22. Leaving aside the Impact of Smart Meters, the increase is 12% over two years.

### **Hydro One Position**

23. Hydro One argues that it has provided evidence that increased costs are justified and explained:

*Mr Rogers*

*But at the very outset, I would ask the Board to be mindful of two defining features of this case when we're dealing with the revenue requirement.*

*First, the requested OM&A expense for 2008 is actually less than the OM&A expense incurred by the company in 2007. The company's proposal actually seeks approval of a reduction in OM&A expenses over actual expenditures in 2007.*

*Second, the capital increase of \$90 million in 2008 over actual 2007 levels is almost entirely attributable to smart meter spending. In fact, the increase in capital spending, excluding smart meters, is only \$1.5 million more than actual 2007 expenditures. I will come back to that a little later in the argument.*

*I, therefore, ask the Board to look carefully at the actual level of costs incurred by the company in the bridge year 2007. This was a year in which the revenue requirement was determined by the 2nd generation IRM. [emphasis added]*

*The company's selfish financial interests would have been best served by avoiding or deferring costs in 2007. [Tr. Vol 7 page 15]*

## **VECC Submissions**

24. VECC submits that what happened to Hydro One's expenditures in 2007 is not relevant.
25. What is relevant is the significant increases sought above the 2006 approved expenditures and rates.
26. VECC suggests that in its 2007 fiscal year Hydro One chose not to live within the 1.1% increase in rates allowed under the OEB second generation IRM and overspent with an apparent expectation of maintaining the much higher actual operating and capital increases in 2007 and recovering these from ratepayers, not only in 2008, but as the new higher base revenue requirement going into third generation IRM from 2009 onward.
27. VECC submits that this constitutes "padding" or "stuffing" of the base revenue requirement and is most evident in the OM&A claim for 2008.
28. Apart from the level of costs claimed for 2008 there is also evidence that some cost increases are non-recurring in future years and the regulatory approach should be to amortize the costs and/or to stipulate a base revenue requirement adjustment for 2009 prior to 3GIRM.
29. VECC submits that Hydro One's position does not meet the regulatory requirement that the cost increases proposed for 2008 and beyond are reasonable, prudent and necessary to maintain the quality of Hydro One's Distribution services.
30. Hydro One may seek to excuse its high operating costs per customer based on the long radial nature of its system and the low density of its distribution network, [Exhibit A, Tab 15, Schedule 2, Page 1] but in VECC's view that does not excuse the fact that these and other important cost metrics are "going south", [Exhibit H, Tab 12, Schedule 10] i.e. deteriorating markedly year over year and in VECC's view demonstrate a lack of cost control by Hydro One management.
31. With regard to rate harmonization, Hydro One's mitigation plan is to limit increases to 10% based on total bill impacts for average use customers. This ignores the much higher impacts on "non-average" consumers, including vulnerable low and fixed income customers.

## **Detailed Argument Based on Unsettled Issues**

### **1.1 Has Hydro One responded appropriately to all relevant Board directions from previous proceedings?**

32. Partially Settled. The parties agree that the Applicant has appropriately responded to all directives from prior proceedings including those from the 2006 Distribution rate application (EB-2005-0378) and the 2007/08 Transmission rate application (EB-2006-0501) as outlined in Exhibit A-17-1, Table 1 with exception of those directives related to the following:

- CDM
- Compensation

33. The narrowed scope of the issue is: “Has Hydro One responded appropriately to Board directions from previous proceedings with respect to CDM and compensation?”

### ***CDM***

### ***Summary of VECC Position***

34. VECC agrees with Hydro One that the Board’s directive has been superseded by the OPA financing of LDC CDM Programs:

The Board expects Hydro One to present future CDM load reduction forecasts with a bottom-up analysis estimating the expected results of their CDM activities and those of others that affect their loads. The Board expects Hydro One's next CDM load reduction forecast, of this order of magnitude, to include a proposal for an LRAM. (2.3.13)

Response Note - Hydro One has concerns with the practical difficulties and related accuracy of determining the actual amount of CDM savings achieved by its customers in a given year, through the implementation of CDM initiatives from various sources such as the Ontario Power Authority, Provincial Government and Federal Government. Hydro One believes it is prudent to wait for the OPA to develop Measurement and Verification programs for determining actual CDM achievements and as such is not proposing or requesting an LRAM at this time. (Exhibit A, Tab 17, Schedule 1)

## **Compensation**

### **VECC Submissions**

35. Compensation is still presented as part of the OM&A associated with Work Programs and this is in VECC's view not helpful to the Board's direction to demonstrate reductions in compensation in this application.
36. Hydro One should provide comparative Historic, Bridge and Test year compensation/payroll costs in a standard format that allows the contribution of employee levels and compensation to the cost of work programs and OM&A to be assessed at a high level by Intervenor and the Board.

*MR. ROGERS: I do know this whole issue about these labour rates has been an issue in the cases before. I have to say that it has always been an issue and people have trouble understanding how this applicant does it, but their explanation is --*

*MR. KAISER: Let me just tell you I had the same concern as Mr. Sommerville, I guess. This is from a regulator's perspective, and I don't know how you got to this point, but the company actually has audited statements separately for distribution and transmission, which in itself is unusual. That's the good news.*

*The bad news is that the usual cost elements that a regulatory process would look at, such as labour, because of the way -- are not there, so we need to resolve this once and for all. It may be that the statements need to be done in a different fashion so that we're not going through this every year, you know we just end up and say, Well, you can't rely on this number. It is both distribution and transmission.*

*But, in any event, have a look at what the -- we just want to know what the real world is. We're not asking you to manufacture anything.*

*MR. ROGERS: I understand. You want to see what it looks like in the real world. I understand.*

*Tr. Vol 3. Page 118*

37. Although Hydro One provided some Compensation and payroll information in Exhibit C2, Tab 3, Schedule 1, in VECC's view the filed material is not responsive to the usual regulatory requirement to provide historic, bridge and test year payroll and total compensation and employee data in a consistent logical format that relates to the claimed OM&A and revenue requirement.

### **1.2. Has Hydro One responded appropriately to the Board's Directions on CDM and Line loss reduction?**

38. Partially Settled. The parties agree that the Applicant has responded appropriately to the Board's Direction on Line Loss reduction. The parties also

agree that the remaining issue relating to Hydro One's response to the Board's Direction on CDM is covered under issue 1.1.

### **1.3 Are the Affiliate Service Agreements appropriate?**

39. Settled. The parties agree that the Applicant's Affiliate Service Agreements are appropriate. They are similar in form and substance to those previously reviewed and approved in EB-2005-0378 and EB-2006-0501. However, the parties' agreement on this issue is without prejudice to the positions that they may take on the costs of Affiliate Services which fall within Issues 3.3 and 4.6.

### **1.5 Is the load forecast and methodology appropriate and have the impact of Conservation and Demand Management initiatives been suitably reflected?**

40. Partially Settled. The Applicant continues to apply the same forecasting methodology as approved by the Board in EB-2005-0378. The only issues that the parties were unable to reach agreement on are the impact of CDM on the load forecast, the compatibility of Hydro One's load forecast with the OPA's load forecast and whether an LRAM is appropriate.

41. The narrowed scope of the issue is: "Have the impact of Conservation and Demand Management initiatives been suitably reflected in the load forecast? Is Hydro One's load forecast compatible with the OPA's load forecast? Is an LRAM appropriate at this time?"

***Issue 1.5 a) Have the impact of Conservation and Demand Management initiatives been suitably reflected in the load forecast? Is Hydro One's load forecast compatible with the OPA's load forecast?***

### ***Hydro One Networks Position***

42. Hydro One Networks uses a number of different methods (i.e., econometric models, end-models and customer surveys) to produce the load forecasts required for its distribution business<sup>1</sup>. The load forecast supporting the Application was prepared in April 2007 and uses economic information and forecasts that were available at that time<sup>2</sup>.

43. In developing the load forecast, explicit adjustments were made to account for the provincial CDM target of 1350 MW by 2007 and the OPA's forecast of incremental CDM savings for 2008. Furthermore, consistent with the Board's Decision's August 2007 Decision regarding Hydro One's Transmission Rate Application (EB-2006-0501) the 2007 provincial target of 1350 MW was

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<sup>1</sup> Exhibit A, Tab 14, Schedule 3, page 1

<sup>2</sup> Exhibit A, Tab 14, Schedule 3, page 5

reduced by 350 MW to account for natural conservation<sup>3</sup>. These megawatt adjustments were translated into GWh adjustments based on assumptions regarding the load factors of Hydro One's retail customers and embedded distributors<sup>4</sup>.

### ***VECC's Submissions***

44. VECC's submissions regarding Hydro One Networks' load forecast focus on the appropriateness of the Hydro One Networks CDM adjustments.

45. In its Decision regarding Hydro One's 2007&2008 Transmission Rate Application, the Board made the following findings<sup>5</sup>:

Having said that, the Board is not satisfied that Hydro One's proposed CDM adjustments are appropriate. While we do not object to Hydro One starting its analysis with the provincial target of 1,350 MW for 2007, we agree with intervenors that Hydro One has double counted the impact of natural conservation. It is clear from the evidence that the OPA intends to count natural conservation in determining if the 2007 target of 1,350 MW has been met. Hydro One testified that its forecast, before the CDM adjustment, already factors in natural conservation. Therefore, the Board fails to understand how Hydro One can rationalize not reducing the 1,350 MW target for estimated natural conservation.

The Board also agrees with the consumer group intervenors with respect to the impact of demand response programs. Hydro One's base forecast is weather-normal, which means that extreme weather events are excluded. It would seem logical to reduce the impact of demand response programs, which are most effective in extreme weather situations, when adjusting a weather-normal forecast.

The Board finds that Hydro One should reduce the expected impact of CDM on total Ontario peak demand by 350 MW. This adjustment is intended to address both the natural conservation and demand response issues discussed above. The Board acknowledges that this reduction is probably at the low end of an acceptable range given that it is only marginally above the 328 MW of natural conservation for 2006 referred to in the Chief Energy Conservation Officer's 2006 annual report. The Board finds there is sufficient data to support a reduction of 350 MW but also finds there is not enough reliable data to support a larger reduction as advocated by some intervenors.

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<sup>3</sup> Exhibit A, Tab 14, Schedule 3, page 8

<sup>4</sup> Exhibit H, Tab 1, Schedule 105, page 7

<sup>5</sup> Pages 91-92

46. Based on these findings Hydro One Networks has incorporated an adjustment of 350 MW for natural conservation in its estimate of 2007 CDM savings (i.e., reduced the savings from 1350 MW to 1000 MW) and adjusted its forecast of GWhs accordingly.
47. However, additional information is now available regarding CDM savings for 2007 and projected values for 2008 in the form of the CECO's June 2008 report regarding actual 2007 CDM results and the OPA's load forecast for 2007.
48. The OPA's load forecast for 2007 includes roughly 600 MW of natural conservation<sup>6</sup>. When asked about this difference, Hydro One witnesses suggested that issue of the OPA's target 1350 MW initially including natural conservation was no longer relevant, as more recent reports from the OPA<sup>7</sup> indicate that the 2007 target was achieved even before including any allowance for natural conservation<sup>8</sup>. Indeed, the CECO's report includes two estimates of conservation achieved in 2007: 1462 MW based on a top-down analysis which is admitted as being simplistic and 1391 MW based on a more detailed bottom-up analysis<sup>9</sup>.
49. However, the 1391 MW of achieved CDM (excluding natural conservation) documented by the OPA includes 590 MW of savings attributed to Demand Response Programs<sup>10</sup>. When the Hydro One witness was asked about the need to exclude demand response, he claimed that inclusion of the demand response program savings was consistent with the OPA's forecast for CDM under normal weather conditions.<sup>11</sup> This point was re-emphasized by Hydro One's Counsel during his Argument-in-Chief, with reference made to the OPA's recent IPSP Application<sup>12</sup>.
50. VECC does not agree with Hydro One's position regarding the treatment of Demand Response programs. Indeed, VECC finds the Hydro OneN position to be inconsistent with the Board's EB-2006-0501 Decision and the expected role of Demand Response Programs.
51. First, the Board (in its EB-2006-0501 Decision) clearly concluded that the load forecast should not be adjusted for the demand response programs and the 350 MW included a conservative allowance for both natural conservation and demand response programs.

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<sup>6</sup> Transcript Volume 4, page 150, lines 21-26 and OPA IPSP Exhibit D1-1-1, page 13

<sup>7</sup> Exhibit K5.1

<sup>8</sup> Transcript Volume 4, pages 151, line 3 to page 152, line 20

<sup>9</sup> See Exhibit K5.1, Tables 3.1 and 3.2

<sup>10</sup> Exhibit K5.1 page 10 (OPA DR Programs – 317 MW plus IESO DR programs – 273 MW)

<sup>11</sup> Transcript Volume #6, pages 209-210

<sup>12</sup> Transcript Volume #7, page 31, lines 8-14

52. Second, the OPA's forecast for Demand Management savings includes more than just Demand Response programs. As the IPSP Application notes, it also includes time-differentiated and real time pricing programs. In particular, it includes the anticipated effect of smart metering<sup>13</sup>.
53. Third, while the OPA reported reductions for Demand Management likely include MWs reductions from Demand Response programs as being available under normal weather conditions this does not mean that the demand reduction will actually occur under such conditions. Indeed, as the Board has acknowledged in its Transmission Decision, Demand Response programs are typically "activated" during abnormal system conditions (such as extreme weather).
54. Finally, when such programs are activated it is generally only for a short period of time during extreme system "peak" conditions. This would suggest that even if one were to agree that the Demand reductions (i.e., MWs) should be reflected in Hydro One's load forecast, these programs will account for little to no energy reduction<sup>14</sup>. As result, the 590 MW should be excluded when determining the energy reduction (i.e., GWh's) to be incorporated into Hydro One's load forecast.
55. As a result, VECC submits that the CDM adjustment to Hydro One's energy forecast for 2007 should be calculated using 800 MW<sup>15</sup> of demand reduction province wide due to CDM (as opposed to the 1,000 MW) used in the Application.
56. For the 2008 CDM adjustment, VECC agrees with Hydro One's approach which is to add to the 2007 calculated adjustment its estimated share of the 0.8 TWh of incremental CDM forecast by the OPA for 2008.

***Issue 1.5 b) Is an LRAM appropriate at this time?***

***Hydro One Networks' Position***

57. Hydro One Networks' position is that it has adequately incorporated CDM in its load forecast and does not require an LRAM<sup>16</sup>. Furthermore, in response to previous Board directives on this issue the Company has stated<sup>17</sup>:

Hydro One has concerns with the practical difficulties and related accuracy of determining the actual amount of CDM savings achieved by its customers in a given year, through the implementation of CDM

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<sup>13</sup> IPSP Application, Exhibit D-4-1, page 11

<sup>14</sup> K5.1, page 4

<sup>15</sup> Based on 1391 MW less 590 MW of demand response programs.

<sup>16</sup> Exhibit H-Tab 3-Schedule 1

<sup>17</sup> Exhibit A, Tab 17, Schedule 1, page 1



initiatives from various sources such as the Ontario Power Authority, Provincial Government and Federal Government. Hydro One believes it is prudent to wait for the OPA to develop Measurement and Verification programs for determining actual CDM achievements and as such is not proposing or requesting an LRAM at this time.

### **VECC's Submissions**

58. In VECC's view it is premature to put an LRAM in place for Hydro One Networks at this time. An LRAM applies to programs that are implemented by a distributor within its service area<sup>18</sup>. To be effective and fair an LRAM requires that there be a detailed understanding of the expected savings from such programs that was incorporated in the load forecast used for rate setting purposes and proper EMV (Evaluation, Measurement and Verification) processes to establish the actual savings achieved through such programs. Neither exists at the current time. The CDM incorporated in the Hydro One Networks' load forecast is based on a crude top-down estimate of total CDM savings (not just those from programs implemented by Hydro One Networks). Furthermore, as Hydro One Networks has indicated the OPA is just starting to establish the necessary EMV programs<sup>19</sup>.

### **2.1 Is the proposed Capital Structure and Rate of Return on Equity for Hydro One's distribution business appropriate?**

59. Settled. The parties agree that the capital structure and ROE proposed by Hydro One is appropriate. Hydro One is following the Board's deemed capital structure of 60% debt and 40% equity as approved in EB-2006-0501 and per the Board's direction in its report issued on December 20, 2006, *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors*. When implementing the Board's Decision in the establishment of final 2008 distribution rates, the Applicant will reflect the Board approved 2008 ROE for LDCs of 8.57%.

### **VECC Submission**

60. VECC notes the above condition of Settlement and requests the Board to Direct Hydro One to update its ROE calculation for 2008 before submitting its draft Rate order following the Board's Decision.

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<sup>18</sup> Guidelines for Electricity Distributor Conservation and Demand Management, EB-2008-0037, page 18

<sup>19</sup> Transcript Volume 4, page 10, lines 8-12

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

#### **Hydro One Position**

*Mr Rogers (in Reference to E1, Tab 1, Schedule 1, page 4, table 3).  
Now, table 3 also shows the increase in OM&A expense, line 2. You will see it is \$45 million. A large sum.  
Most of this is attributable to the planned increase in vegetation management, which the Board heard a good deal of evidence about during oral testimony and is outlined in Exhibit C1, Tab 2, Schedule 2. About \$26 million of this \$45 million increase results directly from that vegetation management proposal. [Tr. Vol . 7 Page 18]*

**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	280.3	280.0
Development	5.5	4.8	4.2	8.0	9.1
Operations	16.3	11.2	14.9	11.1	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

61. VECC notes that the Board Approved 2006 OM&A was \$423.1 million and this (plus an increase under 2GIRM) is the level that will be reflected in current rates.

OM&A Cost Categories (\$ million)	2006 Actuals (\$ million)	2006 Board Approved (\$ million)	Variance (\$ million)
Sustaining	\$255.6	\$230.3	\$25.3
Development	4.2	4.9	(0.7)
Operations	14.9	14.3	0.6
Customer Care	103.7	101.1	2.6
Shared Services & Other Costs	21.2	67.9	(46.7)
Taxes other than Income Taxes	4.5	4.6	(0.1)
Total OM&A	\$404.1	\$423.1	\$(18.9)

### **Summary of VECC Position**

62. Mr. Rogers indicates that the size of the increase in OM&A can be judged based on the Board approved 2006 OM&A amount of \$423.1 million.

63. If the Board is inclined to follow an “envelope approach” to the appropriate level OM&A for 2008, then VECC supports the submissions of CME and other intervenors that a 6% increase from the actual 2006 OM&A is a generous allowance. This computes to a 2008 OM&A envelope of \$423.00 million or \$54.8 million less than claimed by Hydro One (excluding Smart Meter spending).

