RP-2007-0681

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch.B, as amended;

AND IN THE MATTER OF an Application by Hydro One Networks Inc. pursuant to the *Ontario Energy Board Act* for an Order or Orders approving just and reasonable rates for the delivery and distribution of electricity.

FINAL ARGUMENT
ON BEHALF OF THE
SCHOOL ENERGY COALITION

August 18, 2008

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0 GENERAL COMMENTS

0.1 *Introduction*

0.1.1 On December 18, 2007 Hydro One Networks Inc. filed an application for new distribution rates commencing May 1, 2008. The application identifies a deficiency of $104 million, and seeks approval for rates to recover a base revenue requirement of $1,067 million. It also seeks to take steps to adjust rates for cost allocation and rate design purposes, including a major rate harmonization proposal, the second time it has come before this Board for that purpose (the last, in 2006, having been rejected by the Board). It represents an overall rate increase of about 6.7%, and for some customer groups, including schools, the rate increase proposed is many times that amount.

0.1.2 This is the Final Argument in this matter on behalf of the School Energy Coalition. In this first section, we will summarize our positions. We will also include submissions on confidentiality, as directed by the Board during the proceeding. The sections following are numbered to be consistent with the Board-approved Issues List, except for section 9, which contains comments on other matters not included in the Issues List.

0.1.3 In preparing this Final Argument, we have benefitted from a review of the Staff Submission dated August 15, 2008. That was most helpful, and the fact that we had it before finalizing our own submissions has simplified this argument.

0.1.4 The time available to do final argument in this proceeding allowed a number of parties to circulate draft submissions for review and comment. This had two beneficial results. First, each party had input from others, which improved the quality of submissions and the thoroughness of evidentiary references. Second, it allowed work to be divided up in a number of areas, with one party writing detailed submissions on an issue, and others supporting it or providing only limited additional comments. We stress that where we have supported the submissions of others, that is not because the issue is less important to SEC. Rather, in the interests of efficiency we have adopted arguments of others as opposed to duplicating their effort.

0.2 *Summary of the Positions of School Energy Coalition*

0.2.1 ***Revenue Requirement.*** We have had an opportunity to read the general submissions of CME with respect to the range of revenue requirement that is appropriate in this case. We agree with the thrust of those submissions.

0.2.2 We also note that in 3rd Generation IRM extensive work has been done to find appropriate numbers for a price cap formulation going forward. It appears clear that, based on those numbers, the revenue requirement in 2008, based on the last COS revenue requirement, would be no more than about $990 million if the increase in volumes is taken into account. While it is not, in our submission, technically correct to apply an IRM formula in a rebasing year, it is true that, if the proposed revenue requirement is wildly different from what the econometric studies say is a reasonable level, the onus on the Company to justify the variance is particularly heavy. We do not believe the Company has met that onus.

0.2.3 ***Load Forecast.*** We believe that the load forecast should be increased as proposed by VECC and CCC to refelct a more appropriate CDM adjustment.

0.2.4 ***OM&A.*** We will submit that the budget for distribution OM&A should be reduced by a total of at least $44.8 million. Of that total, a) $30 million should be an overall reduction in OM&A compensation budget, b) there should be a reduction in pension costs (the distribution component of a $15 million overall reduction), c) there should be a reduction in Asset Management Costs of at least $5 million (less a proportionate share of the total compensation reduction), and d) there should be a reduction in Vegetation Management costs of at least $27.3 million (again, less a proportionate amount of the total compensation reduction).

0.2.5 ***Capital Spending and Rate Base.*** The Cornerstone Project should be approved, but in a manner that ensures ratepayers only bear the costs if they get the benefits, and vice versa. Smart Meters should be treated for regulatory purposes in the same manner as in the recent Toronto Hydro decision. Capital and rate base should be reduced by the impact of capital component of the pension cost adjustment.

0.2.6 ***Deferral and Variance Accounts.*** All of the proposed new deferral and variance accounts, including the LRAM proposed by the environmental groups, should be disallowed.

0.2.7 ***New Rates and Harmonization.*** Hydro One has provided no evidence that customers in the acquired LDC areas are undercontributing. A cost allocation study that they say provides that evidence uses rate classes, and a cost allocation method, that assumes the undercontribution. Without any undercontribution, without any homework being done on what are the appropriate rate classes, and what cost drivers should be used to allocate which costs, this Board has no evidentiary basis on which to approve the harmonization proposal put forth by Hydro One. The new rate classes for residential and general service customers, and the costs purportedly allocated to those classes, cannot be approved. The harmonization of loss factors also should not be approved, for similar reasons.

0.2.8 Hydro One should be directed to do a proper cost responsibility study, and come back to this Board in a separate application with a harmonization proposal that is based on empirical evidence and proper analysis.

0.2.9 ***Effective Date.*** Although Hydro One filed its full application in this matter very late, we believe this is an appropriate case for an exception, and thus rates should be calculated as if effective from May 1, 2008. Any deficiency between that date and the date new rates are implemented should be recovered by way of a rate rider, amortized over the period until December 31, 2009.

0.3 *Confidentiality Claim by the Applicant*

0.3.1 The Applicant seeks to have three documents treated as confidential, and proposes unusual confidentiality restrictions that are not consistent with the Board's confidentiality rules. We will deal with each of those points in turn.

0.3.2 ***Exhibit J2.5 – The CN Utility Study.*** The Applicant seeks confidential treatment of this document because it is the proprietary work product of CN Utility Consulting, Inc., and Hydro One had to pay to purchase it. The thesis is that, if it is filed in public in this proceeding, then the value of the work product to the consultant will be reduced, and presumably they will be less willing to sell their studies to regulated entities.

0.3.3 The difficulty we have with this is that many consultants' studies are relevant to the regulated activities of companies like Hydro One, and if this Board allows confidential treatment for this study, then at least in theory every study that any regulated entity obtains or contracts for will include a confidentiality clause, thus denying public access. This Board's approach to the regulatory process has been consistent: the process should be transparent to the public. If consultants' studies are treated as confidential, a substantial percentage of evidence in Board proceedings will qualify for confidential treatment, to the detriment of the regulatory process.

0.3.4 We also note that the harm proposed, ie. that Hydro One will have more limited access to information like this in the future, is in our view overstated. Consultants like CN Utility Consulting Inc. are in the business of selling information to utilities, most of whom are regulated entities. When you do business with a regulated entity, you know from the get-go that they are going to have obligations to file material in public regulatory proceedings. You can't limit access by regulated utilities to your work product; that is central to your business. You instead just have to accept that some of your work product will end up on the public record, because you have chosen a business in which public disclosure is an obligation of your customers.

0.3.5 For these reasons, we believe that J2.5 should not be treated as confidential.

0.3.6 ***J3.3 – Acquisition Financial Model.*** Hydro One argues that this represents a proprietary financial model used by them, even today, to assess acquisitions of other LDCs.

0.3.7 In general, we believe that documents like this should be accorded confidential treatement. It is not fair, in our view, for a utility considering acquisitions to have to disclose to the target company their analytical tools. It puts them at a competitive disadvantage.

0.3.8 In this particular case, the material filed is not a very complex spreadsheet, and if there are any unusual algorithms in the cells, they have not been disclosed in any case. Further, it is several years old, and if it is still being used without significant refinements for acquisition analysis, Hydro One should be asking itself why.

0.3.9 Those things having been said, Hydro One has advised that this is their current acquisition analysis tool, and on that basis we agree with their submission that it should be treated as confidential under the Board's guidelines.

0.3.10 ***J3.10 – Quarterly Management Reports.*** The Applicant's position on this set of documents is that securities laws prohibit them from disclosing this information, which includes actual results and revised forecasts. With respect, their submission is simply incorrect, and if this Board were to accept it, the result would be to throw the entire regulatory process into disarray.

0.3.11 The essence of the disclosure restrictions under the Ontario Securities Act is that disclosure should be available to all members of the public at the same time, rather than selective, and it should not be untruthful or misleading, given the context in which it is disclosed.

0.3.12 In order to assess this, it is submitted that the Board should ask itself why the extensive public disclosure of past actual data, and future forecasts, that is inherent in the regulatory process, is OK, while disclosure of these management reports is not. In both cases, the disclosure is public, but in fact only a small handful of people will know about it and use the information. In both cases, actual information far more detailed than that seen in financial statements, and often very different than the financial statement data, is provided, along with detailed narratives that provide much richer understanding of past results. In both cases, future forecasts are far more detailed, and more up to date, than anything in securities disclosures (such as quarterly reports, conference calls, and guidance). But in all of these cases, the regulatory process goes significantly beyond the information in these management reports.

0.3.13 In our submission, allowing an exception to be made for internal management reports would be a major change in how this Board operates, and would result in many company documents that have been filed – and very useful – in the past now being treated as confidential. Consider, for example, the regular filing of budget preparation documents, and business cases for capital projects, and budget to actual comparisons, and so many other internal documents that allow this Board to arrive at a true picture of the business and operations of an applicant.

0.3.14 It is submitted that these management reports are not distinguishable from many other internal company documents that include similar, often more detailed, information, and yet are routinely filed with this Board on the public record.