64. If the Board is inclined towards a “line by line approach” to the 2008 OM&A Expense, then VECC has identified several areas that the Hydro One 2008 OM&A claim of \$478 million should be reduced:

- Vegetation Management Program , which is discussed under Issue 3.2.
- Productivity/Efficiency of Hydro One Operations as evidenced by the PA Benchmarking Study.
- Expenditures and revenue forecasts for generation connection assessments as part of the 2007 and 2008 Development OM&A expense.
- Escalation of the Inergi Outsourced Services costs due to changes in Scope and the Cost Of Living Adjustment (COLA) factor.

- Regulatory Costs for 2008.
- LT Load transfer costs.
- Smart Meter OM&A.

### **VECC Submissions**

#### ***Productivity/Efficiency of Hydro One Operations as evidenced by the PA Benchmarking Study***

65. In past proceedings the Board and intervenors have had concerns about Hydro One costs and performance metrics. A study completed in 2006 was filed in the Transmission Hearing. The Board was not satisfied with the study:

The PA study filed in this Application suffered from various deficiencies and shortcomings, as noted by the authors of the study, the Applicant and the intervenors. The Board expects the new study to be comprehensive and reliable, with none of the limitations of the PA study. If Hydro One cannot correct all of these deficiencies in time for the Company's 2008 Distribution rate filing, the Board expects them to be corrected in the 2009 transmission filing. (Page 33 of Decision EB-2006-0581).

*MR. KAISER: I understand what you have done here and lots of questions have been asked on it. But I want you to look at something. I will get it to you. I don't have it here. But in the OPG case which just finished, this whole question of benchmarking came up, and finally they agreed on comparable – comparators, I guess you would say, and measured such things as their costs per production megawatt and certain standard indices that you might say reflected productivity as opposed to comparing minimum wages and maximum wages and that kinds of thing. Having regard to the 14 organizations that apparently agreed to participate in this, is there work underway to calculate what I could call comparisons in productivity by different functions whether it is total costs per kilowatt-hour distributed, or more economy-wide, if I can use that term, what we refer to more as productivity indices? Anything being done in that area?*

*MR. VAN DUSEN: Yes, sir, they can. Once again, I will call your attention to the exhibit we filed in these proceedings, we did file a PA Consulting Group performance benchmarking study as part of this.*

*MR. KAISER: Right.*

*MR. VAN DUSEN: We are intending, in terms of transmission, of doing further work in that area, in terms of performance benchmarking and productivity and bringing it back in front of the Board. (Transcript Vol. 3 pages 192-193)*

66. In VECC's view the PA study filed at Exhibit A, Tab 15, Schedule 2, Attachments A and B, still suffers from problems in the comparability of the data. However, taking the study at face value the conclusions remain that Hydro One costs on a per customer basis are among the highest in the sample comparator group. Perhaps more critical is that as well as being the highest in costs per customer most of the performance metrics are deteriorating.

67. VECC IR Exhibit H, T12, Schedule 10 shows the data:

	ACTUAL				BUDGET
	2004	2005	2006	2007	2008
Assets \$per km of line	46,655.37	48,774.74	51,748.68	52,330.92	57,280.63
Assets \$per customer	4,124.14	4,274.60	4,497.57	4,542.57	4,942.16
Assets \$per GWH distributed	119,249.85	123,227.32	133,897.73	131,043.76	143,108.62
Capital \$per km of line	1,819.97	1,956.16	2,534.05	2,436.04	2,542.77
Capital \$per customer	160.88	171.45	220.24	211.27	218.09
Capital \$per GWH distributed	4,651.78	4,942.47	6,556.77	6,094.88	6,315.30
O&M \$per km of line	1,477.58	1,518.73	1,814.91	2,003.71	2,153.10
O&M \$per customer	130.61	133.11	157.74	173.78	185.81
O&M \$per GWH distributed	3,776.67	3,837.24	4,696.01	5,013.21	5,380.41

68. The conclusion is clear; unit costs have increased dramatically from 2004.

OM&A per line km by 45% and per customer by 41% and per GWh distributed by 42%.

69. More importantly the increase in unit costs has accelerated since 2006.

70. Hydro One also offered a metric that relates the Work program spending to headcount [Exhibit C1, Tab 4, Schedule 2, Pages 14-16 and Table 2]. In the OEB's Decision with Reasons on Hydro One's recent Transmission rate filing (Ref EB-2006-0501), issued on August 16, 2007, the Board stated "in the [compensation] study that Hydro One is [now] preparing, the Board expects it to provide empirical evidence which reveals the relative productivity of its workforce in comparison to other utilities."

71. VECC IR Exhibit H, Tab 12, Schedule 22 explores this response and based on the fact that the metric proposed by Hydro One is circular and does not correspond to usual productivity measures (output/input) the Board should reject this evidence and rely on the new benchmarking study or require a Total Factor Productivity Study.

72. VECC is not necessarily recommending a specific reduction in the claimed 2008 OM&A budget due to the findings of the PA Benchmarking Study, but submits the fact that Hydro One costs per customer are so comparably high is a factor that VECC submits the Board should take into account when considering an appropriate level of OM&A and/or whether the specific OM&A reductions identified by VECC and other ratepayers should be accepted.

### **Generation connection studies and revenues**

73. Undertaking J2.6 shows the Total 2008 OM&A costs of RESOP as \$4.5 million.

74. Although the total 2008 OM&A costs for connection studies are the same as in 2007 [Exhibit C1, Tab 2, Schedule 3 and Exhibit H, Tab 3, Schedule 3], the forecast number of studies decreases by 25% while revenues decrease by 67% [Exhibit E3, Tab 1, Schedule 1 Page 3 Table 2 and Page 10 Table 11]. Hydro One has no good explanation for this projected reduction and VECC is concerned that Hydro One is giving in to pressure from small generators to pay a higher portion of the assessments at ratepayer expense.

*MR. BUONAGURO: Looking at E3, Tab is 1, Schedule 1, page 3, table 2, talking about the revenues from those studies, there's a decrease of 67 percent. I think it goes from 1.5 million to 0.5 million.*

*MR. GRAHAM: Yes.*

*MR. BUONAGURO: So based on what you have been telling me though, it should actually be, as of right now, it looks like it is going to be closer to 1.5 million.*

*MR. GRAHAM: I think it would be fair to say there is a potential for that revenue figure to be somewhat increased. Of course there are many ups and downs that change circumstances with respect to the filing we made. But at this point in time we have not seen a slack in any of the demand that had been forecast. Tr. Vol 2, Page 85*

75. VECC suggests that the Board either decrease the 2008 OM&A budget, or more reasonably, increase the revenue projection to be the same as 2007. This would provide an incentive for Hydro One to negotiate with generators and will reduce the 2008 revenue requirement by \$1,000,000.

### **Inergi Outsourced Services**

76. Exhibit C1, Tab 2, Schedule 6, Attachment A shows the breakdown of the Inergi fees since 2006. VECC notes this schedule indicates that there are significant fee increases due to scope changes, pension costs and Cost of Living Adjustments ("COLA").

77. VECC is most concerned with the COLA adjustment that is built into the contract and will cost \$14.9 million in 2008.
78. Undertaking J3.8 shows the impact of the COLA adjustment formula since 2002. It is clear that the COLA results in compounding of fees paid to Inergi so that the total as stated at page 2 of the Undertaking is a 23% escalation of fees compared to the inflationary increase of 2.5% in the Business Case for outsourcing.
79. VECC suggests that although changes in service scope may lead to higher fees, these should be offset by efficiency gains generated by Inergi. The COLA adjustment formula provides Inergi with increased returns without commensurate increases in the cost to Inergi of providing the outsourced services.
80. The Board should reject the cost consequences of the 2008 COLA and allow a normal inflationary increase in base service costs above 2006 levels.
81. VECC estimates that the disallowance should be related to setting the 2008 COLA component of fees for base service costs at 2006 approved levels, plus a two-year inflationary increase of about 6%. This would result in a 2008 COLA of \$8.8 million for 2008. This would reduce 2008 OM&A by \$6.1 (\$14.9-\$8.8) million.

### **Regulatory Costs for 2008**

**Table 10**  
**Regulatory Affairs Function (\$ Millions)**

Description	Historic			Bridge	Test	
	2004	2005	2006	2007	2008	2008 DX
Regulatory Affairs	5.3	5.8	7.0	7.9	8.9	4.7
OEB Costs	8.7	5.9	8.8	10.1	10.8	5.6
<b>Total Cost</b>	<b>14.0</b>	<b>11.7</b>	<b>15.8</b>	<b>18.0</b>	<b>19.7</b>	<b>10.3</b>

82. While OEB costs are recurring, the other 2008 regulatory costs are not. The Board has made decisions on other applications amortizing the recovery of 2008 regulatory costs.<sup>20</sup>
83. The increase in costs over 2007 is \$1.3 million (\$8.1-\$6.8 million [Tr. Vol. 1 Page 87] and VECC submits that this increase is largely due to this proceeding and should be recovered over the 4 year proposed 3GIRM in an amount of \$310,000 a year. This reduces the claimed 2008 regulatory cost by \$1 million (rounded).

<sup>20</sup> For example, EB-2007-0742, page 12, with respect to Guelph Hydro's 2008 rates.

### **LT Load transfer costs**

84. LT Load Transfer costs are part of Development OM&A (Exhibit C1, Tab 2, Schedule 3 Page 1/2) and are another one time 2008 cost:

*MR. MILLAR: Thank you. If you look at 64(b), it asks if any of the expenditures related to development, OM&A are one-time costs. Then your response is that some expenditures related to development OM&A, are one-time costs. These are associated with long-term load transfers but other LTLT costs will continue through 2009.*

*So just to be clear. Are there any costs that aren't LTLT costs that are one time?*

*MR. JUHN: Those are the only ones that we envision that are going to -- that are going to decrease to pretty much to zero in 2011.*

*MR. MILLAR: Can you give me an idea of what the quantum of the costs of these one-time costs are for 2008? I guess the total budget is 9.1 million, if I am not mistaken, for development OM&A.*

*Can you give me an idea of how many millions of that is one time?*

*MR. JUHN: It's one million.*

*MR. MILLAR: One million?*

85. Accordingly VECC suggests that as was proposed above for the one time regulatory costs the LT load transfer cost be amortized over a 4 year period resulting a reduction of about \$800,000 in 2008 OM&A costs.

### **3.2 Is the 2008 Vegetation Management budget appropriate?**

#### **Hydro One Position**

*Mr. Rogers*

*In 2006, the company spent \$89.1 million on vegetation management. In 2007, it spent \$115 million on vegetation management. In 2008, it has a budget of \$119.4 million, that is found at Exhibit C1, Tab 2, Schedule 2, page 3.*

*So you can see these costs are increasing very dramatically, as was discussed in considerable detail. [Tr. Vol. 7 Page 20]*

#### **Summary of VECC Position**

86. VECC supports the proposed vegetation management program with an increased accomplishment of 12,500 km/year (corresponding to an 8-year cycle). However it submits that this can be achieved at a lower budget level by improved cost control/management of the program.



87. In addition, in order to assess if the program is working, the Board should require rigorous tracking and reporting, by region, of tree contacts causing outages, both under normal weather and storm conditions.

### **VECC Submissions**

#### **Cost Control**

88. Hydro One's proposal is to decrease cycle times and increase budgets as set out in Exhibit H, Tab 1, Schedule 14, attachments B, C:

*MR. JUHN: It's not necessarily based on specific regions. It is based on - the work -- the frequency of the work is determined through our asset condition assessment process, which determines the condition of -- the condition of the right of way. It's determined on -- other factors that are included are the reliability of those particular -- of the feeders, customer issues in those areas.*

*When one combines all of that, a decision is made on the annual program and what we're -- what we would like to accomplish is, on an annual program of 12,500, move that from current level of 10,000 kilometres on an annual basis.*

*That takes us from a ten-year to an eight-year cycle.*

*MR. SOMMERVILLE: It's an intensification equal to 20 percent of the effort across the board. So wherever that assessment is going on, wherever you are doing this work, there's -- what you're building into your program is a 20 percent boost in activity. Is that roughly what we're talking about?*

*MR. JUHN: Actually, the number is 25 percent.*

And

*MR. KAISER: Gentlemen, I just had -- I am sure you have been over it at length with a number of counsel. That's this business of whether you should move to six or eight.*

*I am looking at the chart that you have famous figure 3.1 which is on page 11 of A1 of H, T1-14, attachment B. That's the one that Mr. Lokan went through you with this, annual costs of you were comparing costs of \$135 million a year with \$121 million a year on an eight-year cycle. And \$114 million a year with a six-year cycle. So there was a saving, as he pointed out, of \$14 million per year if you went to eight years and \$21 million if you went to six years.*

*I take it you believe these numbers?*

*MR. JUHN: Yes, we do. [Tr. Vol 2 Page 167]*

89. VECC is most concerned by the fact that Hydro One's unit costs/km of feeder for Vegetation Management are above average for the cohort of utilities shown in the PA Study [Exhibit A, Tab 15, Schedule 2 Attachment A Appendices C39 , C40, C41].

90. PA comments on this at page 4-21:

Tree-trimming appears as a high-cost activity for Hydro One. The costs for Hydro One would be expected to be high, given the long distribution lines through substantially forested areas. With average tree density, the exposure levels for the extensive system would create large amounts of tree-trimming requirements. With the high tree density levels in the Hydro One territory, the exposure is that much greater.

The above comments notwithstanding, it would appear there is an opportunity to improve the overall costs of tree-trimming for Hydro One. The key metrics shown in the table above measure the costs on a per-tree or per-km basis, and could be expected to be roughly comparable across companies. However, as noted below, there are differences between utilities in the factors impacting tree trimming performance.

91. VECC submits that Hydro One higher costs cannot be explained only by the low density and remote nature of the system and Hydro One's claim that shorter cycles will in fact reduce unit costs needs to be verified [Exhibit H, Tab 12, Schedule 16 part e].

92. Importantly, Hydro One has not provided convincing new evidence that it practices rigorous cost control over the program.

93. Accordingly the Board should reduce the claimed 2008 budget for the Vegetation Management-Tree trimming. The data for this reduction are shown in the evidence, including the PA Report (Appendix C Pages C39, C40) which is extracted here for convenience:

Parameter	3 <sup>rd</sup> Quartile Cohort Cost	Hydro One Cost
Cost per tree trimmed	\$67	\$83
Cost per km of feeder	~\$4100	~\$4300

94. Accordingly based on an accomplishment of 12500 km the 3<sup>rd</sup> quartile benchmark cost (not average) would be \$2.5 million a year less than Hydro One's historic cost (~5%). Based on the cost per tree the 3<sup>rd</sup> quartile benchmark cost is ~20% lower.

95. The budgeted costs are shown in Exhibit C1, Tab 1, Schedule 2 Table 9:

**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
<b>Total</b>	<b>88.9</b>	<b>86.4</b>	<b>89.1</b>	<b>115.0</b>	<b>119.4</b>

(d) - includes the ins. downed program

96. The line clearing budget claimed for 2008 represents an increase of \$26.2 million (52%) since 2006.
97. Accomplishment has increased by about 25%. The unit costs in 2006 were in the order of \$5000/km and will be over \$6000/km in 2008, which corresponds to a 20% increase in per unit costs.
98. VECC submits that from these rough calculations, it is clear that cost control is not being exercised over the vegetation management program.
99. Accordingly, the 2008 budget should be reduced to reflect the fact that Hydro One line clearing/tree trimming costs are well above benchmark.
100. VECC recommends that a unit cost of \$5000/km or a total of \$63.5 million for Line Clearing should be allowed for 2008 corresponding to the 2006 level of unit cost, but allowing for the higher (12,500 km) 2008 accomplishment, recognizing that the benchmark unit cost in the PA study is still almost 20% lower. The corresponding reduction in 2008 OM&A is estimated at \$13.3 million.
101. In addition, VECC submits that the Board should require improved reporting and metrics on costs for the Vegetation Management Program and require that this be added into Hydro One's regulatory reporting requirements.

### **Reliability Analysis and Reporting**

*MS. EFFENDI: If we could go back now to Exhibit C1, Tab 2, Schedule 2 at page 35 of 37, we have on that page table 10, total SAIDI and vegetation contribution. If you could bear with me, I am just trying to understand and confirm my understanding of this table.*

*If we look at the year 2003, am I correct when I say that this table shows that there was 15.1 total hours of interruption of which, for 2003, 8.9 hours were attributed to trees? Is that how you read this table?*

*MR. JUHN: The hours, it's hours per average -- average hours per customer, and, yes, that is correct.*

*MS. EFFENDI: So 59 percent, then, of 2003 interruption were attributed to tree?*

*MR. JUHN: Correct. [Tr.Vol.2 Page 58]*

102. VECC is most concerned about verification of the claimed benefits of intensification of the Vegetation Management Program which are predicated on improved system reliability due to reduced tree contact-related outages.

103. The proper way to ensure this is to collect better data on outages at a regional level and conduct analyses that relate the increased tree trimming cycle and investment to the reliability improvement targets set out in Hydro One's Report [Exhibit H, Tab 1, Schedule 14 Attachments]

104. VECC submits that the Board should require Hydro One to track, monitor and report on the changes in tree-related SAIDI incidents, as a specific RRR reporting requirement for the forward period.

### **3.3 Is the proposed level of 2008 Shared Services and Other O&M spending appropriate?**

#### ***Summary of VECC Position***

105. There are two main issues with regard to the CCF&S Budget for 2008:

- Increases in 2008 Costs of CCF&S
- Increases in inbound services from Affiliates in 2008

106. With regard to outbound services to affiliates the changes for 2008 have not been fully justified. In particular the increase in Costs for Corporate functions is of concern because the time studies have not been recently updated therefore there is an issue as to whether the increased costs, even if justified, should be allocated in the same way as the past:

*MR. BUONAGURO: Okay, thank you. Now, if you could turn to Exhibit H, Tab 12, Schedule 18. This is a VECC interrogatory and we asked at part B for a highlight of an increase in service levels and costs which add a total of \$10 million to CCFS between 2006 and 2008.*

*Your answer, you broke it into four categories: finance, you said there was a \$4.6 million increase associated with work requirements for Bill 198, human resources, 2.1 million; general counsel and secretariat, 0.7, prior external legal costs; and regulatory affairs, 3.9 million higher OEB fees. Now, between 2006 and 2008, as these increased costs are coming up, can you give a description that the process for defining how they are going into either the general bucket and then shared per drivers versus directly allocated to one of the business units, in particular.*

*MR. INNIS: That would be in the Rudden study that was filed in the*

*response to the exhibit, we would have followed that methodology.[Tr. Vol.1 Page 55]*

*MR. BUONAGURO: My example is, in your interrogatory response, you mentioned specifically the Bruce to Milton transmission expansion and one would intuitively expect that would be a simple one, that, those costs would be directly attributed to transmission. Is that the case? Or if not, what was the thought process behind that?*

*MR. INNIS: Bruce to Milton is indeed a transmission project. However, the support that comes from the regulatory affairs group, regulatory affairs uses a common driver. And looking at the nature of the work programs that year, they would have adjusted the application percentage to deduct a proportion to distribution or transmission.  
[Tr. Vol.1 Page 56/57]*

107. With respect that is less than convincing evidence.

108. With regard to the costs of inbound services from Hydro One Inc and from Telecom there is inadequate support and in VECC's opinion, the latter services could now be above fair market value. However, given the lack of any external comparators, the Board is faced with approving big increases in costs for Telecom services without proper evidence.