0.3.15 For these reasons, it is submitted that Exhibit J3.10 should not be accorded confidential treatment.

0.3.16 ***Nature of Restriction.*** The Applicant has also proposed, in their Argument in Chief, that access to documents considered confidential be restricted to members of the Law Society of Upper Canada. This proposal is not reasonable, and should be rejected by this Board, for two reasons.

0.3.17 First, as a practical matter many documents proferred as confidential are technical in nature. The practice before the OEB is not one in which lawyers do everything. In fact, lawyers rely heavily on non-lawyer professionals to deal with the challenging technical aspects of regulatory proceedings. Take the vegetation management study, J2.5. Does Hydro One believe that the lawyers in the room will be able to understand it as well as the non-lawyers, like Mr. Clark, or Mr. Higgin, or Mr. Harper, or Ms. Girvan?

0.3.18 In our view, the proposal fails to recognize the nature of the process before the OEB. Just as we are sure Mr. Rogers would not propose to hide these documents from Mr. Vlahos, who unlike Mr. Kaiser and Mr. Sommerville is not a lawyer, and would not propose to hide these documents from the non-lawyer members of Board Staff, so too it makes no sense to hide them from the members of the intervenor teams whose role is so often to make sense of complex technical material.

0.3.19 Second, the Hydro One proposal implies that the Board cannot police its own rules, and requires the additional enforcement powers of the LSUC to protect parties before the OEB from abuses of confidentiality rules. The Board has in fact shown in the past that it is perfectly capable of enforcing its rules, and if Hydro One's inference that it cannot is true, there is a much bigger problem than confidentiality. Happily, that is not the case, and the Board does not need the assistance of the Law Society of Upper Canada to do its job effectively.

0.3.20 For these reasons, it is submitted that any confidentiality restriction should allow all intervenor representatives – lawyers and non-lawyers – who sign the Board's Undertaking to access and use confidential documents, all in accordance with the Board's confidentiality rules.

1 ADMINISTRATION

1.1 *Response to Board Directions*

1.1.1 Our submissions on Hydro One's response to the Board's directions on compensation are set out in Section 3.6 on Human Resources costs.

1.1.2 Our submissions on Hydro One's response to the Board's directions on CDM are set out in Section 1.2 below.

1.2 *CDM Directions*

1.2.1 We have reviewed the submissions of CCC under Issue 1.5 of their Final Argument, and we adopt those submissions with respect to the response of Hydro One to CDM related Board directives.

1.3 *Affiliate Service Agreements*

Settled Issue.

1.4 *Economic and Business Planning Assumptions*

Settled Issue.

1.5 *Load Forecast and Methodology*

1.5.1 SEC has had an opportunity to review a draft of the submissions of VECC on the load forecast, in which an adjustment is proposed to reflect the removal of demand response and similar programs from the CDM adjustment. We agree with their submissions, for the reasons they have set forth.

1.5.2 We have also had an opportunity to review a draft of the submissions of CCC related to this issue, and we support the constructive suggestions and analysis contained therein.

1.6 *Service Quality*

Settled Issue.

1.7 *Distribution Loss Factors*

1.7.1 This issue was settled, subject to the Board's decision with respect to the new rate classes and the proposed harmonization plan.

1.7.2 These submissions include extensive analysis of the proposed harmonization plan and new rate classes, which would dramatically increase the rates to most residential and general service customers in the acquired LDC franchise areas. For the reasons set forth in that analysis, SEC believes that the Applicant has not done the work necessary to propose a proper plan for harmonization, and that plan should be rejected by this Board.

1.7.3 The harmonization plan also includes the harmonization of loss factors throughout the system. The result is a rate increase for customers in the acquired LDC areas of $4.9 million [Tr.5:174]. No study or analysis has been done to determine whether loss factors in towns are similar to loss factors in rural areas, and common sense suggests that in fact they will be different. Yet Hydro One is proposing that customers in the towns – which is where most of the customers in the acquired LDC areas live – bear the same loss factor as rural customers.

1.7.4 Hydro One witnesses were questioned on this proposal [Tr.5:174-176], and their only justification for this approach was Powerstream used a similar approach to harmonize its loss factors across three predecessor LDCs [Tr.5:176]. It is submitted that Powerstream is not in fact a good precedent in this case. The three predecessor LDCs in Powerstream have similar systems, similar customer bases, and similar densities, so there is no reason to believe that the loss factors would be substantially different. Contrast that with Hydro One legacy and acquired. In that situation, it is intuitive that loss factors in Brockville or Smiths Falls are likely to be materially different from loss factors in low density rural areas with very long low voltage lines serving small numbers of customers. To propose application of the same loss factor to all, <u>without doing any analysis or study to determine relative loss factors</u>, is simply not justified, and this Board should not countenance a proposal that has no evidentiary basis at all.

1.7.5 It is therefore submitted that this Board should reject the proposal to harmonize the loss factors, just as it should reject the proposal to harmonize general service rates, and should direct Hydro One to go back to the drawing board, do a proper analysis based on empirical evidence, and when that is done come back to this Board with a new proposal that is has a proper factual foundation.

2 COST OF CAPITAL/DEBT

2.1 *Capital Structure and Rate of Return on Equity*

Settled Issue.

2.2 *Debt Costs*

Settled Issue.

3 COST OF SERVICE

3.1 *2008 OM&A Budget*

3.1.1 ***Overall Budget.*** In this section, we will go through a number of the components of the OM&A budget to show why they are overstated, but before doing so it is important (as Mr. Rogers correctly predicted in his Argument-in-Chief) to set the overall OM&A budget in context.

3.1.2 What is the fair comparison? Should the "context" be 2007 actuals, or 2006 actuals, or 2005 or 2004? Or, should it be Board-approved figures, of which the last COS figures are 2006?

3.1.3 In our view, when approving an OM&A budget, the Board is trying to answer the question "How much does it reasonably cost to run this utility?". There are three sources of information the Board can use to answer that question.

(a) The detailed budgets and explanations from the Applicant, as tested during the hearing process.

(b) Actual figures for prior years, which demonstrate how much the Applicant actually needed to run the utility in those years.

(c) COS reviews for prior years, in which this Board has already reviewed in detail how much it costs to run this utility.

3.1.4 Each of those sources of information has weaknesses:

(a) The Applicant's budgets are often more like "wish lists", because they are expecting to have only a reduced figure approved, and thus some applicants will, as part of the normal regulatory process, ask for everything they can.

(b) Actual figures for prior years are not always representative of typical years. They have to be adjusted to take account unusual aspects for the prior year. If a prior year has a lot of storms, for example, as with 2006, then the actual spending is probably higher than a normal year. Similarly, if 2006 had $7 million in CDM, which is no longer generally a budget item, that should be adjusted. As well, this Board has seen several instances in which the last IRM year before a rebasing shows spikes of spending.

(c) COS reviews are valuable, but they are in one sense just a previous attempt by the Board what it is trying to do now. If it turns out that actual spending was much lower than the Board-approved figure, that may suggest a utility that has a more

aggressive budget than its ability to spend. Or, it may be evidence of a year in which actual events unfolded quite differently from what was expected at the time of the rate case.

3.1.5 In our submission, each of these sources of information is useful to the Board. But, it is also true that, if all of them deliver indicators that the proposed budget is very high, the Board has powerful evidence supporting a substantial reduction.

3.1.6 It is true, as explained by Mr. Rogers in Hydro One's Argument-in-Chief, that their 2008 OM&A costs are relatively flat as compared to 2007. This may be the result of pumping up 2007 going into a rebasing year, or it may be an indication that Hydro One is holding the line on spending in 2008.

3.1.7 Overall spending is up considerably, however, over the longer historic period. That suggests that 2007 is not a good base year for comparison purposes.

3.1.8 Total OM&A in 2008, at $477.8 million, is 18% higher than 2006. The 2006 application, however, itself contained a large step up in expenditures. As a result, when compared to 2004, OM&A expenditures have increased at an alarming rate: OM&A in 2008 is 38% higher than 2004. [C1-2-1, Table 1].

3.1.9 It is valuable to stop for a second and ask why a utility that could be run on OM&A of $346 million in 2004 would need $478 million for OM&A in 2008. Inflation during that period of 2% per year would increase the costs by 8.2%, bringing it up to $375 million, before taking into account productivity. Thus assuming there was no productivity improvement in OM&A during those four years, there is a $103 million increase in OM&A to explain.

3.1.10 Of this, the biggest component at $30.5 million is Vegetation Management, up from $88.9 million in 2004 to $119.4 million in 2008. Inflation would have brought this up by $7.3 million, so there is a real increase of $23.2 million that needs explanation. We will have comments on the Vegetation Management budget, below.

3.1.11 The next largest impact is the $25.7 million increase in Lines, up from $92.4 million in 2004 to $118.1 in 2008. The inflation component of that is about $7.6 million, so there is a real increase of $18.1 million that needs explanation.

3.1.12 The other major area of increase is Shared Services and Other OM&A, which increased from $9.3 million to $66.9 million. The bulk of this $57.6 million increase is the result of pension costs increasing from 2004 to 2008. We will have comments on pension costs, below.

3.1.13 The balance of these increases arises from increases in excess of inflation in several other areas, some of which we have identified later in these submissions.