*MR. BUONAGURO: Okay.*

*Now, I think you talked a bit about this with Mr. DeRose, about the inbound services. As a general question -- well, we note in particular, in this particular application, that the inbound service from telecom are increasing from \$6.4 million in 2006 to \$8.7 million in 2008.*

*According to IR response at Exhibit H, Tab 12, Schedule 2, part e, just -- basically it was attributed to telecom passing through increased labour and pension costs.*

*MR. INNIS: Yes, that is correct.*

*MR. BUONAGURO: Is there a process for examining that sort of pass-through of costs between an affiliate and the regulated entity?*

*MR. INNIS: Yes, there is. As part of the annual budget process, all of the inter-company costs are calculated, and they are reviewed by the business leaders of each of those entities.*

*So there is a -- as with any shared services, there's information that's provided, and there is push-back and there is challenge, and there is a development of full understanding of the services that are being sold to another entity.*

*MR. BUONAGURO: So is that entirely internal to the affiliate and to the regulated entity?*

*MR. INNIS: If you're talking between telecom and ourselves, yes, that would be done internally. There would be discussions and a meeting that*

*would have some understanding of the nature of the service, and also questions, and certainly with respect to any increase like that, there would have been explanations sought.*

*[Tr.Vol. 1 Page 63/64]*

And

*MR. SHEPHERD: Sorry. Thank you for that, but I guess my question is a different one.*

*Have you gone to the marketplace to see whether somebody else, not an affiliate, can give you these services cheaper?*

*MR. STRUTHERS: Again, I will refer back to the Shpigler report, which we believe demonstrates that we are receiving services at fair market value.*

*MR. SHEPHERD: It's a simple question. Either you have gone to competitive bidding or you haven't.*

*MR. STRUTHERS: The answer is, no, we have not.*

*[Tr. Vol. 1, Page 132]*

109. VECC submits that since Telecom Services are competitive services available in the marketplace, before accepting such a large increase in Telecom's service costs ( no matter how caused) being passed to Hydro One Distribution and its ratepayers, Hydro One management should have satisfied themselves that the services were still being provided at or below Fair Market Value. That they did not do so is a major flaw in the Hydro One affiliate services/ relationships model.

110. The Board should disallow the increase in Hydro One telecom service costs from 2006 to 2008, apart from a reasonable increase for growth in services related to Hydro One's increased head count. Any increase greater than 10% above 2006 should be disallowed.

111. Accordingly, the reduction to 2008 OM&A should be:

$$(\$8.7 \text{ million} - \$6.4 \text{ million}) + (0.1 * 6.4) = \$1.7 \text{ million.}$$

**3.4 Are the methodologies used to allocate Shared Services and Other O&M costs to the distribution business and determine the distribution overhead capitalization rate for 2008 appropriate?**

112. Partially Settled. The parties agree that the methodology used by the Applicant to determine the distribution overhead capitalization rate for 2008 is appropriate. This methodology was approved by the Board at page 36 of their Decision in EB-2005-0378. The settlement of this issue was also accepted by the Board in proceeding EB-2006-0501.

113. The narrowed scope of the issue is: “Are the methodologies used to allocate Shared Services and Other O&M costs to the distribution business for 2008 appropriate?”

### **Summary of VECC Position**

114. There is a need to “refresh” the CCF&S “Rudden” Methodology in respect of time studies and cost drivers prior to 3GIRM.

### **VECC Submissions**

115. VECC has the following submissions regarding CCF&S Costs for 2008 and the Rudden CCF&S Allocation Methodology.
116. The Rudden Methodology inherently recognizes that some Corporate Costs should be allocated to the account of the shareholder, yet Hydro One allocates only \$3,000 (or 0.07% of the total allocation per J1.4) which, in VECC’s view puts in question the veracity of the Time Studies and costs for the Governance component of the Utility.

*MR. ROGERS: No, no. I don't.*

*Mr. Chairman, the evidence is what it is. There is nothing more I think we can add. I don't understand why any of these costs would be allocated to the shareholder. The company, this company is in the business of transmitting electricity. That's all basically it does.*

*MR. KAISER: I think that's right, Mr. Buonaguro. I think it's pretty clear the position is that all of these expenses relate to the core business and not to other businesses.*

*MR. VLAHydro OneS: Mr. Buonaguro, can I interject for a second here? Mr. Van Dusen, I have the decision, 2006 decision, the distribution rates. I am looking at page 22 where it covers a discussion on the corporate cost allocation.*

117. VECC notes that the Rudden Methodology explicitly recognizes the shareholder “bucket” of costs. The fact that Hydro One is not allocating any costs (only 0.07% per Undertaking J1.5) to the shareholder is not appropriate and should be a matter that Rudden be asked to review from a best practices perspective for typical investor- owned, Crown Corporations and Public Utilities like Hydro One. VECC requests that the Board provide the appropriate Direction to Hydro One in its Order.
118. The CCF&S costs that Rudden reviewed have changed since 2005 when the Rudden Report was prepared based on 2006 forecast costs. The Methodology should be reviewed, not only as proposed for the Transmission rate application for 2009, but critically for the establishment of the base

revenue requirement for distribution going into 3GIRM. In particular the time studies should be redone for both distribution and transmission:

*MR. BUONAGURO: Now, my understanding from the transmission -- from the Hydro One transmission case last year is that the Rudden methodology is being looked at for the upcoming 2009 and 2010 transmission filing. Is that understanding correct?*

*MR. INNIS: We have engaged Rudden to review the methodology to confirm that it is still appropriate to use.*

*MR. BUONAGURO: So I take it that it is at least possible that the methodology may change or specific drivers may change? There may be changes to the Rudden methodology?*

*MR. INNIS: That is possible. I am not aware of any changes at this time, though. [Tr. Vol 1. P61]*

*MR. BUONAGURO: So can you -- I'm going to ask you to propose something you haven't proposed. How would we go about capturing any differences that flow out of the Rudden methodology over the next few years?*

*[Witness panel confers]*

*MR. INNIS: In terms what we would expect, we would expect very little change to take place, because the methodology is very stable, and we would refresh it on an annual basis.*

*Then in terms of what we might do, we would have to deal with that at the time, but we're not expecting anything material to come out of that review. [Tr. Vol 1. P63]*

119. VECC submits that the Board should order Hydro One to file the Rudden Report Update for both Transmission and Distribution and file a letter with the Board requesting a Base year adjustment to the 2009 Distribution revenue requirement, if the change in cost allocation is material (> \$1.0 million).

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

***Hydro One Position***

*Mr. Rogers*

*Now, I would also observe that Hydro One's work programs - this is both distribution and transmission combined - have grown by about 40 percent between 2006 and 2008. During that same period, its regular staff numbers - this is both transmission and distribution - have grown by only 23 percent, and the total staff growth, including temporary work force, by about 34 percent, so less than the growth in the work programs, once again, I submit, an indication that the company is getting more work done with less resources. Tr. Vol. 7 Page 28*



120. Total Payroll Costs for Hydro One Networks (Transmission and Distribution) are presented at C1 Tab3 Schedule 2:

<b>Hydro One Networks Inc. Payroll* (M\$)</b>					
<b>Year</b>	<b>Total Wages</b>	<b>Base</b>	<b>Overtime</b>	<b>Incentive</b>	<b>Other**</b>
2004	404.2	323.7	53.2	12.3	15.0
2005	397.9	321.1	50.6	8.4	17.7
2006	459.3	367.7	66.5	4.4	20.8
2007	493.0	394.4	70.7	6.9	21.0
2008	508.0	406.4	72.1	8.5	21.0

\* This payroll reflects compensation costs associated with year-end headcounts for all EPSCA, PWU, Society and MCP staff.

\*\* "Other" includes travel time, vacation bonus, unused vacation days paid out, standby allowance, shift allowance, vacation pay on termination.

121. The Total payroll cost forecast for 2008 is in error and the amount claimed is \$580.7 million.

122. The breakdown between Capital and OM&A was provided in Exhibit H, Tab 1, Schedule 71:

**Total Wages  
Hydro One Networks Inc.**

<b>M\$</b>	<b>2006 Board Approved</b>	<b>2006</b>	<b>2007</b>	<b>2008 Test Year</b>
OM&A	263.4	281.4	298.3	349.6
Capital	166.6	177.9	197.2	231.1
<b>Total</b>	<b>430.0</b>	<b>459.3</b>	<b>495.5</b>	<b>580.7</b>

123. Incomplete (in terms of total compensation) total average per employee payroll data for Distribution are shown in Exhibit C2, Tab 3, Schedule 1:

**Table 1**

<b>Year</b>	<b>Total Wages</b>	<b>Base</b>	<b>Overtime</b>	<b>Incentive</b>	<b>Other*</b>
2004	\$98,822	\$67,987	\$26,377	\$2,483	\$1,975
2005	\$102,325	\$70,208	\$29,186	\$760	\$2,170
2006	\$111,439	\$74,117	\$34,639	\$0	\$2,683
2007	\$114,782	\$76,340	\$35,679	\$0	\$2,764
2008	\$118,226	\$78,630	\$36,749	\$0	\$2,847

NOTE: all of the above are average dollars.

**Table 2**  
**Annual Salary (MP4)**

Year	Total Wages	Base	Overtime	Incentive	Other*
2004	\$96,423	\$85,578	\$8,028	\$0	\$2,817
2005	\$69,200	\$62,420	\$3,125	\$0	\$3,656
2006	\$95,524	\$92,564	\$1,207	\$0	\$1,753
2007	\$98,390	\$95,341	\$1,243	\$0	\$1,806
2008	\$101,342	\$98,202	\$1,281	\$0	\$1,860

NOTE: - 2005 results are lower due to the impact of the labour strike.

- all of the above are average dollars.

**Table 3**  
**Annual Salary**

Year	Total Wages	Base	Overtime	Incentive	Other*
2004	\$107,813	\$90,068	\$423	\$11,620	\$5,702
2005	\$107,938	\$89,136	\$1,187	\$7,806	\$9,808
2006	\$114,332	\$96,066	\$222	\$3,139	\$14,905
2007	\$117,762	\$98,948	\$0	\$11,200	\$7,615
2008	\$121,295	\$101,916	\$0	\$11,600	\$7,779

NOTE: all of the above are average dollars.

\* Other includes: travel time, vacation bonus, unused vacation days paid out, standby allowance, shift allowance, vacation pay on termination, depending on the nature of the position.

124. VECC IR Exhibit H, Tab 12, Schedule 20 elicited some information on total compensation for Networks:

<b>2004</b>						
REPRESENTATION	TOTAL NO. EMPLOYEES	TOTAL WAGES	% CHANGE	Average Overtime	Average Incentive	Benefits per EE
Building trades	571	36,164,442		10,216		
MCP	287	36,904,235		191	19,793	n/a
PWU	3,080	246,066,961		13,339	2,099	n/a
SOCIETY	935	85,096,183		6,663	182	n/a
<b>Total</b>	<b>4873</b>	<b>404,231,822</b>				
<b>2005</b>						
REPRESENTATION	TOTAL NO. EMPLOYEES	TOTAL WAGES	% CHANGE	Average Overtime	Average Incentive	Benefits per EE
Building trades	594	34,788,694	33.51%	6,952		
MCP	322	41,337,068	-0.95%	459	17,628	3,855
PWU	3,280	262,822,737	-1.12%	13,393	811	2,876
SOCIETY	882	58,938,274	13.58%	2,767	54	2,352
<b>Total</b>	<b>5078</b>	<b>397,886,774</b>				
<b>2006</b>						
REPRESENTATION	TOTAL NO. EMPLOYEES	TOTAL WAGES	% CHANGE	Average Overtime	Average Incentive	Benefits per EE
Building trades	598	39,153,993	12.55%	9,828		
MCP	476	59,707,957	44.44%	120	9,239	3,624
PWU	3,495	294,019,129	11.87%	16,901	1	2,901
SOCIETY	732	66,443,825	12.73%	2,030		3,390
<b>Total</b>	<b>5301</b>	<b>459,324,903</b>				
<b>2007</b>						
REPRESENTATION	TOTAL NO. EMPLOYEES	TOTAL WAGES	% CHANGE	Average Overtime	Average Incentive	Benefits per EE
Building trades	740	50,810,389	29.77%	9,972		
MCP	524	67,717,643	13.41%	121	12,690	3,879
PWU	3,825	306,580,259	4.27%	13,439	0	2,788
SOCIETY	804	70,417,819	5.98%	2,955	8	2,629
<b>TOTAL</b>	<b>5893</b>	<b>495,526,109</b>				
<b>2008</b>						
REPRESENTATION	TOTAL NO. EMPLOYEES	TOTAL WAGES	% CHANGE	Average Overtime	Average Incentive	Benefits per EE
Building trades						
MCP						
PWU						
SOCIETY						
<b>TOTAL</b>	<b>7079</b>	<b>580,700,000</b>				

125. Undertaking J3.11 provides the 2008 projection for Networks in total:

<b>2008</b>						
<b>REPRESENTATION</b>	<b>TOTAL NO. EMPLOYEES<sup>1</sup></b>	<b>TOTAL WAGES<sup>2</sup></b>	<b>% CHANGE</b>	<b>Average Overtime</b>	<b>Average Incentive</b>	<b>Benefits per EE</b>
Building trades	800	53,400,000	5.09%	9,747		
MCP	607	76,320,000	12.70%	0	14,308	3,900
PWU	4,646	363,500,000	18.560%	13,200	0	2,900
SOCIETY	1,026	87,480,000	24.23%	2,900	0	2,700
<b>TOTAL</b>	<b>7079</b>	<b>580,700,000</b>				

### Summary of VECC Position

126. Overall, Networks 2008 Payroll Costs will increase significantly by \$120 million or approximately 17% over the Board-Approved 2006 levels. Since firm data has not been provided on 2008 benefits it is likely that overall increase in total compensation could be larger.

127. VECC submits that this increase is clearly excessive and should be addressed by the Board as part of the issue of the overall OM&A allowance for 2008, since OM&A is driven by the portion of labour costs that are not capitalized.

### ***VECC Submissions***

128. Given Hydro One's integrated workforce approach, it is not easy to determine how much of the \$120 million increase is related to Distribution.

129. Based on the Data in Exhibit C2, Tab 3, Schedule 1 Tables 1, 2 and 3 it appears that the average salary has increased from 2006 to 2008 by \$6520 on a base of \$107,000 which is about 6%.

130. Drivers of the increase in total compensation therefore appear to be both increased staffing (FTEs) and increased compensation per employee. However it appears that the annual average wage increase of 3% is within reason. The main driver is therefore the increase in employees from 5039 in 2006 to 7079 in 2008. (The increase above 2007 is 1190 new hires).

131. Given the great difficulty that intervenors and the Board have in assessing total Compensation Hydro One should be directed to maintain records in a format similar to Exhibit H, Tab 12, Schedule 20 and J 3.11 and routinely file compensation information in standard formats that allows for comparison of year over year actual with test year forecasts.

132. An ongoing issue with Hydro One is the relationship between payroll/compensation costs and OM&A and standard labour rates. Hydro One has been unable to reconcile the amounts shown as OM&A with the labour rates for its work programs. J3.12 requested by the Board Panel Chair, provides information on the costing system at a conceptual level, but still leaves the record confused as to why overall 2008 OM&A is less than 2007 when 2008 payroll/compensation costs are increasing dramatically as are standard labour rates, which contain many more components than simply labour. [Exhibit H, Tab 13, Schedule 26]

133. VECC notes that another unresolved issue is why standard labour rates are increasing at more than 10% when labour costs are going up at less than 5% and what cost element is driving this increase. This is not explained in J3.12.

### ***Pension Costs***

134. With regard to 2008 Pension Costs. At the time of filing Hydro One had an estimate for Networks of \$104 million (plus \$6 million for Inergi) of which \$33

million was attributed to Distribution OM&A. [Exhibit C1, Tab 3, Schedule 2 Appendix A Page 2]

135. Since then the results of the actuarial evaluation are available and have been filed as part of the current proceeding [Exhibit H, Tab 1, Schedule 76]. Hydro One's current expectations are that the Corporation's 2008 overall pension costs will be close to the 2007 level of \$95 million, the amount determined through the December 2006 evaluation. Accordingly VECC submits that the amount allowed for Distribution should be \$31.5 million and the 2008 Revenue requirement adjusted accordingly.

136. VECC has related submissions on the proposed 2008 Pension Cost Variance Account under Issue 6.

### ***Smart Meter OM&A***

137. Under Issue 8 VECC and other intervenors submit that all 2008 SM costs should be removed from the Revenue Requirement and 2008 SM Capital and operating costs be recovered by means of a rate adder/deferral account. Accordingly the SM OM&A of \$9.7 million should be removed from the 2008 cost of service.

### **3.10 Is the level of Hydro One initiated and or delivered CDM activity and budget appropriate and should it be funded by OPA or in rates?**

#### ***Summary of VECC Position***

138. Legacy third tranche and rate funded CDM should be allowed to continue for the program term approved by the Board. The exception is that where a program or measure is now covered under an OPA-funded program the legacy program should be phased out/discontinued.

139. The Board has made a decision that an LRAM is available to distributors. However VECC agrees with Hydro One that there is no basis for filing such a claim since neither baseline load forecasts (without CDM) map to the OPA forecasts nor will there be verified CDM savings for several years. (See VECC's submissions on Issue 1.5)

#### ***VECC Submissions***

140. Hydro One is asking for approval in rates of \$1 million to maintain the programs it initiated in the 2005-2007 period through the market adjusted rate of return ("MARR") CDM funding framework. The funding is to maintain a base level of CDM capability required to participate in industry activities, and to assess resources required to develop future CDM programs and prepare funding applications. (Tr. Vol. 4, p. 32)

141. VECC submits that Hydro One has provided evidence that it is participating in a large number of CDM programs which are being funded by the OPA. Potentially, that funding may exceed \$30 million if Hydro One's current application before the OPA is approved.
142. VECC has major issues with the lack of OPA-funded targeted CDM programs directed to low Income electricity consumers and Seniors. However these are issues to be addressed by the OPA first.
143. If there is an opportunity for LDCs, such as Hydro One, to participate in such programs or alternatively undertake complementary programs, then Hydro One should have an opportunity to apply to the Board for approval of those programs and funding through rates.

- 4.1 Are the amounts proposed for Rate Base appropriate?**  
**4.2 Are the amounts proposed for 2008 Capital Expenditures appropriate?**  
**4.3 Are the 2008 sustaining capital expenditures proposed for Asset Replacement appropriate?**  
**4.4 Are the 2008 amounts proposed for Development capital appropriate?**  
**4.5 Is the 2008 budget for storm related capital expenditures appropriate?**  
**4.6 Is the proposed level of 2008 Shared Services and Other Capital expenditures appropriate?**

### ***Hydro One Position***

*Mr. Rogers (in reference to E1, Tab 1, Schedule 1, page 4, table 3.  
In 2006, the Board approved \$333 million in capital expenditures as part of the 2006 case. Assuming a similar level of capital spending in 2007, the combined impact on 2008 revenue requirement is about \$45 million. That is taking the return on the increased investment in rate base starting with the approved level in 2006.  
So of the \$63 million there, about \$45 million is directly flowing from the Board's decision in 2006.*

*Now, we know, in fact, that capital spending in 2006 was higher than Board approved, primarily because of storm damage which contributes another approximate \$5 million to the increase. [Tr Vol. 7 Page 22]*

And

*Mr. Rogers  
May I now deal briefly with capital expenditures. Capital expenditures are increasing from \$392.6 million in 2006 to a forecast of \$566.2 million in 2008. Once again, this is a large increase. These increases are primarily driven by smart meter spending, and I would like to refer to ..... Exhibit*

J2.2,[Tr. Vol. 7 Page 23]

And

*Mr. Rogers*

*The remaining capital expenditure increase, after you take smart meters out, is more than accounted for by an increase in the distribution generation connection budget from \$1.8 million in 2007 to 8.4 million in 2008. Once again, this was fully explained in the prefiled and oral evidence.*

*In accordance with its distribution licence, Hydro One distribution is required to connect new generators that comply with the requirements of the market rules and the applicable codes. The number of new generators applying for connection has grown immensely in response to the provincial government's initiatives to promote distributed generation.*

*[Tr. Vol. 7 Page 24]*

**COMPARISON OF CAPITAL EXPENDITURES – HISTORIC, BRIDGE AND  
TEST YEARS**

	2004	2005	2006	2007	2008
<b><u>Distribution Capital (\$ millions)</u></b>					
<b>Sustaining</b>					
Lines Capital					
Trouble Call and Storm Damage	38.3	51.7	90.6	51.7	53.4
Joint Use & Line Relocations	19.2	22.0	24.0	27.1	23.7
Line Asset Replacement	35.2	33.2	47.5	60.0	62.4
Total Lines Capital	92.7	106.8	162.1	138.8	139.5
Stations Capital					
Spare Transformers	4.8	1.7	2.8	0.6	3.5
Mobile Unit Substation Refurbishment	1.1	0.4	1.0	0.3	1.5
Station Refurbishment & Component Replacement	5.1	7.0	4.7	6.8	5.3
Total Stations Capital	11.0	9.1	8.5	7.7	10.3
Metering Capital					
Retail Meter Replacement	1.2	1.4	1.6	0.4	2.5
Smart Meters			14.1	76.7	164.8
Total Metering Capital	1.2	1.4	15.7	77.1	167.3
Total "Sustaining"	104.9	117.3	186.3	223.6	317.1
<b>Development</b>					
New Customer Connections & Upgrades	94.2	100.3	104.6	105.9	103.9
Distribution Generation Connection	0.0	0.3	1.5	1.8	8.4
Wholesale Revenue Meters	6.8	8.7	11.1	9.7	11.4
System Capability Reinforcement	37.7	32.4	29.7	36.9	44.0
Total "Development"	138.6	141.7	146.8	154.2	167.7
<b>Operations</b>	6.3	4.7	2.1	2.0	3.6
Transport and Work, and Service Equipment	12.0	32.1	33.6	35.7	44.5
Information Technology Capital	10.6	19.5	19.3	46.7	43.3
Facilities Capital	2.8	1.8	2.1	6.4	4.4
Other (including CDM)	(3.2)	0.1	2.4	8.0	(14.4)
<b>Total Distribution Capital</b>	<b>272.0</b>	<b>317.2</b>	<b>392.6</b>	<b>476.6</b>	<b>566.2</b>



### **Summary of VECC Position**

144. The 2008 Rate base increase is a function of the incremental Capital Expenditures (less Depreciation). VECC does not have the resources to assess the details of Hydro One's 2008 CAPEX and so will adopt an overall expenditure envelope approach to assess the level of 2008 Increase, relative to Board approved 2006 CAPEX.

145. The exceptions to this CAPEX envelope approach are the 2006-2008 CAPEX increases for Smart Meters, generation connections and for Shared Services, including IT capital (the "Cornerstone" Project).

### **VECC Submissions**

#### **Overall 2008 CAPEX Budget**

146. VECC has no overall major concerns about the base level of 2008 Capital expenditures relative to the 2006 historic year.

147. The comparison to 2006 is best made with Smart Meters and IT capital related to Cornerstone removed.

148. As shown in J2.2 the increase in CAPEX from 2006 to 2008 with smart meters removed is \$378.5 million to \$401.4 million.

149. The majority of the year over year increase relates to Cornerstone. According to Hydro One the CAPEX for Cornerstone was \$33.7 million in 2007 and \$28 million in 2008 (including Phase II.)

Exhibit H  
Tab 1  
Schedule 37  
Page 2 of 2

c. The capital and MFA cost breakdown for Hydro One Transmission and Distribution for 2007 and 2008 is:

<b>Cornerstone Phase I</b>	<b>2007</b>	<b>2008</b>
Hydro One Transmission	\$43.0 M	\$28.0 M
Hydro One Distribution	\$33.7 M	\$22.3 M
<b>Total</b>	<b>\$76.7 M</b>	<b>\$50.3 M</b>

150. While there is no major concern that the level of \$400 million is appropriate for 2008 there is an important issue as to an appropriate base level of CAPEX for 2009 and beyond.
151. In VECC's view the Board should not embed the revenue requirement related to \$400 million in CAPEX for the base year of 3GIRM. Rather the level should be reflective of the lower (than the \$28 million in 2008) future expenditure on Cornerstone Phases 2-3.

*MR. BUONAGURO: Okay.*

*Now, sticking, then, with the \$63 million figure for 2008, I understand that 28 million of that is allocated to distribution. I think you talked about this already today.*

*MR. CURTIS: That's correct.*

*MR. BUONAGURO: And then of the \$28 million, \$22.3 million is for phase 1, which is the part that you completed.*

*I think if you look at H1-37A, that would support that.*

*MR. CURTIS: Sorry, what is your reference?*

*MR. BUONAGURO: H1-37, part A. It gives the allocation.*

*MR. CURTIS: That's the allocation.*

*MR. BUONAGURO: Yes. And then part C shows Hydro One distribution, 2008, Cornerstone phase 1, 22.3 million.*

*MR. CURTIS: That's correct, yes.*

*MR. BUONAGURO: So you have 22.3 million for phase 1. And our understanding is that the balance of 5.7 million is for phase 2 and 3?*

*MR. CURTIS: Yes, that's correct. [Tr.Vol.3 Page 151]*

152. Accordingly VECC submits that the appropriate base level of CAPEX for Distribution is approximately \$380 million a year. This should be the amount that drives annual increases in rate base through 3GIRM, and if Hydro One requires an increment due to a project such as CIS replacement, it should apply for an increase in CAPEX for the years covered by the project.<sup>21</sup>

### **Smart Meters**

153. VECC has no issue with the 2008 forecast of installations and the unit capital costs of SM for Minimum Functionality, subject to details of the costs of procurement and support services (CapGemini) being subjected to a prudence review at the time of inclusion in rates.

154. VECC also does not agree that Hydro One has demonstrated that the support costs paid to CapGemini in 2007 were prudent and requests the

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<sup>21</sup> VECC understands that the level of spending may not have any direct effect on rate increases throughout 3GIRM, but does submit that there still needs to be a reference point for an appropriate level of spending for the utility, if only for the purposes rebasing later on.

Board to exclude these costs when clearing the 2007 SM deferral account and direct that the costs be held in the account pending a prudence review.

155. VECC has concerns with the regulatory treatment of SM 2008 costs and with costs above minimum functionality. These concerns are addressed under Issue 8 below.

### ***Generation Connections***

156. As Hydro One indicated in its evidence it is required to connect generators at distribution voltages if they meet the requirements set out in the Distribution System Code.
157. VECC has concerns about the forecasts of small generator activity and the related Capital for connections and system upgrades as well as OM&A for generation assessments. The latter topic has been addressed under OM&A.
158. In 2008 Hydro One is projecting a large increase in retail and net metering small generator connections with an increase in capital budget from \$1.8 million in 2007 to \$8.4 million (Exhibit D2, Tab 2, Schedule 1). This does not include \$4.4 million in related system upgrades. (Exhibit H, Tab 1, Schedule 23 and 26)
159. An IR response to VECC shows that in 2007 Hydro One budgeted \$6.1million, but only spent \$1.8 million. [H, T12, Schedule 30 ]. Further, Part d of that response indicates that neither the OPA nor Hydro One have forecasts of total small generators and capacity that will connect to distribution.
160. VECC is concerned that neither OPA nor Hydro One have a good handle on how many generators and what capacity will connected in 2008 i.e. the support for the budget is lacking and may be too high or too low. This situation is one that variance account treatment may be appropriate. While this would work for 2008 and there is still the issue of what allowance to embed in base rates going into 3 GIRM..
161. VECC suggests that a \$ 10 million variance in CAPEX due to activity not under Hydro One's direct control is material and should continue be accorded deferral account treatment in 2009 and beyond.

### ***IT Capital (Cornerstone)***

162. VECC has two submissions related to Cornerstone:
- The Overall level of IT capital for 2008 is driven by the costs of Cornerstone Phase I. However as noted in submissions on the CAPEX

envelope, Hydro One has not provided a solid forward projection of expenditures for subsequent Phases of the project which creates an issue for the base capital and ratebase component of the Revenue requirement going into 3GIRM.

- Hydro one has not provided adequate support for the multi year costs and benefits of Cornerstone including CCA and a proper Benefits Realization tracking plan.

163. The benefits expressed in terms of O&M reductions, from Cornerstone are projected to be \$200 million over the period 2009 to 2015. The amount allocated to Distribution is less clear:

*MR. CURTIS: I think, as I was explaining earlier, in terms of the costs that were allocated, there is about a 44 percent allocation of costs to the distribution system or the distribution customers.*

*What there is, there's specifically identified savings to the distribution customers of Cornerstone phase 1 of about 30 percent.*

*However, all of our distribution customers are also our transmission customers, Hydro One transmission customers. So the benefits that accrue on the transmission side are also available to our distribution customers. (Transcript Vol. 3, p. 165-166)*

164. VECC submits that it is not appropriate for the ratepayer O&M benefits from Cornerstone to be appropriated by Hydro One during 3GIRM. VECC submits that because all of the costs of the Cornerstone Project have already been paid by customers, by having those costs included in rate base as part of this proceeding. VECC disagrees that incentive regulation is intended to allow utilities to recover 100% of the efficiency benefits related to spending they have already passed on to customers through rates, either in rate base or through O&M expenditures. VECC notes, by way of example, the recent Horizon application, wherein the utility, in recovering costs associated with its Enterprise Resource Planning Project (commonly referred to as the "ERP" project), included the projected cost savings associated with the ERP Project over the course of the years following the base year as reductions to the revenue requirement.<sup>22</sup>

165. With respect, VECC disagrees that Distribution customers of Hydro One are properly characterized as receiving a portion of the Transmission OM&A benefits of Cornerstone. While customers may receive a portion of the

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<sup>22</sup> See, for example, EB-2007-0697, Response to Board Staff Interrogatories, page 62 of 157, where Horizon Reiterates that with respect to the revenue requirement associated with the ERP for 2008, they have incorporated the estimated cost savings, even though those savings remain to be realized over a 5 year period.

Transmission benefits, they do so because they pay Hydro One transmission rates that include recovery of the Cornerstone costs in the transmission rate base, not simply by virtue of also paying Hydro One distribution rates.

166. This illustrates why a simplistic approach to matching of costs and benefits for Cornerstone is not appropriate and a proper benefits realization analysis and plan is required.

167. VECC submits that the appropriate way to proceed is for the Board to direct Hydro One to file a proper benefits realization plan for Cornerstone and based on that plan, the Board should provide for annual reductions in O&M and revenue requirement throughout the 3GIRM period.

168. If the Board is not inclined to make such an order, then in the interest of fairness to ratepayers, the Board should make a base year adjustment to O&M corresponding to the future 30% benefits (\$60 million) noted above that are claimed to be allocated to Distribution. Based on J3.7, this would amount to \$8 million reduction in OM&A a year over the planned 4 year 3GIRM (2009-2012).

**4.7 Are the methodologies used to allocate Shared Services and Other Capital expenditures to the distribution business and determine the Working Capital component of the Rate Base consistent with the methodologies approved by the Board in previous Hydro One rate applications?**

169. Partially Settled. The parties agree that the methodology used by the Applicant to determine the Working Capital of \$273.2 million is consistent with the methodology approved by the Board at page 29 of their EB-2005-0378 Decision. This amount represents 11.2% of total OM&A and cost of power. The settlement of this issue was also accepted by the Board in proceeding EB-2006-0501.

170. The narrowed scope of the issue is: "Are the methodologies used to allocate Shared Services and Other Capital expenditures to the distribution business consistent with the methodology approved by the Board in previous Hydro One rate applications".

***Summary of VECC Position***

171. VECC accepts Hydro One's Evidence, subject to recalculating the final Working Capital allowance with a 2008 GST rate of 5% and changes to reflect the Board's decisions on OM&A. [Exhibit J1.2]

### **5.3 Is the proposed accounting treatment of non utility revenue and expenditures associated with OPA funded CDM appropriate?**

#### ***Summary of VECC Position***

172. VECC is satisfied that Hydro One is correct to exclude the costs and revenues from OPA-funded CDM from the 2008 distribution revenue requirement.

173. However the issue is complicated by the fact that in the future Hydro One could apply for an LRAM. VECC reserves its right to argue that the net income earned by Hydro One from OPA-funded CDM should be taken into account when considering any application for an incentive paid for by ratepayers.

### **6.1 Is the proposal for the amounts, disposition and continuance of Hydro One's existing Deferral and Variance Accounts (Regulatory Assets) appropriate?**

#### ***Hydro One Networks Position***

174. In its filed Application, Hydro One Networks proposed to dispose of the balances (calculated as of April 30, 2008) for the following Regulatory Asset accounts:

- OEB Costs
- Tax Changes
- Smart Meter Minimum Functionality (under recovery to May 31, 2007)
- Smart Meter Minimum Functionality (under recovery between June 1, 2007 and April 30, 2008)
- Smart Meter Exceeding Minimum Functionality (under recovery)
- Retail Settlement Variances

175. Overall, the disposition involved a refund of \$48.7 M to customers<sup>23</sup>.

176. During the proceeding, these amounts were updated for 2007 audited results and revised 2008 forecasts. The new total for disposition to customers

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<sup>23</sup> Exhibit F, Tab 1, Schedule 1, page 2

is \$65.5 M<sup>24</sup>. It is this amount that Hydro One Networks is proposing to refund to customers<sup>25</sup> over a four year period.

177. Hydro One Networks also provided, in response to information requests, the balances for those regulatory asset accounts for which it was not requesting disposition<sup>26</sup>.

### ***VECC's Submissions***

#### ***Balances to be Cleared***

178. VECC recognizes that it has not been Board practice to order disposition of forecasted balances of principal transactions on deferral and variance accounts. The usual practice for disposing of variance and deferral accounts in the electricity sector is to use the most up-to-date audited balances, as supported by audited financial statements, plus forecasted carrying charges on those balances up to the start of new rate year.

179. VECC also acknowledges that the Board has issued a letter dated February 19, 2008 announcing the Board's intention to launch an initiative to review commodity variance accounts<sup>27</sup>, possibly including other RSVA and RCVA accounts as well in this process. This has led to the Board deferring clearance of RSVA and RCVA accounts until the review process is implemented, unless there were extenuating circumstances (e.g., Hydro 2000 Inc. EB-2007-0704 and Toronto Hydro-Electric System Limited EB-2007-0680).

180. In the case of Hydro One Networks, VECC submits that there also extenuating circumstances sufficient to justify clearance of the variances proposed by Hydro One Networks, including the RSVA accounts. Even with the four year implementation plan, Hydro One Networks' proposed realignment of its customer classes and harmonization of its rates is having a significant impact on total bills for many of Hydro One Networks' customers. Clearance of the April 2008 projected Regulatory Asset Account balances will help to offset these impacts a facilitate Hydro One Networks' overall rate harmonization plan.

181. VECC submits that the Board should approve Hydro One Networks' proposal to dispose of the (projected April 31, 2008) balances in OEB Cost, Tax Changes and Retail Settlement Variance accounts.

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<sup>24</sup> Exhibit J6.2

<sup>25</sup> Transcript Volume 7, page 12, lines 10-13

<sup>26</sup> Exhibit H-Tab 1-Schedule 115

<sup>27</sup> It should be noted that Hydro One Networks does not have an RSVA for Commodity (Exhibit H, Tab 1, Schedule 121)

182. VECC submissions with respect to the regulatory treatment of smart metering costs are provided under Issue #8.4. Consistent with these submissions VECC submits that the various Smart Meter-related deferral accounts should be treated as follows:

- Smart Meter Exceeding Minimum Functionality – The balance in this account should not be cleared at this time. Rather the balance should be maintained and the account continued until the Board has established what types of costs are eligible for recovery and the account balances can be accordingly assessed.
- Smart Meter Minimum Functionality – This account should be cleared based on the December 31, 2007 balance and interest to April 31, 2008. Costs after December 31, 2007 should be considered in setting the 2008 rate adder.
- Support costs paid to CapGemini in 2006/2007 should not be cleared and remain in the SM deferral Account pending a prudence review.
- Cost incurred after December 31, 2007 should be considered in setting the 2008 Smart Meter Rate Adder.

## **6.2 Is the proposal to establish new Deferral and Variance Accounts appropriate?**

### ***Hydro One Networks Position***

183. Hydro One Networks is seeking approval for three variance accounts not currently authorized by the OEB's Accounting Procedures Handbook<sup>28</sup>:

- Pension Cost Differential – to track the difference between the actual pension cost booked and the estimated pension costs used in the rate filing<sup>29</sup>.
- OEB Cost Differential – to track the difference between the annual OEB Cost Assessments, intervenor cost awards and cost associated with OEB-initiated studies and the amount for these expenditures approved by the OEB as part of the 2008 Distribution Rates<sup>30</sup>.
- Bill Impact Mitigation – to record the difference between Hydro One's requested (approved) revenue requirement and the application of Hydro One's proposed revenue to cost ratios<sup>31</sup>.

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<sup>28</sup> Transcript Volume 6, page 110, lines 8-24

<sup>29</sup> Exhibit F, Tab 3, Schedule 1, page 1

<sup>30</sup> Exhibit F, Tab 3, Schedule 1, page 1

<sup>31</sup> Exhibit F, Tab 3, Schedule 1, page 2



184. These accounts would continue for the duration of the 3<sup>rd</sup> Generation IRM period and the “forecast” amounts posted to the accounts in subsequent years would be those included in the approved 2008 revenue requirement<sup>32</sup>.
185. In the case of the Bill Impact Mitigation Account, the amount posted to the account will be known once the 2008 Distribution Rates are finalized<sup>33</sup>. While Hydro One Networks is not requesting disposition of the amount as part of this Application the Company did suggest that the amount should be recovered from all customers<sup>34</sup>.