3.1.14 While the Company has identified some increased work programs, which are discussed below, to explain some of the increase in expenditures, this increased work does not explain the large increases in total costs. In addition, while the Company is spending a great deal of money on capital and OM&A in areas, such as smart meters, that we would expect would result in lower operating costs, there do not appear to corresponding savings.

3.1.15 In SEC's submission, the rate of increase in OM&A spending since 2004 is not sustainable. The increased work programs do not justify the large increase in spending and in any event Hydro One needs to learn to manage increasing work demands by keeping overall spending to a reasonable level. This is an important point that appears to have been lost during this proceeding. It is not enough to focus on pressures to increase spending in specific areas. Any well-run business first looks to whether it can find the money for increased spending in one area through reductions in other areas. That kind of prioritization is the essence of the skillset for which you pay top management people high salaries.

3.1.16 Unfortunately, this does not seem to be the case for Hydro One, and cost drivers for increased spending are not matched by reductions in other areas, even in areas where one would expect to see reductions given the investments made in new technologies.

3.1.17 ***Overall OM&A Reduction.*** We have had the opportunity to review the draft final argument of CME dealing with overall OM&A levels. We believe that an overall reduction in the range CME has proposed - $44.8 million or more - is a good benchmark for the Board to use in assessing the reasonableness of the specific OM&A reductions proposed by ourselves and others. We believe that the specific issues we raise, below, are between the low and high points of the range of reductions proposed by CME, which suggests that our specific reductions are reasonable.

3.1.18 The remainder of these submissions on OM&A will deal with the components of the OM&A budget, and areas in which we believe reductions should be considered.

3.1.19 ***Sustaining OM&A.*** Total Sustaining spending is proposed to increase by 10% in 2008 over 2006 actuals, by 35% over 2004 actuals, and by 22% over 2006 Board-approved. The bulk of the increase is due to increased expenditures on Vegetation Management and Metering:

Sustaining OM&A

Expense Category	*2004 Actual*	*2005 Actual*	*2006 Approved*	*2006 Actual*	*2007 Actual*	*2008 Budget*	*2006 to 2008*	*2004 to 2008*
Lines	92.4	105.3	106.1	126.5	124.6	118.1	-6.6%	27.8%
Stations	18.4	19.9	21.5	26.0	25.0	24.9	-4.2%	35.3%
Metering	8.2	10.3	8.8	14.0	15.7	17.6	25.7%	114.6%
Vegetation Management	88.9	86.4	93.9	89.1	115.0	119.4	34.0%	34.3%
Totals	207.9	221.9	230.3	255.6	280.3	280.0	9.5%	34.7%

Source: C1/2/2, Table 1, and H/10/16

3.1.20 Sustaining OM&A makes up the largest proportion of OM&A and the largest proportion of the increase in OM&A expenditures. The largest increase in Sustaining OM&A is in the Vegetation Management program, which is dealt with in Issue 3.2 below.

3.1.21 The budget for Lines shows a decrease over actual 2006 spending, but an 11.1% increased over the forecasted 2006 spending. In 2006, Hydro One experienced an unusually high number of storms, so the more accurate comparison is to the 2006 forecast numbers.

3.1.22 A key component of the Lines budget is Trouble Calls. The budget for Trouble Calls, $58.9 million, is 17% below 2006 actual but 9% higher than the 2006 projected spending of $54.0 million [EB-2005-0378, Exhibit C1-2-2, pg. 10] The 2006 budget was based on a forecast of 47,000 trouble calls [ibid., at p. 12], while the 2008 forecast is based on a forecast of 49,100 trouble calls [C1-2-2, pg. 12] Projected spending is therefore 9% higher than 2006 but the projected work (# of storm calls) is 4.4% higher. As in other categories of spending discussed elsewhere in these submissions, we see that the forecast of expenditures is increasing at a faster rate than the forecast of work accomplishment.

3.1.23 The bulk of the increase in Metering is due to Smart Meter OM&A expenses, which increase from $4.9 million in 2006 to $6.7 million in 2008.

3.1.24 By the end of 2008, Hydro One projects that 620,400 smart meters will have been installed, 370,000 of which are being installed in 2008 [H-10-31]. Hydro One projects a further 700,000 smart meters to be installed beyond 2008. These expenditures are part of the Sustainment capital budget.

3.1.25 Despite the fact that almost half of its conventional meters will have been replaced by the end of 2008, HON is projecting only minimal reductions in traditional metering costs.

3.1.26 Sustaining OM&A associated with Customer Retail Meters is declining from $8.1 million in 2006 to $6 million in 2008 [C2-2-2, pg. 25] The saving is due to a dispensation from Measurement Canada allowing meters coming due for verification from 2008 through 2010 to remain in place without verification. [C2-2-2, p. 25]

3.1.27 Meter reading costs, which are part of the Customer Care budget, also decline only slightly in 2008 despite the new meters. Meter reading costs decline from $22.6 million in 2006 to $19.9 million in 2007 and $19.6 million in 2008. [C1-2-5, pg. 4] Hydro One has said that customers with smart meters and who have the technology will begin time of use rates in 2008.

3.1.28 ***Customer Care OM&A.*** Customer Care Base Services are up by 4.9% in 2008 over 2007 [C1-2-5] On a per customer basis, however, customer care costs are up substantially since 2007, from $82.08 per customer to $86.94 per customer, a 6% increase.

3.1.29 Within Customer Care Base Services, Customer Care management costs increase from $4.1 million in 2006, to $6.3 million in 2007 to $7.2 million in 2008. The Hydro One witnesses said that part of the reason for the increase in Customer Care base services from 2006 to 2008 is the change in allocation methodology [H-1-66; Tr1:124]. That explanation, however, would only apply to increases in 2007 over 2006, since that is when the allocation changed [H-1-66]. The increase in customer care management costs from 2007 to 2008 ($6.3 million to $7.2 million) represents a one year increase of 14.2%.

3.1.30 Hydro One also said that customer care costs per customer tend to fluctuate from year to year due to variations in bad debt costs. We therefore looked at customer care costs per customer excluding bad debt costs. The result is actually worse - an 8% one year increase in customer care costs per customer, excluding bad debt costs, from $70.67 in 2007 to $76.05 in 2008. This is true despite the fact that the introduction of smart meters and time of use rates will lead to a reduction in meter reading costs beginning in 2008.

3.1.31 As mentioned above, meter reading costs decline only slightly in 2008 despite the large expenditures on smart meters. Hydro One provided the projected number of meter reads in 2008 in response to an interrogatory by AMPCO. Hydro One projects the total number of meter reads in 2008 to be 8.8% less than 2007 (4,510,251 in 2007 compared to 4,110,000 in 2008- see H-11-16]. Given the fact that about 20% of Hydro One's smart meters were installed as of the end of 2007, and a further 28% are being installed in 2008, SEC believes the number of meter reads in 2008 is high. Nonetheless, even using Hydro One’s estimated number of meter reads, the projected budget of $19.6 million for 2008 means a cost per read of $4.76, 8.2% higher than 2007 ($4.40 per read).

3.1.32 We therefore believe that the meter reading budget should be lower than that proposed. However, we are not proposing a specific reduction, because we believe that if the Board accepts our proposed reduction in total compensation, part of the impact of that will be to reduce meter reading costs closer to a reasonable level.

3.1.33 On the other hand, if the Board determines not to reduce the total compensation level as proposed, we believe that meter reading costs should be reduced by $1.5 million to reflect a more reasonable cost per read, and by a further $2 million to reflect a more reasonable estimate of the number of reads required.

3.2 *Vegetation Management*

3.2.1 While SEC does not dispute the need or justification for the plan to increase the level of accomplishment in the Line Clearing function, SEC questions the budget proposed to achieve that increase.

3.2.2 Hydro One proposed to increase its Vegetation Management substantially in 2008 over both 2006 and 2004. The following is the historical breakdown:

Vegetation Management

Expense Category	*2004 Actual*	*2005 Actual*	*2006 Actual*	*2007 Actual*	*2008 Budget*	*2006 to 2008*	*2004 to 2008*
Customer Notification	6.9	6.8	6.8	6.5	7.9	16.2%	14.5%
Line Clearing	55.6	52.9	50.6	74.1	76.8	51.8%	38.1%
Brush Control	19.6	21.1	25.2	26.9	28.2	11.9%	43.9%
Demand Work	6.2	5.3	6.1	6.9	6.0	-1.6%	-3.2%
Asset Condition Assessment	0.5	0.2	0.5	0.5	0.5	0.0%	0.0%
Totals	88.9	86.4	89.1	114.9	119.4	34.0%	34.3%

3.2.3 ***Line Clearing.*** The largest driver of the increase is the increase in Line Clearing. This reflects a plan to reduce tree trimming cycle lengths from ten years to eight years, and increase annual accomplishments to 12,500 kilometres. Hydro One explained that the increased vegetation management expenditures would increase reliability by decreasing the number of outages caused by tree contact [C1-2-2, pg. 31, 35-36].

3.2.4 Hydro One's internal Vegetation Management Program Review also shows that, as cycle lengths for tree trimming are reduced from the current 10 years to the proposed 8 years, the per kilometre cost is expected to drop from $6,144 to $4,246. [H-1-14, Att. B, pg. 10].

3.2.5 The proposed budget for Line Clearing, however, shows that the per kilometre cost is increasing substantially in 2008 over 2006:

Line Clearing and Brush Control

Item	*2004 Actual*	*2005 Actual*	*2006 Actual*	*2007 Actual*	*2008 Budget*	*2006 to 2008*	*2004 to 2008*
Line Clearing Total Cost	55.6	52.9	50.6	74.1	76.8	51.8%	38.1%
Accomplishment (KM)	10,361	8,746	8,889	12,211	12,500	40.6%	20.6%
Cost per KM	$5,366	$6,048	$5,692	$6,068	$6,144	7.9%	14.5%
Brush Control Total Cost	19.6	21.1	25.2	26.9	28.2	11.9%	43.9%
Accomplishment (KM)	10,731	9,076	10,246	10,777	12,500	22.0%	16.5%
Cost per KM	$1,826	$2,325	$2,459	$2,496	$2,256	-8.3%	23.5%

Source: Budget from C1/2/2, p30; Accomplishment H/1/63; Cost per km. confirmed Tr.2:20

3.2.6 The per kilometre cost of Line Clearing is 8% higher in 2008 than in 2006. That per unit increase reflects the fact that the budget for Line Clearing increases by 52% in 2008 over 2006 but the projected level of accomplishment increases by only 41%.

3.2.7 Rather than realizing economies of scale or productivity improvements as the level of work increases, therefore, Hydro One's costs appear to be increasing.

3.2.8 When asked about this increase, the Hydro One witnesses said that the per kilometre costs fluctuate from year to year depending on tree density [Tr2:20]. The witnesses also said they use historical costs as a starting point, then look at the particular feeders they're projected to work on during the 2008 period and determine the projected cost for that year. [Tr2:21].

3.2.9 Nothing in the evidence, however, identifies why the particular kilometers being trimmed in 2008 are so much more difficult to trim than those trimmed in 2006. Nor is there any explanation for why there are no economies of scale, or productivity improvements, factored into the 2008 projections. Nor is there any explanation for why a budget for "difficult to trim" kilometers should be used for a period that, with IRM, will be four years.

3.2.10 In fact, the table above shows that the cost per kilometre for Brush Control, which covers most of the same territory as Line Clearing, decreases from 2006 to 2008, from $2,459 to $2,256 in 2008.

3.2.11 ***Customer Notification.*** The same problem is seen in the Customer Notification budget, which increases by $1.4 million, or 22%, in one year, from $6.5 million in 2007 to $7.9 million in 2008. Hydro One states that the Customer Notification increases in lock-step with the Line Clearing accomplishment [C1-2-2, p. 33], yet the level of accomplishment for Line Clearing is increasing just 2.4% from 2007 to 2008, from 12,211 kilometres to 12,500 kilometres. There is therefore no explanation for why the budget for Customer Notification is increasing by 22%.

3.2.12 ***Number of Employees.*** To get an understanding of how the Vegetation Management budgets for 2008 were developed, SEC asked for a breakdown of what new employees were being hired for the Vegetation Management program. HON's answer was that, by the year end 2008, it planned on hiring 520 regular and non-regular staff for the Vegetation Management function alone [J3.5].

3.2.13 In Response to Undertaking J3.6, HON provided a breakdown of how many employees were assigned to the Vegetation Management program from 2004 to 2008. The response was as follows:

Vegetation Management Program
No. of Employees at Year End

2004	747
2005	522
2006	498
2007	606
2008	803

3.2.14 There appears to be a discrepancy between J3.5, which shows 520 new employees assigned to Vegetation Management, and J3.6, which shows an additional 197 (803 minus 606) staff in Vegetation Management. In either case, however, the projected hiring and increased complement is far out of proportion with the planned 2.4% increase in accomplishment in the Vegetation Management function from 2007 to 2008.

3.2.15 ***Benchmarking.*** The study by PA Consulting, which was commissioned by Hydro One and included in the pre-filed evidence, found that Hydro One's tree trimming costs per kilometre were near the top of the comparator group in 2006. Hydro One's costs at that time were $4,367 per kilometre [Exhibit A-15-2, Attachment A, p. C-40]. Hydro One's tree trimming costs for 2008, $6,144, are 41% higher than the 2006 amount reported by PA Consulting.

3.2.16 PA Consulting states that, notwithstanding the different conditions faced by Hydro One (tree density, geography, etc.) which may increase its costs relative to other utilities "there is an opportunity to improve the overall tree trimming costs for Hydro One." [A-15-2, Att. A, p. 4-21] During cross-examination the Hydro One witnesses acknowledged that this is an opportunity to make improvements [Tr3:67]. The 2008 forecast, however, appears to show deteriorating performance rather than an improvement.

3.2.17 We have also had occasion to review J2.5, the study by CN Utility Consulting Inc. Assuming – as appears to be the case – that Utility #12 in that study is Hydro One, one thing this study shows is that when the annual salary for Hydro One employees at every level of vegetation management is compared to their peers, the Hydro One is salary is higher, not just than the average, but higher than every single one of their peers, often by very substantial amounts. The study also shows that utilities that contract out their vegetation management have on average much lower costs per unit of work than utilities that use their own employees. Hydro One, of course, relies 100% on their own employees. Thus, for both of these reasons, it is not surprising that Hydro One has such high unit costs to do something as basic as vegetation management.

3.2.18 In SEC's submission, the 2008 budgets for Customer Notification and Line Clearing are over-stated. We have had an opportunity to review the draft submissions of AMPCO in this regard, and we agree with them that the appropriate result is to freeze the budget at the 2006 level, but challenge Hydro One to increase its accomplishment to the targetted 12,500 km in the test year. Even if that places budgetary pressure on Hydro One in 2008, the pressure should be relieved during the remaining IRM years, as we discuss below. Further, it is consistent with their own internal prediction that cost per km will go down as the cycle is accelerated.

3.2.19 ***Impact of IRM.*** Later in these submissions, we will have comments on the general issue of whether it is appropriate to approve spending increases in the test year that are designed to produce savings in the IRM years. We submit there that this perverts the purpose of IRM, which is to encourage utilities to make productivity investments on their own account, and reap the benefits of those investments also on their own account.

3.2.20 The proposed increase in the vegetation management budget is just another example of that problem. If the Board approves the requested budget, the result would be that the ratepayers would pay the additional cost (which, as we have noted above, should not arise in any case) to shorten the tree trimming cycle, but the cost savings (reduced outages, reduced cost per km for tree trimming, reduced repair and maintenance costs per km, etc.) would all accrue to the utility and its shareholder. The ratepayers would share none of it.

3.2.21 In our submission, if the utility believes that additional spending on vegetation management will reduce costs, then they should spend money during IRM to do so, and reap the benefits of that additional spending. To ask the ratepayers to make the investment, but have the shareholder get the return on that investment, is simply the wrong way to approach it.

3.2.22 ***Cycle Frequency.*** Our submissions on this point have proceeded from the premise that shortening the cycle to eight years is an appropriate goal. Board Staff, in their submissions have asked whether shortening the cycle to six years would be better still.

Hydro One, in their Argument in Chief [Tr.7:20] have opposed this, preferring to take a step by step approach.

3.2.23 In general, we agree with Hydro One on this point. That having been said, Hydro One has a large franchise area. We believe that it may be possible for Hydro One to develop a pilot project to try out a six year cycle in one or more smaller areas of the overall franchise, and see what the results are. Not only will this improve the tree trimming cycle in those areas, but it will allow Hydro One to gain valuable information on the costs and benefits of a potential move to six years. When Hydro One next comes before this Board, it will have information on which this Board can determine whether a further step to a six year cycle is appropriate.

3.2.24 We therefore believe that the Board should encourage Hydro One to implement a pilot project of the type described, to gather information on whether a six year cycle is the next appropriate step.

3.3 *Shared Services andOther O&M*

3.3.1 ***Asset Management.*** Total Asset Management costs increase 13% between 2006 and 2008 [C1-2-6, Table 1]. It is submitted that the Applicant has not provided a suitable justification for that increase.

3.3.2 In Hydro One's Transmission application [EB-2006-0501], filed in September 2006, Asset Management costs were projected to be $97.5 million in 2007 and $96.4 million in 2008. In the current application, filed in August 2007, Asset Management costs are given as $93.8 million in 2007, a decrease of $3.7 million from the projected amount for 2007 from the Transmission evidence, and $118.9 million for 2008, an increase from the Transmission projection in the amount of $22.5 million. [H-13-21]

3.3.3 In terms of the amount allocated to the Distribution business, the increase between the two 2008 projections amounts to $7.2 million in Asset Management costs [H-13-20 and Tr1:105].

3.3.4 When asked for an explanation for such a large increase in 11 months, the Hydro One witnesses said that the planning cycles for the two applications were more than 11 months apart and that in the intervening time "we gathered new information about the work environment and certainly we identified much more work that was required in the system investment and business integration area." [Tr1:106] The System Investment and Business Integration areas of Asset Management budget make up $10.3 million and $4.2 million, respectively, of the $22.5 million increase in Asset Management budget between the two applications [see H-11-19].