## ***VECC Submissions***

### ***Pension Cost Differential Account***

186. When asked about the precedent for such an account, Hydro One Networks’ witness noted that the Company had a pension deferral account previously<sup>35</sup>. However, VECC notes that the previous account was approved specifically because Hydro One Networks did not have an opportunity (prior to 2006) to rebase its rates to reflect then current pension cost forecasts. In contrast, in its 2006 Rate Application (RP-2005-0020/EB-205-0378) Hydro One Networks:

- Proposed that the forecast balance to April 2006 be cleared, noting that the forecast balance was based on an actuarial valuation of the pension plan and, as such, the funding required was predictable<sup>36</sup>.
- Did not propose that the pension deferral account be re-established for the 2006 rate year.

187. Furthermore, VECC notes that Hydro One Networks neither requested nor was granted a Pension Cost Differential account for its Transmission business as part of its 2007&2008 Transmission Rate Application.

188. In its initial 2008 Distribution Rate Application, Hydro One Networks forecast that pension cost for the overall Company would be \$104 M for 2008. The portion of these costs attributable to its Distribution business’ OM&A expense was estimated to \$33 M<sup>37</sup>. At that time, the most recent actuarial evaluation of Hydro One Network’s pension plan had not been released and, as result, there was admittedly considerable uncertainty as to what the pension costs for 2008 would be.

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<sup>32</sup> Transcript Volume 5, page 14, line 21 to page 15, line 5

<sup>33</sup> Transcript Volume 6, page 130, lines 1-14

<sup>34</sup> Transcript Volume 5, page 49, lines 9-17

<sup>35</sup> Transcript Volume 5, page 57, line 27 to page 58, line 4

<sup>36</sup> 2006 Rate Application, Exhibit F1, Tab 1, Schedule 2, page 3, lines 2-3

<sup>37</sup> Exhibit C1, Tab 3, Schedule 2, Appendix A, page 3

189. Since then the results of the actuarial evaluation are now available and have been filed as part of the current proceeding<sup>38</sup>. While not known with total certainty, current expectations are that the Corporation's 2008 overall pension costs will be somewhat higher than \$95 M<sup>39</sup>, the amount determined through the December 2006 evaluation. Indeed, Hydro One Networks currently forecasts that the Deferral Account will have a 2008 variance of \$1.5 M<sup>40</sup>.
190. At the time of its 2006 Rate Application, Hydro One Networks expressed a high level of confidence in its pension cost forecast given that it had a recent pension valuation. VECC submits that the circumstances are the same for 2008. In light of this similarity, there is no need for a Pension Cost variance account for 2008. Instead the Board should simply reduce the pension costs included in the 2008 Distribution Revenue Requirement by \$1.5M (i.e., \$31.5 M versus the original \$33 M).
191. Finally, VECC notes that none of the distributors who have applied for and received approval of the 2008 rates on a cost of service basis have been granted a pension cost differential account. In VECC's view there is no need to treat Hydro One any different, particularly in light of the fact it has a recent pension plan evaluation and the next evaluation does not occur until December 2009 – after the rate year<sup>41</sup>.
192. VECC submits that the Board should deny Hydro One Networks request for a Pension Cost variance account and, in light of the updated forecast of pension cost for 2008, reduce the proposed Distribution Revenue Requirement by \$1.5 M.

### ***OEB Cost Differential Account***

193. During the proceeding, Hydro One was asked why it should be granted an OEB Cost Differential Account when the Board denied a similar request from Toronto Hydro (EB-2007-0680 Decision, page 69). Hydro One Networks' witness responded by saying that their situation was different as Hydro One Networks finds itself involved in a number of different proceedings and tends to engage very actively in Board initiated proceedings<sup>42</sup>. In particular, the witness went on to state<sup>43</sup>:

*"These proceedings for the most part are done by our core staff. However, from time to time, we require to undertake specific studies and do other research in order to add value to the process. There's a number*

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<sup>38</sup> Exhibit H, Tab 1, Schedule 76

<sup>39</sup> Transcript Volume 4, page 167, lines 15-25

<sup>40</sup> Transcript Volume 6, page 114, lines 7-27

<sup>41</sup> It is VECC's understanding the pension evaluations are required to be carried out every 3 years.

<sup>42</sup> Transcript Volume 6, page 124, lines 8-22

<sup>43</sup> Transcript Volume 6, page 124, line 23 to page 125, line 10

*of discussion papers and other considerations that we submit to the Board.*

*So what we are asking for is relief from the -- for those incremental costs that we incur associated with these special Board-initiated activities. And we would track those costs in this deferral account.*

*I have to mention, this is strictly the incremental costs and, as a result of us actively participating in Board-initiated proceedings, not major proceedings like this, but there is a number of ad hoc initiatives and studies and discussion papers that we file and/or engaged with."*

194. However, when specifically asked by VECC's Counsel as to what types of costs would be recorded in the account, the following exchange occurred:

*MR. INNIS: These would be studies in relation to directives from the OEB. So what we'd be doing is let's say we're studying for incentive rate regulation mechanism. To the extent we would be required to initiate a special study to consider that some of the factors in that, we would seek to be tracking those costs.*

*In terms of specific examples, I don't have any that immediately come to mind from the past. But what we would be expecting those in the future to the extent we would have to undertake work beyond what is in our core regulatory program, we would track those costs and put those in this account.*

*MR. BUONAGURO: I see. So you mentioned incentive regulation in part of your answer. For example, as I understand it Hydro One along with some other LDCs, have retained London Economics to assist them with the third generation IRM process. Is that something you would consider an OEB-initiated study?*

*MR. INNIS: Not in this particular case, we would not be tracking that. I used that as an example of the types of things. We would not be seeking to recover costs associated with the third generation IRM work.*

*MR. BUONAGURO: So is it limited to studies that the Board, as part of this particular rate application, says You will do this and come back again with a study on this particular topic?*

*MR. INNIS: It could be that, or it could be directives from the Board that would arise a number of months from now that we just haven't anticipated.*

*What we are concerned about is incurring costs for work that is beyond what we have in our core budget, and so to the extent that a number of months from now there is some direction from the Board that we undertake a certain initiative, we have not anticipated that in our core funding for 2008. We would seek to track those costs.*

*These would be of a material amount, certainly not small, small initiatives or just ad hoc queries and that type of thing. But if we're required to do some specific studies, then we would track those costs and put those costs in this account.*

*MR. BUONAGURO: It is not limited to specific studies that the Board asks you to do as part of this application? It may also include studies that result from things that you are supposed to do as a part of this application decision that down the road you say, Oh, we have to do a study for that as part of that undertaking?*

*MR. INNIS: It could include those. Or it could include new initiatives by the Board that arise over the next few years, as well, which we haven't specifically, don't specifically know about and haven't specifically included in the funding request for 2008.*

195. Based on this exchange, it appears the variance account is to be limited to special studies that the Board specifically directs Hydro One Networks to carry out as opposed to the cost of preparing discussion papers and undertaking other research that Hydro One believes will add value (and/or promote its particular interests) during a Board-initiated process. VECC submits that it is not Hydro One Networks tendency to actively participate in OEB-initiated proceedings that would lead to the incurrence of such costs. Rather it would be a Board decision that it requires specific input that only distributors can provide and a subsequent directive that Hydro One should carry out certain analyses or studies.
196. Within this context, VECC does not see how Hydro One is any different from any other distribution utility in the province. Presumably if the Board requires information that only distributors can provided and is going to direct Hydro One to do so, there is no reason to indicate it would not direct other distributors, such as Toronto Hydro, to do the same.
197. As well as the cost of "special studies" Hydro One Networks is also seeking to record in the account the difference between the actual cost of OEB assessments and intervenor cost awards and the amount included in its 2008 rates. However, with respect to both of these cost components, Hydro One Networks circumstance is no different than that of other distributors applying for 2008 rates on a cost of service basis. As the Board Panel noted during the proceeding these other distributors have not requested (nor been approved) the use of variance account for this purpose<sup>44</sup>.
198. As result, VECC submits that the Board should reject Hydro One Networks' contention that its circumstance is different from that of Toronto (or any other utility) and deny its request for an OEB Cost Differential variance account.
199. As a final comment, VECC does not believe that such a variance account would be appropriate if the scope of the studies to be included in the account was expanded to cover all work done by Hydro One Networks in support of its participation in Board-initiated processes. While such studies may add value

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<sup>44</sup> Transcript Volume 6, page 134, lines 10-12

to the Board processes, it would be naive to ignore the fact that they are also made to support the interests of the utility and its shareholder. Granting such an account would give Hydro One a blank cheque to fund such studies/interventions in the future.

### ***Bill Impact Mitigation Account***

200. According to Hydro One Networks' evidence the need for this account arises as a result of Hydro One's Decision to not increase the revenue to cost ratio for the R1 customer class higher than 0.88, in order to mitigate the bill impacts for that class<sup>45</sup>. However, this is a very narrow characterization of the issue. In reality, Hydro One Networks' proposal involves adjusting the revenue to cost ratios for a number of its customer classes such that<sup>46</sup>:

- For all classes where the ratio was higher than 1.0 and above the range set by the OEB, it has been reduced to be within the range. Indeed, in the case of the new DG class the ratio was reduced to 1.0.
- For all classes where the ratio was below 1.0 and below the range set by the OEB, it has been increased to the low end of the range set by the OEB. The one notable exception is Residential R1 where the ratio is increased from 0.82 to 0.88 relative to a range of 0.85 to 1.15.
- For all classes where the ratio was below 1.0 but within the OEB guidelines the ratio has been increased to 1.0.

201. In VECC's view, it is the overall effect of all of these changes that has led to an under recovery of \$2.5 M in Hydro One Networks' proposed revenue requirement.

202. The Board's Guidelines do not require that revenue to cost ratios be moved to 1.0. Indeed, the Guidelines express specific concerns about distributors doing so given the quality of data and limited modeling experience. These concerns were reiterated in the recent Board Decision regarding Guelph Hydro's 2008 rates<sup>47</sup>:

*As the Board has noted in the Cost Allocation Report, cost causality is a fundamental principle in setting rates. However, observed limitations in data affect the ability or desirability of moving immediately to a revenue to cost framework around 100%. The Board's target ranges are a compromise until such time as data is refined and experience is gained.*

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<sup>45</sup> Transcript Volume 6, page 126 and Exhibit G1, Tab 3, Schedule 1, page 4

<sup>46</sup> Exhibit G1, Tab 3, Schedule 1, pages 4-5

<sup>47</sup> EB-2007-0742, pages 23-24.

203. The Guidelines also acknowledge the principle of avoiding rate shock and recognize that reducing the revenue to cost ratios for some classes requires offsetting increases for others. This principle has been recognized in a number of the recent 2008 Rate Decisions issued by the Board<sup>48</sup>, where utilities were directed to phase-in the reduction in their revenue to cost ratios for certain customer classes in order to mitigate the rate impact that increasing the ratios for other classes would have on customers' bills.
204. Therefore VECC submits that it is incorrect (and misleading) to characterize the need for the Bill Impact Mitigation account as being associated with an under recovery by the R1 Class. This is particularly the case since the revenue to cost ratio for the R1 class is within the range specified by the Board's Guidelines. VECC notes that in its decision regarding Barrie's 2008 rates<sup>49</sup> (EB-2007-0746), the Board decline to increase the revenue to cost ratio for GS>50 kW further after it had been moved to within the Board's range.
205. Rather the need for the account arises as result of the fact Hydro One Networks overall rate proposal does not include a set of rates ( and class revenue to cost ratios) that addresses both rate shock and the need to recover the overall revenue requirement. VECC notes that if the revenue to cost ratio for the ST class was reduced from 2.35 to 1.25 (instead of to 1.15) the additional revenue would more than cover the \$2.5 M shortfall<sup>50</sup>. At the same time, the 1.25 revenue to cost ratio would reduce the gap for the ST class between the upper range and the 2008 approved ratio by substantially more than the 50% that the Board has generally used when addressing the need to realign revenue to cost ratios<sup>51</sup>.
206. VECC submits that a more balanced approach to adjusting the revenue to cost ratios (as suggested above) would negate the need for this variance account and be more consistent with the approach the Board has taken in its other 2008 EDR Decisions. This matter will be addressed further under Issue #6.4.
207. If the Board chooses to approve the Bill Impact Mitigation account, then VECC submits it should also recognize that the need for the account is not directly attributable to any one customer class and the approach to any future decision regarding the recovery of the balance in the account should be governed accordingly.

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<sup>48</sup> For example Oshawa (EB-2007-0710)

<sup>49</sup> EB-2007-0746, page 14

<sup>50</sup> Based on Hydro OneN's cost allocation methodology, the allocated revenue requirement for the ST class is \$27.4 M (Exhibit G1, Tab 3, Schedule 1, page 2). Increasing the revenue to cost ratio by 10 percentage points would yield \$2.7 M in additional revenue while still producing a proposed revenue requirement for the class that is significantly less than revenue at current rates (i.e. \$34 M vs. \$64.2 M)

<sup>51</sup> See the Decisions for Guelph Hydro (EB-2007-0742, page 25) for reference to the 50% principle

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

### ***Hydro One Networks' Position***

208. Hydro One Networks is proposing 12 new customer classes which will apply to all legacy and acquired LDC customers, including embedded distributors<sup>52</sup>.

209. With respect to VECC's Residential Customer constituency, Hydro One Networks' proposal maintains the same three customer classes and continues to use the same customer class definitions as are currently applied<sup>53</sup>. In addition, Hydro One Networks has undertaken a "density review" of its Urban areas and identified (reclassifying where necessary) all customers who qualify to be classified as Urban Residential, Urban General Service Energy Billed and Urban General Service Demand Billed<sup>54</sup>.

### ***VECC's Submissions***

210. VECC agrees with Hydro One Networks' customer classification proposal as it applies to Residential customers. VECC also agrees with the continued use of Hydro One Networks' current density criteria at this time. There is no basis on which to change the density criteria at this time and a number of reasons to maintain the existing criteria including:

- Any change in density criteria could increase the total bill impacts for one or more of the customer classes.
- The current definition of "urban" reflects the average density of other distributors<sup>55</sup>.
- The current definition of R2 (Residential Year-Round Class Normal Density) determines who receives Rural and Remote Rate Assistance.

211. VECC commends Hydro One Networks for reviewing its customer base and reclassifying those R1 and R2 customers who qualify to be considered "urban residential". However, VECC notes that Hydro One Networks has not undertaken a similar review to determine if any of its R2 customers should be moved to R1 based on increased customer density<sup>56</sup>. During the proceeding Hydro One explained that in order to complete such a review it would require better connectivity data and lines detail. The Hydro One Networks witness

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<sup>52</sup> Exhibit G1, Tab 2, Schedule 3, page 1

<sup>53</sup> Exhibit G1, Tab 2, Schedule 3, page 1

<sup>54</sup> Exhibit G1, Tab 2, Schedule 4

<sup>55</sup> Transcript Volume 6, page 156, line 28 to page 157, line 2

<sup>56</sup> Exhibit H-12-41 b)

also indicated that work was ongoing to obtain such information<sup>57</sup> but did not know when it would be available. VECC submits that the Board should direct Hydro One Networks to undertake such a review once the necessary data is available and provide an updated density review (for both Urban and R1 Residential customers) as part of its next rebasing rate application.

212. During the course of the proceeding parties raised questions regarding a) the inclusion of embedded distributors and retail customers in the same (ST) class and b) the lack of a separate class for unmetered and scatter loads (USL). Set out below are VECC's view on both of these issues.

213. VECC supports the creation of a single ST class that includes both embedded distributors and large retail customers. As Hydro One Networks has indicated<sup>58</sup>, all of these customers generally utilize the same assets. One exception is metering. However, in this case, the distinguishing factor is whether the customer concerned is a wholesale market participant<sup>59</sup> and there are both embedded distributors and large retail customers who are market participants<sup>60</sup>. Furthermore, Hydro One Networks has addressed this distinction by introducing a separate "meter charge" for ST customers who do not provide their own metering<sup>61</sup>.

214. The other exception is the fact that some embedded distributors are served at voltages below 13.8 kV<sup>62</sup>, the dividing point for Hydro One Networks' sub-transmission system<sup>63</sup> when dealing with retail customers. In VECC's view this is the one area where Hydro One Networks' definition of the ST class could be questioned. From a service voltage and facility use perspective these delivery points are similar to large General Service customers. However, in the interest of having a standard approach to all embedded distributors, VECC accepts that the classification of these customers as ST is reasonable. VECC notes that Hydro One Networks' cost allocation methodology assigns a portion of the cost of low voltage distribution stations and primary lines to the ST class and that there are separate charges applicable to these smaller embedded distributors to recover the associated costs<sup>64</sup>.

215. The second issue raised during the course of the proceeding was Hydro One Networks' treatment of unmetered and scattered load (USL) customers. Hydro One Networks currently does not have a USL customer class and is not

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<sup>57</sup> Transcript Volume 5, page 24, line 7 to page 25, line 25 and Volume 6, page 158, lines 13-23

<sup>58</sup> Transcript Volume 4, page 32, line 1 to page 33, line 20

<sup>59</sup> Transcript Volume 4, page 55, lines 11-21

<sup>60</sup> Transcript Volume 4, page 56, lines 4-7 and Exhibit J4.1

<sup>61</sup> Exhibit G1, Tab 4, Schedule 4, page 4

<sup>62</sup> Exhibit H, Tab 12, Schedule 38, part c)

<sup>63</sup> Exhibit G2, Tab 1, Schedule 1, page 3, lines 4-7

<sup>64</sup> Exhibit G1, Tab 4, Schedule 4, pages 2-4



proposing to introduce one. The stated reason is that they are seeking to reduce, not increase, the number of customer classes<sup>65</sup>. Hydro One also noted, while there was no separate USL class, there is credit given to USL customers to recognize the fact that they are unmetered<sup>66</sup>.

216. VECC does not accept as sufficient rationale for not having a separate USL class, the claim that Hydro One Networks is seeking to reduce the number of customer classes. As part of this application, Hydro One Networks is introducing a new class for distributed generators. While this is in response to previous Board Decisions, Hydro One Networks has not argued against the introduction of such a class in the interest of simplifying the number of customer classes. Also, another reason Hydro One Networks has given for its new customer classes is to “provide similar customer classes as other LDCs”<sup>67</sup>. VECC notes that a number of other LDCs have a separate USL class.

217. However, in VECC’s view the provision of a credit to USL customers based on the fact they are not metered recognizes the material cost differences between servicing USL loads versus other small General Service loads<sup>68</sup>. VECC also notes that the load factor for USL is in the range of that for other customers also included in the GS energy-billed class<sup>69</sup>. As a result, VECC does not see any compelling need to create a separate USL class at this time.