3.3.5 However, when asked to produce the underlying plan that would show how those assumptions changed, and whether they justified the projected increases, the company said they would look for it [Tr1:110], but then never produced anything.

3.3.6 The essence of the Company's argument on this point appeared to be "We needed more planners because we had more planning to do, but those new planners didn't actually produce any plan that we can show you" [a loose paraphrasing of Tr.1:109-111].

3.3.7 We believe that the Company has explained $2 million of the increase in Asset Management costs as relating to distributed generation [Tr.1:113], and the balance should not be approved.

3.4 *Allocations of Shared Services*

3.4.1 ***Hydro One Telecom.*** The amount that Hydro One pays to Hydro One Telecom for telecommunications services is increasing by 40% between 2006 and 2008, from $6.4 million in $9 million. Hydro One explained that part of this increase is due to labour escalation and increased pension costs. [H-13-28]

3.4.2 When asked whether Hydro One had ever gone to the market to see whether the services provided by Hydro One Telecom can be obtained more economically from another provider, the Hydro One witnesses, after initially referring to the Shpigler study, eventually agreed that they had not. [Tr1:132]

3.4.3 In our submission, Hydro One should be directed to hold an appropriate competition for the services currently provided to it by Hydro One Telecom, and make an objective selection of the best provider at the most cost effective rates.

3.4.4 ***Rudden Methodology Updating.*** The Hydro One witnesses said that the Rudden Methodology is updated annually to make sure that the allocations as between Distribution and Transmission are correct. [Tr1:61] Rudden is also being engaged to review the methodology for the next Transmission rate proceeding to make sure that it is still appropriate to use. [Tr1:61] Large Transmission projects such as the Bruce to Milton line and others may also result in a higher proportion of corporate costs being allocated to Transmission. That leaves open the possibility that, at the next Transmission proceeding, changes to the methodology will result in a larger amount being allocated to Transmission versus Distribution. If the Distribution rates are not adjusted for several years due to incentive regulation, however, there will be no opportunity to re-adjust Distribution rates downward to adjust for the increase to Transmission.

3.4.5 In our submission, this Board should direct that any re-allocation that takes place in the next Transmission rate case should be treated as a Z factor for distribution rates, and an appropriate re-allocation to distribution, with resulting rate impacts, should be made.

3.5 *E-Factor Methodology*

Settled Issue.

3.6 *Human Resources Costs*

3.6.1 ***General.*** The Board has been consistent in telling Hydro One that they have to start taking action to deal with their high compensation costs. In the 2006 distribution case (EB-2005-0378) and in the 2007 transmission case (EB-2006-0501) the board made clear that the next time Hydro One appears before them, it should be with a plan. No plan was filed with the Board in this case.

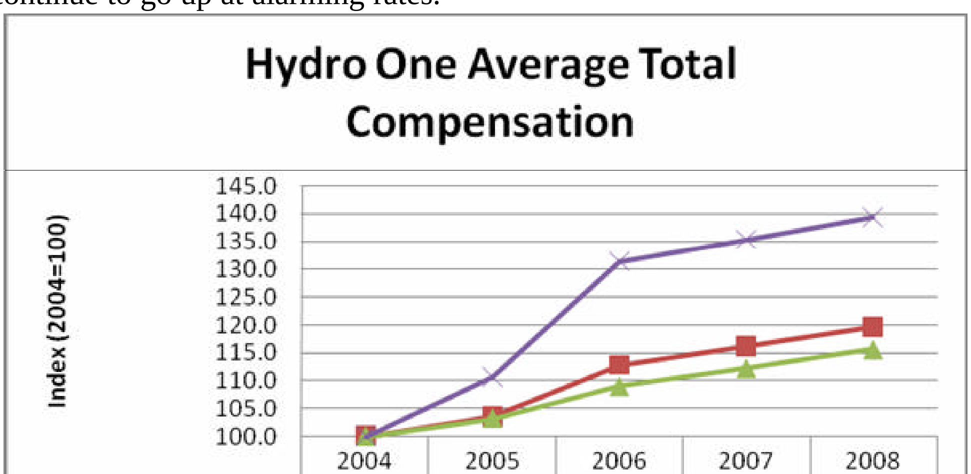
3.6.2 In the 2007 Transmission application, the Board summarized the direction given to the company during the 2006 distribution rate proceeding, as follows:

(a) In future rate cases it expects Hydro One to identify what steps the Company has taken or will take to reduce labour rates;

(b) The contrast between the compensation structure of Hydro One and some other utilities is of concern; and

(c) In future rate cases it expects Hydro One to demonstrate that lower compensation costs per employee have been achieved or to have concrete initiatives in place to bring compensation costs more in line with other utilities. [EB-2006-0501, p. 29]

3.6.3 The Board saw none of that in that case. In fact, the compensation levels at Hydro One continue to go up at alarming rates.



	2004	2005	2006	2007	2008
PWU	100.0	103.5	112.8	116.2	119.6
Society	100.0	103.3	109.0	112.3	115.7
Manager Band 7	100.0	110.6	131.3	135.3	139.3

Data source: Exhibit C2-3-1; index prepared by SEC

3.6.4 We also saw evidence in J2.5 that for a number of critical positions, Hydro One's salaries are not just above the industry averages, but above every single one of their peers for not one, but a whole list of positions.

3.6.5 In the face of these serious problems, instead of showing that it had a plan, or even that it was working on a plan, Hydro One filed a study from the Hay Group apparently justifying Hydro One's high compensation levels.

3.6.6 Hydro One states that the results of the study prepared by the Hay Group [results of which were filed at A-15-2, Attachment B] show that it is at or below average for three representative utility job functions that represent a large component of its workforce [A-15-2, pg. 2].

3.6.7 The Hay Group study suffers from several limitations. First, it looked at only minimum and maximum pay for each band, without considering how many employees were actually at the minimum or maximum.

3.6.8 Most importantly, in looking at Hydro One salaries, the Hay study adjusted those salaries based on a points system purportedly designed to normalize the skill set of Hydro One positions with the skills required of employees in the same position at other utilities.

3.6.9 These adjustments are based on Hay Group's judgment on the relative skills required for each job. The result of these adjustments are that Hydro One's wage rates are for the most part adjusted downwards for comparison with other utilities.

3.6.10 The reality is that insisting your high costs are fine, after this Board has twice told you to go do something about it, is simply not acceptable.

3.6.11 And we saw how seriously the Company takes the problem in cross-examination on the first day. Asked whether the Company had established any special task force, or group, or committee, to tackle this serious problem, the Company did not appear to understand what we were talking about, and certainly has not taken any extraordinary steps like that [Tr.1.129].

3.6.12 It is submitted that this Applicant does not appear to have understood the Board's message (and the message from its own ratepayers) that its personnel costs are out of control and have to be treated as a serious problem. In our view, it is past the time when this Board should again tell them to go away and figure out what to do about it. It is now time, in our submission, for this Board to reduce the total compensation budget, so that the Board finally gets Hydro One's attention, and convinces them to take some real action to deal with this situation.

3.6.13 ***Aging Workforce.*** This "issue" was highlighted a number of times by the Applicant in their written and oral evidence. This is not a new issue. All companies have this issue, as a result of aging baby boomers in skilled positions getting closer to the time they qualify for retirement. It is an economy-wide concern.

3.6.14 Hydro One says that this means they have to hire more people right now, and thus they use this to justify massive increases in total compensation and FTEs. But where is the plan? This is a problem that, over the next few years, could cost hundreds of millions of dollars, and affect Hydro One's ability to deliver critical services day to day. Yet Hydro One has produced no plan that analyses what the problem is, and how they plan to solve it.

3.6.15 It is submitted that, if Hydro One plans to hire hundreds of extra people each year for the next few years to deal with this major problem, it should present to this Board an analysis that shows, at minimum:

(a) Demographic pressures by position and by year, including both "retirement eligibility" and <u>actual</u> retirements forecast.

(b) Employment market information and forecasts.

(c) Projected costs to the system of those retirements as they arise, including costs to recruit and train new employees, costs and benefits of high priced employees moving to pension status, changes in wage rates, etc.

(d) Alternative solutions to the problem, including early hiring, reduction in unionized positions by attrition, outsourcing components of operations, sharing services with other utilities, use (with or without modification) of existing external training facilities, sharing training facilities with other utilities, etc. (The sole solution to problems such as this is not, inevitably, spend, spend, spend.)

(e) The preferred plan for dealing with the issue, its costs and benefits, both totals and on a year by year basis.

3.6.16 In our view, if the "aging workforce" issue is not sufficiently serious that such an analysis should be undertaken, then this Board should not treat it as serious either, certainly not serious enough to justify substantial compensation and FTE increases without any analytical basis.

3.6.17 ***Headcounts.*** The Applicant proposes substantial increases in its headcounts, and the evidence on the reasons for those increases is sparse.

3.6.18 Hydro One plans on hiring an additional 1,186 regular, non-regular, and casual employees by the end of 2008 [H-1-31, Att. A]. The increased hiring will bring its total complement to 7,079 employees, up 33.5% over 2006 [Exhibit K3.2].