218. VECC does not understand why all USL customers were reclassified to the General Service (energy billed) class when clearly a number of them qualified for the Urban General Service (energy billed) class<sup>70</sup>. VECC submits that these customers should be properly reclassified as Urban General Service.

## **7.2 Is Hydro One’s cost allocation appropriate?**

### ***Hydro One Networks’ Position***

219. Hydro One Networks’ has modified the OEB’s Cost Allocation Model to take into account its customer classes and to accommodate its sub-transmission system<sup>71</sup>. Also, changes were made to the model used for the Cost Allocation Informational filings to update the minimum system/PLCC

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<sup>65</sup> Transcript Volume 5, page 129, lines 12-15

<sup>66</sup> Transcript Volume 5, page 107, lines 19-22

<sup>67</sup> Exhibit G1, Tab 2, Schedule 3, page 1, line 7

<sup>68</sup> Exhibit G1, Tab 4, Schedule 5, page 1

<sup>69</sup> Exhibit H, Tab 8, Schedule 3

<sup>70</sup> Exhibit H, Tab 8, Schedule 2

<sup>71</sup> Transcript Volume 4, page 13, lines 3-8

values and to refine the density weightings<sup>72</sup>. Hydro One Networks also changed the allocation factor used for Miscellaneous External Revenues<sup>73</sup>.

### ***VECC's Submissions***

220. The issues addressed in this portion of VECC's Final Argument include: Hydro One Networks' modification to the OEB cost allocation model; Hydro One Networks use of Direct Allocation; Hydro One Networks' allocation of A&G expense to customer classes; and the Current Status of Hydro One Networks' cost allocation methodology.

### ***Modifications to the OEB Model***

221. VECC acknowledges the need for Hydro One Networks to modify the OEB Cost Allocation Model to accommodate its proposed customer classes.

222. With respect to the inclusion of a Sub-Transmission component in the model, Hydro One Networks stated that the purpose of modification was to improve the determination of cost responsibility<sup>74</sup>. As part of these modifications, Hydro One Networks' model purportedly breaks out the LV asset (i.e., stations and lines) used by the ST class versus those used by other customer classes<sup>75</sup>. However, in most instances this did not involve the direct assignment of assets. In the case of shared stations, the costs were split based on relative energy use<sup>76</sup>. In the case of lines, the value of ST had to first be estimated<sup>77</sup> and then the "estimated" costs allocated to all customer classes, including ST<sup>78</sup>. The overall result is that the values recorded in sub-accounts created to capture ST assets are to a large extent based on estimates and allocations.

223. VECC accepts that this break out (although an approximation) improves the overall determination of cost responsibility. However, VECC submits that the resulting accuracy of Hydro One Networks' methodology (in terms of determining actual cost responsibility by customer class) is no greater than that of the typical Ontario electricity distributor which has no Sub-Transmission facilities at all and simply uses the OEB's Cost Allocation Model. Indeed, given additional amount of "estimation" involved the accuracy of the Hydro One Networks' model is likely less accurate.

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<sup>72</sup> Transcript Volume 5, page 47, lines 8-21

<sup>73</sup> Exhibit G2, Tab 1, Schedule 1, page 10

<sup>74</sup> Transcript Volume 4, page 35, lines 4-6

<sup>75</sup> Exhibit G2, Tab 1, Schedule 1, page 7, line 13 to page 8, line 3.

<sup>76</sup> H-12-69

<sup>77</sup> Exhibit H-12-70 a)

<sup>78</sup> Transcript Volume 5, page 51, lines 1-17

224. Hydro One Networks retained Black and Veatch to update its minimum system study<sup>79</sup> and to provide new PLCC (Peak Load Carrying Capability) values for the minimum system components. In VECC's view the new study provide values that are more reflective of Hydro One Networks' system than the default values used in the OEB's Cost Allocation model. However, VECC notes that study involved judgment in determining both the replacement cost for the existing system and the appropriate size for the minimum system components<sup>80</sup>. As a result, VECC submits that the results represent (at best) an approximation of the demand/customer split applicable to Hydro One Networks' distribution facilities.
225. VECC notes that while Hydro One Networks has updated the density weighting factors used for the Residential, Seasonal and General Service customers, there are deficiencies in the approach Hydro One Networks has taken with respect to its use of those factors.
226. First, it did not undertake any analyses to determine the most appropriate way of assigning costs between the different customer density classifications. Rather it simply assumed that the approach used (i.e. line kilometers) and the accounts selected for weighting were appropriate<sup>81</sup>.
227. Second, Hydro One Networks has not included any consideration of density in the allocation of costs to the DG, ST, Sentinel Light or Street Light customer classes. For example, the split of LV assets and Primary assets between the ST and other classes does not incorporate density considerations<sup>82</sup>. Also, even when the costs for lines and transformers were being allocated between retail customer classes the density weighting for Street Lights, DG and Sentinel Lights were not calculated; they were all assumed to be 1.0<sup>83</sup>. As a result, VECC submits that Hydro One Networks use of density weightings has not been fully thought out and improvements are likely possible.
228. Finally, VECC acknowledges that Hydro One Networks' proposed allocation factors for Miscellaneous Revenues more accurately reflect cost responsibility. However, the Board's decision to use Weighted Customer Bills to allocate these costs was, in part, predicated on the fact that a large portion of customer billing and service costs were allocated on the same basis. The rationale was that until one could improve the allocation of the "expenses", the "revenues" should be allocated in a comparable manner<sup>84</sup>. VECC notes that Hydro One Networks proposal does not include any refinements to the

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<sup>79</sup> Exhibit G2, Tab 1, Schedule 1, page 20

<sup>80</sup> Exhibit G2-1-1, Appendix B, pages 6-12 and H-12-77 & 78

<sup>81</sup> Transcript Volume 5, pages 166, line 28 to page 167, line 21

<sup>82</sup> Transcript Volume 5, page 51, lines 5-21 and page 52, line 9 to page 53, line 7

<sup>83</sup> H-12-66, parts b) & d) and Transcript Volume 5, page 53, line 20 to page 54, line 6

<sup>84</sup> Cost Allocation Review, EB-2005-0317, pages 79-80

allocation of customer service costs (i.e., the 5300 accounts) and submits that the improvement in tracking of cost responsibility may be overstated.

229. Also, in the calculation of the revised revenue to cost ratios arising from its “unique” allocation of Miscellaneous Revenues, Hydro One Networks has changed both the allocation of revenues and cost to customer classes<sup>85</sup>. For example for the UR class the revised revenue to cost ratio of 0.875 is based on a revised revenue of \$57,701,735 (to reflect the unique treatment of Miscellaneous Revenues). But the “costs” used in the calculation have also been changed from \$66,965,969 to \$65,954,685. VECC understands why the “revenue” was adjusted in light of the new Miscellaneous Revenue allocation. However, there is no reason why the allocated costs should also be adjusted. The impact of this misspecification on the revenue to cost ratios is relatively minor except for the Sentinel Lights class, where correction would change the ratio from 0.62 to 1.25<sup>86</sup>.

230. Overall, the modifications by Hydro One Networks are primarily adjustments designed to make the Board’s Cost Allocation Model fit its particular circumstances. In VECC’s view, the modifications do not improve the accuracy of the cost allocation results when compared to what the standard OEB Model would yield for a typical electricity distributor.

### ***Hydro One Networks’ Use of Direct Allocation***

231. Hydro One Networks Cost Allocation Model reportedly uses direct allocation to assign \$7.17 M to customer classes<sup>87</sup>. However, based on the Board’s Direction on Cost Allocation (EB-2005-0317) direct allocation is defined as the allocation of identifiable OM&A activities to one customer classification<sup>88</sup>. Of the \$7.2 M Hydro One Networks claims are directly allocated only the \$1.48 M associated with Sentinel Lights meets the Board’s criteria. The balance of the costs, which are related to interval meters, are actually allocated amongst a number of customer classes<sup>89</sup>.

232. Hydro One Networks claims that its treatment of the other \$5.69 M meets the spirit of what they consider direction allocation<sup>90</sup>. VECC disagrees. While the allocation parameters Hydro One Networks proposes to use for these interval-meter related costs may represent an improvement over the OEB’s cost allocation model, the result is not a direct assignment as defined by the OEB Decision. This distinction is important in the following discussion regarding the allocation of Administrative and General expenses.

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<sup>85</sup> Exhibit G2, Tab 1, Schedule 1, Attachment A, page 36.

<sup>86</sup> See Attachment A to VECC Argument, Rows 16 vs. 17

<sup>87</sup> Exhibit G2, Tab 1, Schedule 1, page 9 and Exhibit G2-1-1, Attachment A, page 35

<sup>88</sup> Page 32 and Transcript Volume 5, page 36, line 22 to page 37, line 5

<sup>89</sup> Transcript Volume 5, page 37, lines 6-22

<sup>90</sup> Transcript Volume 5, page 37, line 23 to page 38, line 5

### ***Hydro One Networks' Allocation of Administrative and General Expenses***

233. Hydro One Networks allocates Administrative and General Expenses<sup>91</sup> to customer classes using only non-directly allocated O&M costs<sup>92</sup>. Hydro One Networks contends that this approach is consistent with the OEB's Cost Allocation Model and with the Direction from the Board<sup>93</sup>. VECC disagrees.

234. VECC has not had the opportunity to fully audit the OEB Cost Allocation model. However, if the model does exclude directly assigned O&M from the allocation base use to allocate Administrative and General costs then, in VECC's view, there is an inconsistency between the Board's Direction on Cost Allocation and the OEB's Cost Allocation Model. Section 10.3.2 of the Board's Direction sets out the allocation approach to be used for these costs and there is no reference to excluding directly allocated O&M costs<sup>94</sup>.

235. Hydro One Networks claims that there is nothing they can do about it and that that they just followed the model<sup>95</sup>. However, VECC notes that in other instances such as the allocation of Miscellaneous Revenues Hydro One Networks has been more proactive and proposed an alternative allocation methodology it considered to be more appropriate.

236. As noted above, Hydro One Networks has considered certain costs to be directly allocated when these costs did not meet the Board's definition of direct allocation. As result, VECC submits that Hydro One Networks has not even properly implemented the OEB Cost Allocation Model.

237. During the interrogatory process VECC requested that Hydro One Networks provide an alternative cost allocation result where directly allocated costs were included in the allocation base for Administrative and General expense. The Company declined claiming there was too much effort involved<sup>96</sup>. VECC has attempted to calculate the impact and the results are set out in Attachment A<sup>97</sup>. While the revenue to cost ratios do not change materially for many of the customer classes there are marked changes for the following classes when all directly allocated cost are included in the allocation base for A&G costs:

- ST Class – Revenue to Cost Ratio declines from 2.35 to 2.29

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<sup>91</sup> Apart from insurance and community safety program costs – per EB-2005-0317, paged 76

<sup>92</sup> Exhibit H, Tab 12, Schedule 75 f)

<sup>93</sup> Transcript Volume 5, page 38, line 19 to page 39, line 5

<sup>94</sup> Transcript Volume 5, page 39, lines 6-28

<sup>95</sup> Transcript Volume 5, page 39, lines 14-22

<sup>96</sup> H-12-75 f)

<sup>97</sup> Attachment A also adjusts the allocation result to remove the "cost" adjustment the Hydro One Networks included with its unique allocation of Miscellaneous Revenues.

- DG Class – Revenue to Cost Ratio declines from 1.63 to 1.30
- UGe Class – Revenue to Cost Ratio declines from 1.29 to 1.25
- Sentinel Lights-Revenue to Cost Ratio increases from 0.62 to 1.12

238. VECC submits that the Board should direct Hydro One Networks to:

- Include all O&M costs in the allocation base for A&G costs, consistent with its 2006 Direction of Cost Allocation<sup>98</sup>.
- Not adjust the allocation of “costs” as part of its unique treatment of Miscellaneous Revenues.

239. To facilitate the Board’s decision making regarding the rate adjustments required for 2008, VECC requests that Hydro One Networks review its calculation of the impact (as provided in Attachment A) and provide any corrections (with explanations) necessary as part of its reply submissions.

### ***Overall Status of Hydro One Networks’ Cost Allocation Model***

240. As part of their Cost Allocation Informational filings, Ontario’s electricity distributors were required to respond to a number of information requests<sup>99</sup>. The purpose of these questions was to generate information on the account treatment (e.g., USOA reporting) of certain costs and to determine the quality of the data used so as to facilitate future improvements in the cost of service methodology<sup>100</sup>. After reviewing the results of the Cost Allocation Informational filings the OEB issued a Report (Application of Cost Allocation for Electricity Distributors (EB-2007-0667)) which set out the Board’s expectations as approach to cost allocation that would be taken by distributors in their rate applications.

241. The Board’s Report on the Application of Cost Allocation identified a number of influencing factors (including data quality and limited modeling experience) that affected “the ability or desirability of moving immediately to a cost allocation framework that might, from a theoretical perspective, be considered ideal”<sup>101</sup>. With this in mind the Board adopted a range approach to the appropriate revenue to cost ratios for each customer class. The Board

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<sup>98</sup> EB-2007-0317

<sup>99</sup> RP-2005-0317, Cost Allocation Review, Board Directions on Cost Allocation Methodology for Electricity Distributors, page 4.

<sup>100</sup> Transcript Volume 5, page 40, lines 13-17 and OEB Cost Allocation Informational Filing Guidelines, November 2006, pages 19 & 31

<sup>101</sup> Application of Cost Allocation for Electricity Distributors (EB-2007-0667), page 2

also noted<sup>102</sup> that with better quality data, greater experience with cost allocation modeling and further developments in relation to other rate design issues, the policies will be refined as required. The following extract<sup>103</sup> from the Board's recent Decision regarding Wellington North's 2008 Rates is indicative of the approach adopted by the OEB for other distributors when approving their 2008 rates:

This aspect of the application has understandably been heavily influenced by the Report of the Board on *Application of Cost Allocation for Electricity Distributors* issued on November 28, 2007 ("Board's report on cost allocation"). The Board has adopted a practice in virtually all of the rebasing applications for 2008 rates where utilities have been obliged to move revenue-to-cost ratios to points within the ranges depicted above, wherever practicable, and closer to the range in circumstances where achieving the range would result in what is considered to be an unreasonable rate impact.

An important element in the Board's report on cost allocation was its express reservation about the quality of the data underpinning cost allocation work to date. The report frankly indicated that the Board did not consider all of the data underpinning the report to be so reliable as to justify the application of the report's findings directly into rate cases. For this reason, among others, the Board established the ranges depicted above and mandated the migration of revenue to cost ratios currently outside the ranges to points within the ranges, but not to unity. In short, the ranges reflect a margin of confidence with the data underpinning the report. No point within any of the ranges should be considered to be any more reliable than any other point within the range. Accordingly, there is no particular significance to the unity point in any of the ranges.

242. During the course of the current Hydro One Networks proceeding it was demonstrated that the Company's responses<sup>104</sup> to the Questions associated with the Cost Allocation Informational filings indicated there were issues regarding the definition and quality of the data underlying its Informational filing including<sup>105</sup>:

- The ability to assign ST assets between customer classes,
- The ability to separate primary vs. secondary voltage poles and conductors,

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<sup>102</sup> Page 2 and Pages 5-7

<sup>103</sup> Board Decision and Order, EB-2007-0693, pages 29-30

<sup>104</sup> K4.12, pages 45-47

<sup>105</sup> Transcript Volume #5, page 42, line 5 to page 46, line 4

- The need to assume that all three phase farms and GS customers were served from primary facilities while all remaining small customers were served from secondary facilities
- The inability to attribute any “service facilities” to customers served at primary voltages.

243. For all of these issues and other matters raised by the Questions associated with the Cost Allocation Informational filings the approach used by Hydro One Networks for its 2008 rates is similar to that in the 2006 Cost Allocation Informational filing. As discussed previously, Hydro One Networks has changed certain aspects of its cost allocation methodology for the current filing<sup>106</sup>. However, as VECC’s submissions have noted, many of the changes introduced by Hydro One Networks involve an element of judgment and are designed simply to allow the model to reflect the Company’s unique circumstances. Hydro One Networks itself acknowledges that the changes it has made were not intended to improve the quality of the data used<sup>107</sup>.

244. Also, as noted in VECC’s earlier submissions there are outstanding issues as to whether Hydro One Networks has implemented the Board’s cost allocation methodology correctly. There are also issues<sup>108</sup> with some of the allocators Hydro One Networks has chosen to use (e.g., the use of coincident peak in allocation for allocating LV costs to retail customers). As a result, it is VECC’s view that additional “experience” with the Hydro One Networks model is clearly required, in line with the Board’s suggestion in its EB-2007-0667 Report.

245. Overall, VECC submits that Hydro One Networks cost allocation methodology is likely sufficiently robust to be used in conjunction with the Board’s Guidelines. However, Hydro One Networks circumstances are not significantly different from those of other distributors (in terms of data quality and modeling experience) that the current results should be used to justify movement in customer class revenue to cost ratios beyond that envisioned by the Board’s Guidelines.

### **7.3 Are Hydro One’s proposed rates appropriate?**

246. See the response to Issues 7.7 and 7.8.

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<sup>106</sup> Transcript Volume #5, page 47, lines 8-21

<sup>107</sup> Transcript Volume #5, page 35, lines 1-3

<sup>108</sup> Transcript Volume #5, page 47, line 23 to page 50, line12



#### 7.4 Are the proposed revenue to cost ratios appropriate?

##### ***Hydro One Networks' Position***

247. Hydro One Networks is proposing the following changes in the revenue to cost ratios for its 12 new customer classes<sup>109</sup>:

<b>Class</b>	<b>Current RCR</b>	<b>Proposed RCR</b>
UR	0.87	1.0
R1	0.82	0.88
R2	1.04	1.04
Seasonal	0.92	1.0
UGS – Energy	1.29	1.2
UGS - Demand	0.95	1.0
GS – Energy	1.08	1.08
GS – Demand	1.02	1.02
ST	2.35	1.15
DG	1.63	1.0
Street Lights	0.6	0.7
Sentinel Lights	0.62	0.7

248. In making this proposal, Hydro One Networks indicates that the increase in the R1 Residential customer class revenue to cost ratio to 0.88 results in bill impacts that are considered to be the maximum that the Acquired residential customers being harmonized to this class can sustain<sup>110</sup>. Hydro One Networks also indicates that the proposed revenue to cost ratios result in the Company not being able to fully recover its proposed 2008 Revenue Requirement.

##### ***VECC Submissions***

249. The issues addressed in this portion of VECC's final argument include: a) General Application of the Board's Guidelines and b) Hydro One Networks Specific Proposal

##### ***General Application of the Board's Guidelines***

250. Based on VECC's recommendations regarding the changes required to Hydro Networks' cost allocation methodology the current revenue to cost ratios are as follows (see Attachment A, Row 18):

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<sup>109</sup> Exhibit G1, Tab 3, Schedule 1, Tables 1 & 2 (pages 2 & 4)

<sup>110</sup> Exhibit G1, Tab 3, Schedule 1, pages 4-5

<b>Class</b>	<b>Current Corrected RCR</b>
UR	0.86
R1	0.82
R2	1.04
Seasonal	0.92
UGS – Energy	1.25
UGS - Demand	0.94
GS – Energy	1.08
GS – Demand	1.02
ST	2.29
DG	1.30
Street Lights	0.6
Sentinel Lights	1.12

251. Looking at these results, the following customer classes have revenue to cost ratios that fall outside the Board's Guidelines:

- R1 – The Guidelines suggest a range of 85% to 115% (versus the current 82% value)
- UGSe – The Guidelines suggest a range of 80% to 120% (versus the current 125% value)
- ST – This class represents a combination of former large GSd customers (i.e., T-Class), Large Users and Embedded Distributors. The Board provided no specific guidelines for such a class but has set ranges of 80-180% for the GSd class and 85-115% the Large User class. The current revenue to cost ratio of 229% falls outside of both ranges.
- DG – The Board provided no specific guidelines for a DG class. However, this class represents a combination of former GSd and GSe customers where the recommended ranges were 0.80-1.80 and 0.80 to 1.20 respectively.
- Street Lighting – The Guideline suggests a range of 70% to 120%, while the current revenue to cost ratio is 60%.

252. In VECC's view, these are the customer classes that Hydro One Networks should be focusing on when looking to adjust customer class revenue to cost ratios. For those customer classes below the recommended ranges, consideration should be given to moving their "ratios" to the lower end of the range, subject to bill impact considerations. Similarly, consideration should be given to moving those classes with ratios above the Board's guidelines to the upper end of the recommended ranges requires. However, to the extent this requires adjustments to the revenue to cost ratio for the remaining classes, achievement of the "ranges" will need to be balanced against the customer bill impacts.

253. This approach is consistent with the Board's decisions with respect to the 2008 rates for other electricity distributors. For example, in the case of Oshawa PUC<sup>111</sup>, the Board determined that where reducing the revenue to cost ratios for those classes above the recommended range so as to meet the upper value would create unacceptable impacts for customers in the remaining classes, then some mitigation was required and a partial movement to the top end of the range was ordered.

254. In the case of the ST Class there is some question as to what the appropriate range should be for assessing the revenue to cost ratio. Hydro One Networks has indicated that it believes the range dictated for large users is appropriate since direct customers, large users and embedded LDCs make up the majority of the consumption in the class and its embedded LDC and direct customers are currently charged the same rates<sup>112</sup>.

255. VECC does not agree with this rationale. More than half the class' delivery points are associated with embedded LDCs for whom the Board did not set a recommended range<sup>113</sup>. The next largest sub-set for the class consists of the former T-class legacy customer of Hydro One. These customers along with other customers with loads in the 50-4,999 kW range account for a further 40% of the ST class' delivery points. Indeed, embedded directs and large users account for less than 10% of the total delivery points. Furthermore, if one looks at the break down of the total ST class (including embedded LDCs) then only 107 of the more than 670 customers have average demands in excess of 5,000 kW – similar to large users<sup>114</sup>. This means that the majority of the embedded LDCs as well as a majority of the customers overall have demands similar to the GS 50-4,999 kW class. Based on these proportions, VECC does not believe it is appropriate to apply the revenue to cost ratio range that the Board has established for large users. Rather a somewhat wider range should be applied.

256. In VECC's view a range with an upper value of at least 1.25 would be reasonable for the ST class. Such a value is nominally larger than that for the 1.15 applicable to the Large User class but considerably less than the 1.80 value the Board recommended for those customers in the 50-4,999 kW range.

257. In addition there is a need to consider the DG class which consists of generators who were formerly classified as either T-class customers; general service (demand-billed) or general service (energy-billed) customers<sup>115</sup>. The Board provided no specific guidance for this new class. However, the Board recommended range for comparable customer classes is 80-180% for GS

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<sup>111</sup> EB-2007-0710, page 46

<sup>112</sup> H-12-50b)

<sup>113</sup> Exhibit G1, Tab 2, Schedule 3, page 9

<sup>114</sup> H-12-50, part a)

<sup>115</sup> Exhibit G1, Tab 2, Schedule 3, page 7 and H-12-42 b) & c)

450-4,999 kW and 80-120% for GS <50 kW. The upper ends of these two ranges brackets the current revenue to cost ratio<sup>116</sup>. Hydro One Networks has not indicated what it considers to be the appropriate range but rather simply proposed to move the class ratio to 100% “in support of the Government policy to promote Distributed Generation in Ontario”<sup>117</sup>.

258. In VECC’s view the existence of such a policy (which is really a general policy direction<sup>118</sup>) does not resolve the ongoing issues the OEB has noted regarding the ability to rely on the current results of cost allocation studies. Furthermore, in the case of the DG class, these concerns are compounded by the fact DG is a totally new class and there is limited experience with the class’ load profile. As a result, the existence of general government policy supporting DG should not override the policy the Board has established as to application of cost allocation results in setting electricity distributors rates. It is VECC’s submission that the Board should assume that the policies it has developed through its own processes are appropriate (and in line with general government policy) unless directed otherwise. The DG class does not warrant unique consideration at this time from a cost allocation perspective. In VECC’s view a range for DG customers with an upper bound of 1.25 would be reasonable.

### **Hydro One Networks’ Specific Proposal**

259. Based on the revised cost allocation results, VECC agrees with Hydro One Networks proposal to increase the revenue to cost ratio for Street Lighting to the bottom of the Board’s recommended range (i.e. 0.70). However, there is no need to alter the ratio for Sentinel Lights. This change would increase revenue results by roughly \$800,000.

260. VECC also agrees that the revenue to cost ratio for the UGSe class should be reduced to 1.20. VECC notes that this results in roughly a \$0.5 M reduction in revenues from this class.

261. In the case of the ST class, VECC does not agree with the Hydro One Networks proposal to reduce the ratio to 1.15 for a number of reasons:

- As previously discussed, VECC does not believe that 1.15 is the appropriate upper end of the range that should be applied to this class. The class consists primarily of customers who would otherwise be considered in the 50-4,999 kW class for which the range is 0.80 to 1.80; customers equivalent to Large Users for whom the range is 0.85 to 1.15 and Embedded LDCs for whom the Board did not establish a range. In

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<sup>116</sup> VECC notes that the upper ends of the two ranges also bracket the 1.30 ratio calculated based on the corrected cost allocation model

<sup>117</sup> Exhibit G1, Tab 3, Schedule 1, page 3

<sup>118</sup> H-11-32

VECC's view is it inappropriate to apply the lowest range to the group overall.

- Any significant decrease in the ratio for ST customers will necessitate an increase in the revenue to cost ratios for the other customer classes whose ratios already fall within the Board's established ranges<sup>119</sup>. Furthermore, these rate increases will lead to unacceptable impacts, even impacts are only considered for the "average" customer<sup>120</sup>.

262. In VECC's view the preferred approach would be to implement a revenue to cost ratio for the ST class of 1.25. VECC notes that for other utilities the Board has order that the movement to the upper (or lower) end of the designated revenue to cost ratio ranges occur over several years. Doing so in the case of Hydro One Networks is an option. However Hydro One will also be harmonizing rates over the same period<sup>121</sup>, it would make the management of the bill impacts and the calculation of the rates in the subsequent IRM years much more complex. The current proposal, which sees the cost allocation related adjustment all taking place in 2008 and only the harmonization adjustments (along the IRM) occurring in future years is more preferable.

263. VECC does not agree with Hydro One Networks proposal to reduce the revenue to cost ratio for the DG class to 1.0. As discussed previously, VECC does not consider statements of general government policy regarding DG to be sufficient reason for the Board to depart the policy it has established for applying cost allocation to electricity distributors. Given the types of customers that make up the DG class VECC has recommended an upper bound of 1.25. Based on VECC's recommended corrections to Hydro One Networks Cost Allocation methodology the revenue to cost ratio for the DG class is currently 1.30, suggesting the need for a marginal reduction.

264. VECC acknowledges that the revenue to cost ratios for the remaining customer classes will need to increase to accommodate the recommended reductions for the ST and DG classes. This should be accomplished in manner that equally manages the bill impact across all the affected customer classes, subject to the discussion on rate harmonization under Issues 8.7 and 8.8.

265. VECC's submits that the following revenue to cost ratios will meet this objective without the need for a Bill Impact Mitigation Deferral Account:

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<sup>119</sup> The only other class below the Board's Guidelines is the R1 Residential class where an increase in revenue requirement of \$7.2 M would result in a revenue to cost ratio of 0.85, consistent with the Guidelines.

<sup>120</sup> It is these unacceptable impacts that leads Hydro One Networks to propose an under recovery of its 2008 revenue requirement by \$2.5 M and the need for a Bill Impact Mitigation Deferral Account.

<sup>121</sup> While VECC is recommending that Hydro One Networks not proceed with its harmonization plan at this time, the recommendation does anticipate harmonization commencing May 1, 2009.

<b>Class</b>	<b>Current (Corrected VECC) RCR</b>	<b>VECC Recommended RCR</b>
UR	0.86	0.95
R1	0.82	0.88
R2	1.04	1.04
Seasonal	0.92	1.00
UGS – Energy	1.25	1.20
UGS - Demand	0.94	1.00
GS – Energy	1.08	1.08
GS – Demand	1.02	1.02
ST	2.29	1.25
DG	1.29	1.25
Street Lights	0.6	0.7
Sentinel Lights	1.12	1.12

266. Attachment A (Rows 19 &20) set out the resulting revenue requirement by class based on Hydro One Networks proposed 2008 Revenue Requirement. The underlying approach was to increase the revenue to cost ratios for all classes under 1.0 (except Street Lights) by the same percentage (not percentage points)– until a value of 1.0 was reached. This then required a balancing between the UR and R1 classes. In the example below, VECC has maintained the 0.88 for R1 as recommended by Hydro One Networks. If harmonization does not proceed in 2008 this value could be increased and the value for UR reduced accordingly.

**Attachment A**

**REVISED R/C RATIOS - USING OEB DIRECTION REGARDING A&G COST ALLOCATION**

		<u>UR</u>	<u>R1</u>	<u>R2</u>	<u>SEAS</u>	<u>GSE</u>	<u>GSD</u>	<u>STLGHT</u>	<u>SENTLT</u>	<u>DG</u>	<u>ST</u>	<u>UGE</u>	<u>UGD</u>	<u>TOTAL</u>	<u>Source</u> (G2-1-1)
Row 1	A&G Costs (Total) Accts Specifically Allocated	8,175,774	29,160,678	47,082,017	9,807,237	12,800,842	9,184,009	799,545	221,038	6,691	2,444,240	1,128,977	1,269,678	122,080,726	Attach A, p.35
Row 2	5420	50,689	187,777	306,129	66,093	91,074	105,175	7,765	1,684	51	21,954	7,858	18,069	864,318	Attach A, p. 54
Row 3	5635	159,251	589,944	961,771	207,645	286,129	330,430	24,396	5,292	160	68,975	24,686	56,767	2,715,446	Attach A, p. 54
Row 4	Net A&G	7,965,834	28,382,957	45,814,117	9,533,499	12,423,639	8,748,404	767,384	214,062	6,480	2,353,311	1,096,433	1,194,842	118,500,962	Calculated (1-2-3)
Row 5	HON Allocator	25,680,258	91,357,822	147,379,654	30,630,509	39,828,568	27,307,859	2,423,859	684,638	20,673	7,448,318	3,519,246	3,663,865	379,945,269	Attach A, p. 69
Row 6	%	6.76%	24.04%	38.79%	8.06%	10.48%	7.19%	0.64%	0.18%	0.01%	1.96%	0.93%	0.96%	100.00%	
Row 7	Direct Allocation	0	0	0	0	32,053	1,927,169	0	1,483,900	324,534	2,948,850	0	452,745	7,169,251	Attach A, p. 35
Row 8	New Allocator	25,680,258	91,357,822	147,379,654	30,630,509	39,860,621	29,235,028	2,423,859	2,168,538	345,207	10,397,168	3,519,246	4,116,610	387,114,520	Calculated (5-7)
Row 9	New A&G Alloc	7,861,072	27,965,858	45,114,895	9,376,411	12,201,872	8,949,235	741,976	663,819	105,673	3,182,713	1,077,289	1,260,150	118,500,962	Calculated (Using #8)
Row 10	difference	104,762	417,099	699,222	157,088	221,767	-200,831	25,408	-449,757	-99,193	-829,402	19,144	-65,308	0	Calculated (4-7)
Row 11	Prev Costs	66,965,969	242,009,381	391,320,152	83,444,899	111,113,917	105,454,489	8,149,189	3,940,212	388,978	27,200,888	9,702,363	16,885,159	1,066,575,596	Attach A, p. 35
Row 12	Revised Costs	66,861,207	241,592,282	390,620,930	83,287,811	110,892,150	105,655,320	8,123,781	4,389,969	488,171	28,030,290	9,683,219	16,950,467	1,066,575,596	Calculated (11-10)
Row 13	Revenue (per OEB)	58,713,019	198,961,471	405,625,488	76,802,876	119,564,343	107,905,978	4,925,569	901,462	634,423	64,030,500	12,441,840	16,068,623	1,066,575,592	Attach A, p. 35
Row 14	Revenue (per HON)	57,701,735	197,144,695	404,610,136	76,956,720	119,585,358	107,882,602	4,887,805	4,918,867	632,144	64,179,658	12,078,863	15,997,011	1,066,575,594	Attach A, p. 36
Row 15	Costs (per HON)	65,954,685	240,192,605	390,304,799	83,598,743	111,134,932	105,431,113	8,111,425	7,957,616	386,698	27,350,045	9,339,386	16,813,547	1,066,575,594	Attach A, page 36
Row 16	HON R/C RATIOS	0.875	0.821	1.037	0.921	1.076	1.023	0.603	0.618	1.635	2.347	1.293	0.951	1.000	Calculated (14/15)
Row 17	R/C RATIOS (1)	0.862	0.815	1.034	0.922	1.076	1.023	0.600	1.248	1.625	2.359	1.245	0.947	1.000	Calculated (14/12))
Row 18	NEW R/C RATIO	0.863	0.816	1.036	0.924	1.078	1.021	0.602	1.120	1.295	2.290	1.247	0.944	1.000	Calculated (14/12)
Row 19	VECC's R/C RATIO	0.953	0.880	1.036	1.000	1.078	1.021	0.700	1.121	1.250	1.250	1.200	1.000	1.000	
Row 20	VECC Prop. RR	63,718,731	212,601,208	404,605,159	83,287,811	119,586,095	107,884,648	5,686,647	4,918,960	610,213	35,037,862	11,619,862	16,950,467	1,066,507,662	

Notes: Row 11 sets out allocation of costs per HON Model prior to adjustments for Miscellaneous Revenue Allocation  
Row 12 sets out revised allocation of costs with corrected allocation of A&G costs  
Row 13 sets out the allocation of revenues (including miscellaneous revenues) per the OEB model approach  
Row 14 sets out the allocation of revenues based on HON unique approach to allocating miscellaneous revenues  
Row 15 sets out HON revised allocation of costs adjusted to reflect new external revenue treatment  
Row 16 shows the R/C ratios as set out in the HON Application (G1-3-1, page 2)  
Row 17 sets out the revised R/C ratios based on HON's approach without the adjustment in cost allocation that accompanied the unique miscellaneous revenue allocation  
Row 18 sets out the revised R/C ratios based on the corrected allocation of A&G costs and excluding HON's adjustment to allocated costs

## 7.5 Are the fixed-variable splits for each class appropriate?

### ***Hydro One Networks' Position***

267. Hydro One Networks' proposed "target rates" for its various customer classes (i.e. after harmonization and before any mitigation plans) are set out in Exhibit G1, Tab 4, Schedule 2, page 1. The general approach taken was to adopt the lower of either i) the results of Method c) from the cost allocation (i.e. the upper end of range) or ii) the service charge of the predominant class in each new customer group<sup>122</sup>. The only exceptions are:

- Residential R2 – where the gross (i.e., before RRRP) fixed charge is set at 110% of the value for the top end of the range, and
- Sentinel Lights and Street Lights – where the fixed charge is set at \$1.00 per account when the lower values for the relevant ranges are \$5.01 and \$2.36 respectively<sup>123</sup>.

268. The 2008 service charges proposed for each customer class (except Sentinel Lights, Street Lights, DG and ST) differ from the target values as part of a bill impact mitigation plan<sup>124</sup>.

### ***VECC's Submissions***

269. VECC generally accepts Hydro One Networks proposed target rates for its new customer classes – most are consistent with the Board's guidelines. In the case of R2 customers, this acceptance is based on the following considerations:

- When the RRRP payments are taken into account the resulting target customer charge for R2 customers is \$21.41, just nominally higher than the value of \$19.04 for R1 customers<sup>125</sup>
- The current gross charge for R2 customers<sup>126</sup> is well above the range (i.e., \$57.72), and
- The Board's guidelines allow the service charge to be up to 120% of the top end of the range.

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<sup>122</sup> H-8-7

<sup>123</sup> Exhibit G1, Tab 4, Schedule page 2 and H-12-46 b)

<sup>124</sup> Exhibit G1, Tab 8, Schedule 1, page 3 and Exhibit G1, Tab 7, Schedule 3, page 2

<sup>125</sup> Exhibit G1, Tab 7, Schedule 1, page 3

<sup>126</sup> H-12-51



270. VECC takes no position on the service charge proposals for Street Lights and Sentinel Lights. With respect to these classes, VECC's only observation is that there is a need to reconcile Hydro One Networks terminology which refers to charges per account with that of the other LDCs which generally refer to charges per connection<sup>127</sup>.

**7.6 Is Hydro One's proposal to have both fixed and variable service charges for sub-transmission customers, sentinel lights and street lights appropriate?**

271. **Partially Settled:** The parties agree that the Applicant's proposal to include both fixed and variable components for the service charges applicable to sentinel light and street light rate classes is appropriate.

272. The narrowed scope of the issue is: Is Hydro One's proposal to have both fixed and variable service charges for sub-transmission customers appropriate?

***Hydro One Networks' Position***

273. Hydro One Networks has proposed a fixed monthly charge for all ST customers of \$188. There is also an additional fixed monthly charge of \$553 for those customers who do not own their own meters<sup>128</sup>.

***VECC'S Submissions***

274. VECC agrees with the Hydro One Networks proposal. The proposed customer charges are derived from the cost allocation results in a manner similar to that used for other customer classes<sup>129</sup>.