3.6.19 As a result, Hydro One's total compensation by year end 2008 will be $580.7 million, up 26% over 2006 [Exhibit K3.2].

3.6.20 Notably, total compensation for 2008 is up 14% over projections from the Transmission application [EB-2006-0501, Decision with Reasons, p. 28] even though the two applications were filed just 11 months apart. In addition, projected 2008 headcount from the Transmission proceeding was 5,803 [Exhibit J.1.40 in EB-2006-0501], but now is 7,079.

3.6.21 In order to determine whether the projected level of hiring is justified by the additional work Hydro One is planning, SEC asked Hydro One to provide a breakdown of where the new employees would be working.

3.6.22 The response was as follows:

Distribution Work Program
Planned Hires (regular & non-regular staff) by Year End 2008

Distributed Generation	10
Smart Meters	34
Vegetation Management	520

Exhibit J3.5

3.6.23 Therefore, out of the 1,186 new hires for Hydro One as a whole, Hydro One was able to map 564 of them to distribution work programs (although, as we have noted earlier, the number mapped to vegetation management is inconsistent with other evidence on that point). The other 622 additional hires would, therefore, either be allocated entirely to Transmission work programs, or to address "demographic" issues. As mentioned above, however, to the extent the other 622 employees are allocated to Transmission operations, it would be a substantial increase from 2008 headcount that Hydro One projected in its 2007 Transmission application.

3.6.24 ***What Should the Board Do?*** This is the Board’s last chance for four years to get the distribution component of compensation costs under control. In our submission, the Board should reduce the compensation component of distribution OM&A by $30 million annually, and should order Hydro One to, within eighteen months from the Board’s decision, file a comprehensive compensation management plan covering both their distribution and transmission operations, together with an application to adjust rates during IRM to match that compensation plan. Since the Applicant would be dealing with a $30 million per year reduction in personnel costs, it can be expected that they would be diligent in treating their compensation issues seriously.

3.6.25 We note that the figure of $30 million, while an estimate, is not entirely picked out of the air. It is an estimate of the part of the distribution component of the increase in total compensation since 2006 that is a) in excess of inflation, and b) allocated to OM&A as opposed to capital. It is also intended to be sufficient to get Hydro One's attention. We have not proposed a reduction in compensation costs allocated to capital at this time.

3.6.26 It is submitted that Hydro One has demonstrated through its conduct that it does not have the will to control its personnel costs but itself. As we have said in other cases, one of the roles of this Board is to be the proxy for the competitive market. The competitive market does not "give companies a break" when they are unwilling to deal with out of control compensation. This Board should not do that either. This Board must be willing to set limits, and those limits must be sufficiently tough that the utilities get the message. In this case, it is submitted that only a stringent cap on compensation costs will convince Hydro One to apply its expertise to solving this problem.

3.6.27 We note that we are not proposing a reduction of distribution compensation allocated to capital at this time, although we believe that this should be a matter for consideration when the Board next considers how Hydro One is handling this problem. In our view, the best result is if Hydro One gets the message and applies its considerable resources, expertise and creativity to finding the best possible solution. Therefore, what the Board needs to do today is motivate them to achieve that. If this still does not work, then of course the Board would have to consider further tightening of budget levels, including reduction in compensation budgets allocated to capital as well. It would be preferable if that were not necessary.

3.6.28 ***Pension Costs.*** The evidence before this Board from the Mercer study is that the reasonable expected pension cost for 2008 is $95 million, but that the Company proposes to include $110 million in rates [Ex. C1/3/2/App.A, p.2], because they don't actually know that the number is going to be.

3.6.29 With respect, it is of the essence of forward test year ratemaking that a utility does a forecast on the best information available, it is tested in a hearing process, and then the utility lives with the result. Here, the best information is that the cost will be $95 million. This is the amount that should be included in rates.

3.6.30 Based on the information contained in Exhibit C1, Tab 3, Schedule 2, Appendix A, at page 2, our best estimate is that a $15 million reduction in 2008 pension costs would result in a $4.5 million reduction in distribution OM&A, a $3.1 million reduction in distribution capex, and a $0.5 million reduction in Inergi payments.

3.7 *Depreciation Expense*

Settled Issue.

3.8 *Capital and Property Taxes*

Settled Issue.

3.9 *Income Taxes*

Settled Issue.

3.10 *CDM Budget and Activity*

3.10.1 We support the submissions of CME on this issue.

3.11 *Loss Reduction Efforts*

Settled Issue.

4 RATE BASE

4.1 *Rate Base Amounts*

4.1.1 The Applicant in their Argument in Chief have made a point of saying that $45 million of their new revenue requirement is the direct result of the $333 million of approved capital spending in the 2006 [Tr.7:18]. This is not entirely true, of course, and Mr. Rogers was careful to point out that the $45 million number assumes similar spending in 2007 was also "approved". The combined total of the two means $45 million of additional revenue requirement in 2008. That figure seems to be about right, perhaps somewhat low. It might be useful for the Board if, in their Reply Argument, the Company produced the calculation that reaches that result.

4.1.2 The other side of that point, though, is the implications for the $566.2 million budget for which the Applicant is seeking approval in 2008. Since this is expected to be followed by three years of IRM, if this Board assumes $556.2 million for each of 2008 through 2011, what is the revenue requirement impact of that in 2012?

4.1.3 We are not in a position to do that calculation as thoroughly as Hydro One. However, it is possible to estimate the result: approximately a $200 million rate increase in 2012.

4.1.4 When considering the combined impact of the capital budget sought, the already increased rate base, and the huge increases in OM&A, all of which result in an increase in requested revenue requirement this year of more than $100 million, this Board should be cognizant of the fact that, in 2012, Hydro One will be reminding the Board that its approval of the large capital program this year resulted in a further $200 million rate increase at that time.

4.2 *2008 Capital Expenditures Budget*

4.2.1 ***Cornerstone Project.*** The Cornerstone Project, with a total cost of $144 million, is going in service in the second quarter of 2008 [D2-2-2, Ref. IT1].

4.2.2 The Hydro One witnesses said there are no cost savings due to the Cornerstone project that are reflected in the 2008 revenue requirement [Tr1:149] Hydro One has, however, projected total cost savings of $200 million from Phase I of the Cornerstone Project for the 2009-2015 period, $59 million of which are attributed to the distribution business. [Tr3:86]

4.2.3 However, Hydro One will be under incentive regulation for much of this time. The result will be that ratepayers will have to absorb the cost of the project, most of which will be in 2008 ratebase, but not receive any of the benefits in the form of cost savings.

4.2.4 It is our submission that, if the Company is allowed to do this, it perverts the intent of incentive regulation. The essence of incentive regulation is that the Company, using its shareholder's money, invests in productivity improvements and then reaps the rewards during the IRM period. The ratepayers share none of those benefits until rebasing, when the lower costs kick in.

4.2.5 What Hydro One is proposing with respect to Cornerstone is that the ratepayers will put up the initial funds, as part of the approved rate base, and the shareholder will reap the benefits during IRM. Indeed, the Company did not try to hide this. It admitted that it was going to use this ratepayer investment to generate benefits during IRM that would go to meeting its productivity factor [Tr.5:7].

4.2.6 It is submitted that this treatment should not be allowed. Either the benefits should be used to reduce rates today, as CME and CCC have suggested, or the project should be excluded from rate base altogether, perhaps, as CCC has suggested, by tracking costs and benefits in a deferral account for future disposition.

4.3 *Sustaining (Asset Replacement) Capital*

No additional submissions.

4.4 *Development Capital*

No additional submissions.

4.5 *Storm RelatedCapital*

No additional submissions.

4.6 *Shared Services and OtherCapital*

No additional submissions.

4.7 *Allocation and Working Capital*

No additional submissions.

4.8 *Asset Condition Assessment*

Settled Issue.

4.9 *System Loss Expenditures*

Settled Issue.

5 REVENUE REQUIREMENT

5.1 *Revenue RequirementCalculation*

Settled Issue.

5.2 *External Revenues*

Settled Issue.

5.3 *Revenues from OPA Funded CDM*

Settled Issue.

6 REGULATORY ASSETS

6.1 *Disposition of Existing Deferral and Variance Account*

No submissions.

6.2 *New Deferral and Variance Accounts*

6.2.1 ***Lost Revenue Adjustment Mechanism.*** We support the submissions of CME on this issue.

6.2.2 ***Pension Costs.*** We have had a chance to review the detailed submission by CCC on this issue, and we support the reasoning and conclusion contained in that submission.

6.2.3 ***OEB Costs.*** We have also reviewed the CCC submission on this proposed account, and support it for the reasons they have provided.

6.2.4 ***Mitigation Costs.*** In our submission, the harmonization plan cannot be approved by this Board, and therefore the need for a mitigation costs deferral account is premature. When a proper harmonization plan is proposed and approved, we agree that an account similar to the type proposed by Hydro One may in principle be appropriate, depending on the nature and extent of the mitigation required in a proper plan.

6.2.5 ***Smart Meters.*** See Section 8.

7 COST ALLOCATION AND RATE DESIGN

7.1 *New Customer Rate Classes*

See our submissions under Issue 7.7, below.

7.2 *Cost Allocation*

See our submissions under Issue 7.7, below.