**7.7 Is the proposal for harmonization of rates appropriate?**

**7.8 Are the customer bill impacts resulting from the proposed rate impact mitigation plan reasonable?**

***Hydro One Networks' Position***

275. Hydro One currently has 12 rate schedules which are applicable to its legacy retail customer classes along with a set of LV rates which are applicable to embedded LDCs and Direct customers. Hydro One Networks also currently maintains separate rate schedules for each of its Acquired LDCs

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<sup>127</sup> The response to H-12-46 states the Hydro One Networks charge is per account (part (b)) but then goes on to quote precedents from other LDCs on a per connection basis (part (c))

<sup>128</sup> Exhibit G1, Tab 4, Schedule 4, pages 2 & 4

<sup>129</sup> Exhibit G1, Tab 4, Schedule 4, page 4 and H-1-146

which reflect the applicable customer classes to each. In total, the Company has over 280 customer classes to administer<sup>130</sup>.

276. Hydro One Networks is proposing 12 new customer classes where virtually all classes consist of customers from both the existing customer classes applicable to its legacy customers and the customer classes applicable to its acquired LDCs<sup>131</sup>. Furthermore Hydro One Networks is proposing to harmonize the rates to the customers in all classes. For 8 of 12 new customer classes, this harmonization would take place over a 4 year period (starting with 2008) in order to manage the bill impacts that customers (primarily those of the acquired LDCs) will experience. For the other four classes (DG, ST, Street Lights and Sentinel Lights) the bill impacts are not considered material enough to warrant a staged implementation and the “target” rates are being fully implemented in 2008.
277. The bill impact measure that Hydro One Networks has used in designing the harmonization plan for the remaining 8 customer classes is the total bill for the “average customer” in each customer class for each of the existing customer classes being harmonized. In the case of the various residential classes the average is calculated assuming 1,000 kWhs use per month<sup>132</sup>. Furthermore, the calculation is done taking into account changes in rate riders, loss factors and retail transmission charges as well as distribution rate changes<sup>133</sup>.

### ***VECC's Submissions***

278. VECC submissions address the following issues: i) Desirability of Harmonization; ii) Hydro One Networks' Bill Impact Criteria; and iii) Hydro One Networks' Proposed Harmonization Plan

### ***Desirability of Harmonization***

279. In principle VECC supports the concept of rate harmonization. It may be difficult to explain to customers why rates are going up (due to harmonization) shortly after an acquisition or merger. However, in VECC's view, maintaining separate rate schedules for similar customers who are receiving service from the same distributor becomes increasingly difficult to justify over time.
280. It should be noted that VECC has supported rate harmonization plans put forward by other distributors (e.g. Chatham-Kent in its 2006 Rate Application). However, for the principle to be translated into reality careful attention must be paid to identifying and managing any associated bill impacts.

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<sup>130</sup> Exhibit G1, Tab 2, Schedule 1, page 2

<sup>131</sup> Exhibit G1, Tab 2, Schedule 5, pages 1-3

<sup>132</sup> H-12-53 b)

<sup>133</sup> H-12-47 d)

### ***Hydro One Networks Bill Impact Criteria***

281. Hydro One Networks, in assessing customer bill impacts for purposes of designing its rate harmonization and bill impact mitigation plans, has only considered the total bill impact for the “average customer” in each of its original customer classes<sup>134</sup>. Hydro One Networks points to the 2006 EDR Handbook as its justification for this approach<sup>135</sup>. In VECC’s view this approach to assessing bill impacts is totally inappropriate under the current circumstances.
282. The current rate harmonization process involves adjusting not only the average rates paid by the customer in each of the acquired utilities but also moving all of the customers that have been assigned to one of the new rate classes to a common rate structure. Contrary to Hydro One Networks’ claims<sup>136</sup> this harmonization process does involve rate design changes for the affected customers. This fact is clearly evident from the fact that Hydro One Networks plan involves four years of adjustments where the annual changes to the fixed and volumetric charges are different<sup>137</sup>.
283. The 2006 EDR process did not involve any change to rate design that would impact on the bills seen by customers<sup>138</sup>. As a result the current process is more similar to that contemplated in the 2002 Rate Handbook, where the impact criteria required utilities to look at more than just the average customer<sup>139</sup>. In VECC’s view the impact criteria with respect to rate harmonization needs to consider more than simply the bill impact for an average customer.
284. A further concern of VECC’s is the fact that Hydro One Networks does not appear to have even looked at the range of bill impacts for individual customers resulting from its proposal during the preparation of its application. This observation is based on the following:
- No information on range of impacts (on a customer basis) or worst case results were provided as part of the Application<sup>140</sup>.
  - Not only was this information not in the Application, but Hydro One Networks acknowledged that they did not know what the worst case scenario was<sup>141</sup>.

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<sup>134</sup> Transcript Volume #5, page 28, lines 15-26

<sup>135</sup> Transcript Volume #5, page 28, line 27 to page 29, line 3

<sup>136</sup> Transcript Volume #5, page 29, lines 9-14

<sup>137</sup> Exhibit G2, Tab 2, Schedule 1, pages 10-14.

<sup>138</sup> Transcript Volume #5, page 29, lines 4-8 and page 31, lines 14-19

<sup>139</sup> Transcript Volume #5, page 30, lines 21-28

<sup>140</sup> Transcript Volume #4, page 94, lines 7-10

- When pressed on the issue, Hydro One Networks only evidentiary reference was their response to a VECC information request (Exhibit H, Tab 12, Schedule, 61). VECC notes that this request arose because of lack of information in the filing and that the request focused strictly on residential customers. Furthermore, the response did not provide the requested frequency distribution of bill impacts but rather provided tables showing the distribution of customers by consumption level and bill impacts by consumption level<sup>142</sup>. Readers were left with the task of combining the two, suggesting that Hydro One Networks had not gone through the exercise of assessing individual impacts when it developed its filing.
- It is clear from the transcripts that it was only after exchanges with CME's Counsel that Hydro One Networks did the required work to identify the worst case scenarios<sup>143</sup>.

285. The material filed by Hydro One Networks regarding residential customers suggests that there are a substantial number of acquired utilities where certain residential customers will see bill impacts in excess of 10%<sup>144</sup>. Hydro One suggests that this is not an issue since the impacts are typically at low consumption levels and the dollar amounts will be small<sup>145</sup>. However, Hydro One Networks has not provided the necessary information to indicate what the impacts (percentage or dollar-wise) are on an individual customer basis. In VECC's view such information is essential to determining whether a proposed harmonization plan is just and reasonable.

286. In terms of impact criteria, it is VECC position that impacts must be considered taking into account all customers – not just the “average customer”. VECC acknowledges the point made by Hydro One Networks that such criteria should include consideration of both percentage and dollar impacts. However, Hydro One Networks has not undertaken any analysis to support what an appropriate dollar impact would be and if any customers would exceed the combined percentage/dollar threshold.

### ***Hydro One Networks' Proposed Harmonization Plan***

287. Hydro One Networks' harmonization plan calls for moving the all of the customers in each of its new customer classes to a common rate schedule over a four year period. Year over year bill impacts are mitigated through a series of measures<sup>146</sup> that include: a) not increasing the revenue to cost ratios for some customer classes to 1.0; b) phasing-in the target rates over four

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<sup>141</sup> Transcript Volume #4, page 94, lines 11-13

<sup>142</sup> Transcript Volume #4, page 98. line 15 to page 99, line 11

<sup>143</sup> Transcript Volume #5, page 60, lines 21-28,

<sup>144</sup> Exhibit G2, Tab 5, Schedule 6, pages 1-28 and H-12-61, Attachment B

<sup>145</sup> Transcript Volume #5, page 32, line to page 33, line 9

<sup>146</sup> Exhibit G1, Tab 8, Schedule 1, pages 1-2 and Exhibit G1, Tab 8, Schedule 2, pages 1-2

years; and c) deferring recovery of part of the overall revenue requirement.. The plan results in total bill impact for an “average customer” of 10% in 2008; 8% in 2009 and 7% in 2010, leaving some room to accommodate annual incentive rate mechanism increases.

288. Hydro One Networks’ proposal does a reasonable job dealing with average customer impacts. However, in VECC’s view, the plan is unacceptable as it has not identified and included proposals (as necessary) to deal with bill impacts for customers who are different from the average<sup>147</sup>. Hydro One Networks approach is that, provided they’ve managed the average bill impact, all other impacts are reasonable (or irrelevant) regardless of how high they are<sup>148</sup> or whether the Board even knows what they are.

289. It is VECC’s submission that Board should reject the Hydro One Networks harmonization plan and direct the Company to come back (for May 1, 2009 implementation) with a plan that includes a full assessment of customer impacts, proposed impact criteria for individual customers as well as the “average customer” and proposals on how to deal with unacceptable outliers.

290. VECC notes that one approach to managing bill impacts for outliers would be to focus on ensuring individual bills are within certain established criteria based on historical usage and revenue shortfalls recorded in a Bill Impact Mitigation Deferral Account.

### **7.10 Is the proposal for regulatory asset rate rider #3 appropriate?**

#### ***Hydro One Networks Position***

291. For the various Regulatory Asset accounts Hydro One has requested to “clear”, it proposes to use the following allocators to assign the balances to be refunded/recovered to customer classes:

- OEB Costs – Based on the OM&A costs allocated per the Cost Allocation Methodology.
- Tax Changes – Based on the Cost Allocation Methodology’s assignment of Net Fixed Assets.
- Smart Meter-Related – Based on number of customers per class.
- RSVA – For the RSVA (Wholesale Market Service Charges), based on energy consumed by non-market participants in each class. For the remaining RSVA’s, based on total energy consumed by each class.

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<sup>147</sup> Transcript Volume #4, page 98, lines 1-4

<sup>148</sup> Transcript Volume #4, page 60, lines 3-22

## **VECC Submissions**

292. VECC agrees with Hydro One Networks proposed allocation factors for the Tax Changes account and the RSVAs. In the case of the Tax Change account the variance arises due to the change in the Large Corporation Capital tax and is therefore related to net fixed assets. In the case of the RSVAs the proposal is consistent with approach previously adopted by the Board in its Regulatory Asset Decision.

293. With respect to OEB costs, Hydro One Networks' proposed allocator is the same as that used to allocate Administrative and General Expenses<sup>149</sup>. As noted earlier this allocation factor excludes the O&M cost that Hydro One uniquely allocates to various customer classes. There is no reason to exclude these costs from the allocation factor for OEB Costs – they too are part of the regulated business. Thus, for the same reasons as put forward previously, VECC submits that the O&M costs that Hydro One Networks claims are “directly” allocated should also be included in the allocation factor used for assigning the recovery of the OEB Cost variance account to customer classes.

### **8.1 Is the 2008 smart meter O&M budget appropriate?**

### **8.2 Is the proposed 2008 capital spending for the Smart Meter program appropriate?**

## ***Summary of VECC Position***

294. Hydro One's base forecasts 2008 SM Capital and Operating Budgets are reasonable, subject to determination of the framework for the regulatory treatment and prudence review of the costs.

295. The claimed 2007 and forecast 2008 Costs for Above Minimum Functionality should not be approved in the current proceeding, due to

- a) the lack of a Board Approved framework and guidelines specifying eligible costs, the primary issue relating to Time of Use functionality.
- b) The fact that the majority of the assets providing the above minimum functionality are not used or useful pending activation of time of use rates.

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<sup>149</sup> The allocation percentages for the OEB Cost Account shown in J6.2 and the same as those reported in Exhibit G2-1-1, Attachment A, page 119 as being applicable to A&G costs.

**8.3 Are the amounts for Smart Meter related variance accounts appropriate?**

**8.5 Is Hydro One's regulatory treatment of Smart Meter costs appropriate?**

***Hydro One Position***

*Mr. Rogers (in reference to Undertaking J2.2)*

*If you look at this table, the bottom line, you will see the capital program after the smart meter costs are removed. You will see that the proposed capital expenditures increase from a 2006 level of \$378.5 million to \$399.9 million in the bridge year, 2007, and then slightly to \$401.4 million in the test year. So we have a 6 percent increase in capital spending over the 2006 to 2008 period, and relatively flat spending between 2007 and 2008. Once again, while the increase may look dramatic, when you look at the underlying causes, it is, I submit, fully explained. [Tr. Vol. 7 Page 23]*

And

*Mr. Rogers*

*Before we leave this issue of smart meters, can I remind the Board that the company has adduced evidence to demonstrate that all costs actually incurred in the smart meter program, including minimum functionality and exceed minimum functionality, are, I submit, reasonable and have been prudently incurred.*

*It asks that all of these costs be approved for recovery as a regulatory asset up to April 30th, 2008 and be included in its core work program beyond that time for recovery as part of its revenue requirement.*

*However, my client is mindful of the Toronto Hydro decision, and we talked about that during the hearing. If the Board chooses to follow the approach which it applied to the Toronto Hydro case, the applicant asks that both minimum and "exceed minimum functionality", in quotes -- functionality costs incurred as of December 31, 2007 be approved for recovery through a rate rider and inclusion of the in-service capital in rate base.*

*All subsequent smart meter costs would be tracked in a deferral account and the interim smart meter rate rider would continue under this proposal. While dealing with this question of smart meter costs, I observe that -- or I submit that the evidence demonstrates that the 75 percent of "exceed minimum functionality" expenditures supports the government policy of adopting time-of-use rates and the necessary integration with the IESO systems.*

*The remaining 25 percent of "exceed minimum functionality" costs support future business benefits and is being delivered at a competitive price. So I ask that the Board permit recovery of those costs.*

*[Tr. Vol. 7 Page 25]*

### **Summary of VECC Position**

296. With regard to the treatment of 2008 SM Capital and Operating costs, VECC believes that Hydro One should have amended its application to adopt the Rate-Adder/Deferral account treatment of SM Costs approved by the Board for THESL in the EB-2007-0680 Decision and Rate Order. The Board should Direct Hydro One to adopt such regulatory treatment for costs within minimum functionality.

297. However, as noted above, Hydro One has not justified either 2007 or 2008 Costs above Minimum functionality. This is in part due to the absence of Board Direction as to which costs are eligible. Accordingly, the onus of proof has not been met by Hydro One, and VECC submits that as a result such costs should continue to be tracked in a deferral account.

### **VECC Submissions**

298. VECC, like other intervenors, submits that the Board should reject Hydro One's application to include its 370,000 2008 smart meter installations in ratebase and direct Hydro One to remove all the Capital and OM&A for 2008 SM from the revenue requirement and proceed with a rate adder approach. This corresponds to the Boards Direction to Toronto Hydro in the EB-2007-0680 Decision:

*MR. BUONAGURO: Now, you are aware, I would think, that Toronto Hydro applied for the same relief?*

*MR. STEVENS: I understand for 2008 and 2009, I think.*

*MR. BUONAGURO: Right. And their decision just came out in the last, I guess, month or so. In that decision, were you aware that they were denied that treatment and that the Board found -- I will quote from the decision, which is EB-2007-0680, at page 24, where the Board held that:*

*"The current regime where these expenditures [smart meter expenditures] are funded through a smart meter adder shall continue, as shall the variance account mechanisms currently in place in true-ups."*

*Were you aware of that decision?*

*MR. STEVENS: I am aware of that.*

*MR. BUONAGURO: Now, given that decision, would Hydro One agree that the similar treatment for its own costs would be appropriate?*

*MR. STEVENS: For --*

*MR. ROGERS: Can I answer that question on behalf of the company?*

*MR. BUONAGURO: Sure.*

*MR. ROGERS: Mr. Stevens can correct me if I get this wrong. I think really the company's application is for the treatment which he described. It is their preference that that is the treatment that be given to them, but it*



*has since become aware of the Toronto Hydro decision and I have no -- I can give you no rationale why my client should be treated differently from Toronto Hydro.*

*MR. KAISER: I think Mr. Buonaguro's question is: Are you still maintaining your application as is filed, or are you amending it?*

*MR. ROGERS: No. We are asking -- the application stands as it is, but we're realistic and understand the Toronto Hydro decision, and I can't give you any good reason why we should be treated differently. But if somebody can think of one, then we would like to apply for it.*

299. IR Response Exhibit H, Tab 10, Schedule 28, page 2 of 2 and Undertaking J2.2 are helpful to the resolution of this issue.
300. J2.2 shows the OM&A and Capital for the 2008 SM program from Exhibits C1, Tab 2 Schedule 1 and Exhibit D1, Tab 3, Schedule 1. Exhibit H, Tab 10, Schedule 28 shows among other things the breakout of Costs above Minimum Functionality.
301. .
302. The OM&A claim for Test year 2008 without Smart Meters is \$468.0 million- a reduction of \$9.7 million from the claimed \$477.7 million.
303. The 2008 CAPEX without SM is \$ 401.4 million (\$566.2-\$164.8). The 1/2 year Impact of the CAPEX on the Distribution Revenue Requirement can be readily calculated once the final Weighted Average Cost of Capital is known following the ROE update.
304. With regard to the appropriate 2008 SM rate adder, VECC suggests that this be calculated based on the installation of 370,000 meters over the Test year.
305. The remaining issue to determine is the impact of clearing the 2007 SM deferral account for Costs within Minimum functionality ( excluding CapGemini support costs) only to December 31, 2007.
306. With regard to Costs above Minimum Functionality, VECC disagrees with Hydro One that any of these costs (either historic or forecast) should be recovered from ratepayers at this time and submits they should remain in the SM deferral account.
307. VECC has no submission as to whether any of the Costs above Minimum Functionality are or are not prudent. Unlike Minimum Functionality, for which the Board has held a generic hearing, there is no common ground or criteria as to which types of costs, and at what level, are prudent.
308. VECC notes that the majority of the claimed costs above minimum functionality are related to Time of Use rates and In VECCS view, inclusion of

such costs in ratebase does not conform to the regulatory requirement that the assets are used and useful (pending implementation of TOU rates for all customers).

*MR. BUONAGURO: Thank you. Now, with respect to time-of-use capability, I think it's fair to characterize your evidence as suggesting that we're doing it because to some degree the government wants us to do it. Do you want to elaborate on that or correct me or describe why it is you're doing time-of-use?*

*MR. STEVENS: Sure. So the original directive from the government contemplated that we would be able to have price transparency. Meters is – the smart meters, which you know are capable of capturing hourly consumption, are part of that equation.*

*We also know that the OEB has since approved time-of-use rates and we also know that the IESO as the smart meter entity is now moving forward or has substantially moved forward with the development of a data warehouse that's capable of taking our hourly reads and the sole purpose is to translate those into billing determinants on the time-of-use basis.*

*So I think the way of categorizing it is the ship has sailed, so to speak, and therefore not integrating our systems or providing that capability would make a lot of those other expenditures for not.*

*Tr Vol 2 Page 75.*

309. Accordingly VECC urges the Board to not allow recovery of any of Hydro One's costs above minimum functionality and direct Hydro One to leave the costs in the SM deferral account.

310. Finally, VECC submits that the rate adder for 2008 should be based on the recovery of the revenue requirement related to minimum functionality only.

### **Costs**

311. The Vulnerable Energy Consumers Coalition respectfully requests that the Board order payment of our reasonably incurred costs in connection with our participation in this proceeding. It is submitted that the Vulnerable Energy Consumers Coalition has participated responsibly in all aspects of the proceeding, in a manner designed to assist the Board as efficiently as possible.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 18<sup>th</sup> DAY OF AUGUST, 2008**