7.3 *Proposed Rates*

See our submissions under Issue 7.7, below.

7.4 *Revenue to Cost Ratios*

7.4.1 As noted in our submissions below on harmonization, Hydro One has not in fact done a proper cost allocation study, in which costs are allocated in an empirically defensible way to individual rate classes. Therefore, it is submitted that the revenue to cost ratios Hydro One has put in evidence before this Board have no evidentiary basis, and cannot be relied on for rate-making purposes.

7.4.2 We have proposed below that the Board order Hydro One to go back and do a proper analysis of cost causality to determine both the rate classes to be proposed, and the cost drivers to be used to allocate costs between those classes. A subsequent application should be filed by Hydro One with that information, proposing new rate classes and cost allocation. That subsequent application should also include detailed analysis of revenue to cost ratios, and a proposal for moving closer to 1.0 for each class, in line with the Board's long term policies.

7.5 *Fixed/Variable Splits*

No additional submissions.

7.6 *Sentinal Lights, Street Lights and Sub-Transmission*

No submissions.

7.7 *Harmonization of Rates*

7.7.1 ***General.*** This is not the first time the Board has been asked to approve a harmonization plan for Hydro One. In EB-2005-0378, the Board was asked to approve a harmonization plan applying to the Acquired LDCs only, but rejected the proposal.

In rejecting it, the Board noted that there had been no cost allocation analysis done to determine the costs caused by the customers in the acquired areas. Hydro One proposed to do a partial harmonization, but not include the legacy customers. The Board said, in refusing to approve the plan [p.51-52]:

"A harmonization plan needs to be supported by evidence that harmonization is necessary and the rates, which result from harmonization, will be reasonable. While the Board supports the harmonization of distribution rates in principle, the timing of harmonization is important. This is particularly true when the applicant is requesting approval for a harmonization process with significantly high bill impacts extending over a two year period.

The Board finds that Hydro One's proposed rate harmonization plan for the Acquired LDCs is premature. There is insufficient evidence to determine that resulting changes to individual Acquired LDC customers would be fair and reasonable based upon costs. Obviously rates for all Acquired LDC customers will increase as a result of the combination of the cost allocation process and harmonization with Hydro One's legacy customers. For these reasons, the Board has not been convinced that sufficient merit exists to justify the proposed interim harmonization among Acquired LDCs alone, based on the yo-yo effect that some customers will see in their rates.

Harmonization is a utility process aimed at ensuring that all of a utility's customers share fairly in the utility distribution costs. This interim harmonization proposal by Hydro One does not appear to accomplish that objective."

7.7.2 In principle, the School Energy Coalition also agrees that harmonization of rates and rate classes throughout the Hydro One system is an appropriate goal. However, it is submitted that, as the Board determined in the 2006 rate case, a harmonization proposal should only be approved if

(a) it is founded on proper cost allocation and rate design principles, and

(b) the resulting rates are expected to be "just and reasonable" rates based on a reasonable evidentiary foundation.

We believe that the evidence before the Board establishes clearly that neither of these tests have been met in this case.

7.7.3 ***Summary of Position.*** Hydro One's focus in proposing this harmonization plan is on their mitigation proposal. A lot of time and effort is spent on that, while very little is spent on the guts of the proposal itself. In our submission, when the spotlight is turned on the rate classes and rates they have actually proposed, the Board must conclude that the Hydro One proposal does not meet the requirements the Board laid out in 2006.

7.7.4 The paragraphs below lead the Board through the evidence and show that the following facts are true:

(a) ***Purpose.*** Hydro One is proposing harmonization in order to reduce administrative costs and redress an undercontribution from the acquired customers. No administrative savings have been demonstrated to the Board, and the Application contains none. No empirical work has been done to determine whether the acquired customers are undercontributing, and Hydro One provides no evidence in support of that proposition except the fact that the rates charged to the acquireds are high [Tr.5:165]. In fact, the only evidence before the Board on relative rates is inconsistent with an undercontribution from the acquireds, and strongly supports the proposition that on average their rates today are covering the costs they cause, or more.

(b) ***Rate Classes.*** Hydro One has done no empirical work to determi ne if the density split used to divide residential and general service rate classes is appropriate, and therefore the Board has no evidentiary foundation on which those new rate classes could be approved.

(c) ***Cost Allocation*** Hydro One is proposing a new method for allocating costs as between "urban" and non-urban customer groups in the residential and general service classes. The evidence shows:

(i) Hydro One did not in fact seek expressly approval for this new methodology, did not include a detailed description of it in their evidence (until it was disclosed through an interrogatory), and consistently implied that its cost allocation methodology was "Board-approved", which is not the case.

(ii) Hydro One made no attempt to ensure that urban customers would bear only the costs they cause. In fact, prior to stakeholdering they planned to charge urban general service customers on the same basis as their rural customers.

(iii) The new methodology is not based on any empirical study or analysis of cost causality or cost responsibility as between urban and non-urban customers.

(iv) Hydro One did no analysis of the possible methodologies to use, but rather simply picked one without any rigour and applied it despite the consequences.

(v) Even a cursory analysis of the methodology proposed demonstrates that it does not – and cannot, because of its design - capture material cost differences between urban and non-urban customers.

(vi) The only evidence before this Board suggests that the methodology employed likely over-allocates costs to urban customers, and under-allocates to non-urban customers.

(d) ***Impact***. The harmonization proposal would, if approved, result in significant rate and bill increases for many Hydro One customers, without any evidence that those customers' rates today are not just and reasonable.

(e) ***Mitigation.*** The proposed mitigation plan is irrelevant to the Board's consideration of whether to approve the harmonization proposal, because it only arises if the target rates are just and reasonable. If they are, it is appropriate to determine the best transition plan. If they are not, no amount of mitigation changes that.

7.7.5 ***Purpose of the Harmonization Proposal.*** Although the prefiled evidence in this proceeding says that the purpose of harmonization is "to reduce the current 281 rate classes to a more manageable level in order to simplify the rate structures, facilitate customer understanding, and achieve administrative efficiencies" [G1/1/1, p. 3], in fact Mr. Roger agreed that the underlying rationale is about cross-subsidization as between legacy and acquired customers [Tr.5:155]. No evidence has been filed with respect to the achievement of either purpose.

7.7.6 With respect to the originally stated purpose, the Applicant admits that it has no savings in its Application for the efficiencies associated with harmonization. Those savings are said to come later. Further, no evidence was led that there was a problem with customer understanding, or that simplification was necessary to achieve any benefit to either the Applicant or its ratepayers.

7.7.7 In fact, Hydro One has been operating with hundreds of rate classes for several years, yet it led no evidence of problems that had been caused by that fact. Nor, we should add, was any evidence led showing that any analysis had been done of what benefits would be achieved, and the Applicant's witnesses were unable to quantify any such benefits.

7.7.8 We accept that, intuitively, a simpler set of rates is probably a good idea, and we support the goal of harmonization of Hydro One rates. However, given the problems with the current proposal, achieving simplicity does not justify going forward. The Applicant would have achieved simplicity in 2006 if its proposal had been approved. The Board, quite rightly, said that new rates needed evidentiary backup to be approved, and simplicity did not override getting the answer right.

7.7.9 Thus, the simplicity goal is not a good reason for the Board to approve the proposal of the Applicant.

7.7.10 The real reason for harmonization is two-fold.

7.7.11 First, as between the acquired customers, there is no apparent rhyme or reason to the rates in individual franchise areas. They exhibit a broad range, and it is apparent on the face that this broad range is not likely to be justified by cost causality. For this reason, when Hydro One first proposed harmonization, in EB-2005-0378, the proposal was to harmonize the rates for the acquired LDCs with each other [G1/2/5 p. 1], but not with the legacy customers. This would have reduced the number of rate classes, but would have maintained the distinction between the average rate for the acquireds, and the overall rates for legacy customers.

7.7.12 As noted above, that proposal was rejected by this Board, essentially for the same reasons we are urging rejection today, ie. the Applicant had not provided an evidentiary basis on which to approve it.

7.7.13 Second, as between the legacy and acquired customers, the legacy customers pay a lot more for electricity distribution than the average acquired customer. Mr. Roger agreed [Tr. 5:155] that in his view this is because the legacy customers are subsidizing the acquired customers [see also Tr.4:15, Tr.4:109, and numerous other places], and said that is because there are acquired customers "whose current rates are lower than the rates that result from the application of the OEB cost-allocation methodology" [Tr.4:14].

7.7.14 As we discuss in more detail below, that statement is simply not correct. The OEB cost-allocation methodology does have a method of determining the costs to serve the acquired LDC customers. However, a cost allocation study using the OEB cost-allocation methodology to make that determination has never been done [Tr.5:164; also Tr.5:188 and other places].

7.7.15 The Applicant believes that the rates currently being charged to customers in the acquired LDCs do not recover all of the costs to serve those customers. Indeed, Mr. Rogers in Argument in Chief reiterated this belief [Tr.7:35, without citing any supporting evidence]. However, that belief is not based on any study, analysis, or other acceptable foundation whatsoever. It is simply their belief. The Applicant has filed with this Board no evidence to support that belief. Legally speaking, the Board therefore has no evidence on which to form a belief that the current rates for the acquired LDC customers are not just and reasonable, and thus has no legal basis on which to restructure those rates.

7.7.16 It is therefore submitted that the Applicant has posited two reasons for harmonization – administrative efficiencies, and reduction of cross-subsidization – but has led no evidence to demonstrate that these problems exist and must be corrected.

7.7.17 ***Proposed New Rate Classes.*** The Applicant has proposed rate classes for residential, GS<50 and GS>50 that are similar in structure to the standard rate classes used by many other LDCs [Tr.4:12], except that in each case there are parallel classes based on density [Tr.5:159]. In the general service classes, which concern schools, there is a general service energy billed (ie. <50KW) and an urban general service energy billed, then a general service demand billed (ie. >50KW) and an urban general service demand billed. The same tandem structure is proposed for residential.

7.7.18 For all of these pairs, the distinction is a two-fold test: a) there are at least 3,000 customers in a geographic area, and b) there are at least 60 customers per km. of line [Tr.5:159]. While this test applies to both residential and general service customers, in fact it is the residential customer numbers that control whether a given area qualifies as urban [Tr.5:160].

7.7.19 There are two problems with this. First, there is no evidence that density is the appropriate differentiator of cost responsibility. While it may well be, the proper way to determine the differentiator is by study and investigation, not by guesswork. No study or investigation was done, so the Board has no way of knowing whether the assumption that costs vary based on density (more than they vary based on other factors) is correct. The purpose of establishing classes is to group like customers together based on cost responsibility [Tr.5:73-74 and Tr.5:176]. Picking the right differentiating attribute is the first step in doing that.

7.7.20 Second, even if density is the most important reason that one group of customers has different costs to serve than another group, some test of how to apply that differentiator is required. There could be any number of ways density could be measured to identify the proper break point between cost responsibilities.

7.7.21 Hydro One has proposed a 3,000/60 test. The Board has been provided with no evidence on why this test is appropriate. The witness thinks it was introduced in 1996, but provided no details on the basis for this test, and doesn't in fact know why the test is being used today. "It is still the same test that has been approved before" [Tr.5:163]. In fact, the Applicant has made clear [Tr.5:159-160] that it has not considered any other test to distinguish between more dense and less dense customer groups. It leads no evidence on why this is a good test, or at least better than any alternatives. In fact, it doesn't even tell the Board what the alternatives are, because it hasn't made any effort to identify them. It relies solely on the fact that this test has been "approved" by this Board before [Ex. G2/1/1 p.2].

7.7.22 So we looked for a decision of this Board in which this test was discussed. We have not been able to find one. It would appear to us, based on that review, that this Board has in fact never put its mind to whether this test is an appropriate test to distinguish between one supposedly homogenous group – urban residential and/or general service customers – and another suposedly homogenous group – non-urban residential and/or general service customers.

7.7.23 In fact, the timing of the introduction of this test for residential customers, in 1996, suggests that it was not in fact based on cost responsibility. This test was in fact introduced at a time when Hydro One was actively resisting attempts by municipalities like Ottawa and others to annex suburban areas for their LDC, and one of the selling points for annexation was lower rates. It is in fact true that the introduction of the lower residential rates for urban customers co-incided with that time period, and the 3000/60 test covers most suburban areas around cities, and a few larger towns, but excludes hundreds of smaller towns that would still, common sense suggests, have much lower costs to serve than rural areas.

7.7.24 It is submitted that the proper way for a major utility to design rate classes is by doing its homework. That can involve an analysis of the drivers of costs, to determine whether there are natural break points in those costs. It can involve a review of what other utilities, in other jurisdictions, have done to deal with the same issue. It can involve a review of the extensive literative on rate classification and the design of new rate classes. And, it can involve a review of the many other LDCs in Ontario, who service customer bases very similar to some or all of the acquired LDCs.

7.7.25 But in this case, none of this was done. Hydro One did no analysis of the appropriate rate classes. It instead assumes density is the appropriate differentiator without any study, and applied an existing density test it is using for a different rate class – and on which it has no empirical data to show why it is appropraite - to new rate classes, and did not consider in any way whether this approach was appropriate, either for the new rate classes, or even for the rate class to which it already applied.

7.7.26 We note that customer density may in fact be the best way to distinguish between urban and non-urban customers. We suspect investigation would bear that out. Indeed, the 3000 customer and 60 customer per km. dual test may in fact be the best test for the difference, although we think that is unlikely. The problem is that this Board has no way of knowing whether either conclusion is true or not. <u>No evidence has been filed to show</u>

(a) that costs are driven in a manner fairly identified by this differentiator or this test,

(b) that the customers in each of the classes have any reasonable degree of homogeneity, or

(c) that inter class subsidies would be increased or decreased by this distinction.

7.7.27 It is therefore submitted that Hydro One, having made the initial mistake of failing to ask the question "Do we really have a cross-subsidy problem between legacy and acquired at all?", compounded it by assuming that the problem existed, and then by creating new classes without any analysis or study of what new classes would be appropriate. That lack of analysis meant that they first failed to make a distinction between urban and non-urban general service customers, and then, when they did, they did it on a basis that has no evidentiary or analytical foundation.

7.7.28 It is submitted that, as a matter of law, this Board cannot set just and reasonable rates in the absence of an evidentiary basis. Where an applicant proposes rate classes and fails to provide evidence supporting the design of those classes, it is submitted that any rates based on those classes cannot be said to be just and reasonable.

7.7.29 In Argument in Chief, Mr. Rogers once more repeats the mantra of improving cost responsibility and reducing cross-subsidization, but does not refer to any evidence backing that up. In its Reply Argument, we invite Hydro One to take its best shot at answering the questions on customer classification set out above. We invite them to show the Board the basis on which density is proved to be the correct differentiator, and we invite them to show the Board the evidence showing that the 3000/60 test is based in fact, rather than politics. And when the Board reads that Reply, we will ask the Board to pay careful attention to sorting the evidence from the rhetoric. We believe that in doing so the Board must conclude that, if it must decide whether to approve these new rate classes based on evidence, it is unable to do so because the evidence is just not there.

7.7.30 ***Cost Allocation– Approvals Sought.*** How many times during the course of this proceeding did we hear the Applicant tell this Board that it used the Board-approved cost allocation methodology to develop the harmonization plan? How many times did the Applicant tell this Board that it is the Board-approved methodology that is telling the Board that the acquired LDC customers are undercontributing? Mr. Rogers does this again in Argument in Chief [Tr.7:33]. Saying “The Board has already approved the way we are doing this” is no substitute for evidence, and that is particularly true when the statement is wrong on its face.

7.7.31 The method by which Hydro One proposes to allocate costs as between urban and non-urban classes – the guts of the harmonization impacts - has not been approved by this Board in any proceeding or process. Hydro One apears to be seeking approval of this method in this proceeding [Ex. A/2/1 p.5, wherein Hydro One seeks approval of “the modifications to the OEB cost allocation model as discussed in Exhibit G2, Tab 1, Schedule 1”].

7.7.32 In Exhibit G2, Tab 1, Schedule 1, Hydro One says at page 1 “Hydro One modified the OEB Cost Allocation model to take into account density aspects…”. However then it goes on deal with that and other modifications to the OEB Cost Allocation model in two sections: “Density Weighting Factors” and “Modifications”.

7.7.33 Under the former section, at page 2, the Applicant says:

“Density factors have been incorporated as weighting factors for Overhead lines and Transformers, consistent with the customer classes approved by the OEB that are based on Density definitions. The Density definitions have also been approved by the OEB.”

7.7.34 In fact, none of the proposed customer classes has ever been approved by the OEB, and two of them – UGDemand and UGEnergy – are not similar to any previously approved class. Urban residential is similar to a previously approved legacy customer class.

7.7.35 Further, as noted above the definition used for the previous urban residential class has never been reviewed in detail by this Board. It was approved without review in past rate cases.

7.7.36 However, then Hydro One goes on to note that allocating the cost of lines based on density was done by "assigning the total distance of the feeders to the various customer classes proportionally".

7.7.37 This would appear to be contrary to the direction in the Board's Report "Cost Allocation Informational Filing Guidelines for Electricity Distributors" dated November 15, 2006. At page 39 of that document, the Board said "A linear density-to-cost assumption is not acceptable without a supporting justification." If the Board looks at Hydro One's filing, what it will find is that no supporting justification is provided. It is worse. Hydro One is not in fact using the same density weights today that it used in its informational filing [Tr.5:49]. The Board does not have detailed information on why this was changed, or even whether it matters. What we know is that the Applicant still has no justification for using a linear density to cost assumption.

7.7.38 The same proportional allocation was used for Transformers, as set forth later in that page.

7.7.39 The implication of the Applicant's filing G2/1/1 is that the modifications to deal with density are already Board-approved, and that is consistent with the fact that the next section, entitled "Modifications", does not include any reference to density in the modifications it discusses. Further, in a subsequent section, beginning at page 5, entitled "Model Changes", the term density does not appear anywhere in its several pages.

7.7.40 This implication is also consistent with the direct evidence of Hydro One on this point, where they said:

"Hydro One has used the OEB cost-allocation methodology which we have modified to take into account Hydro One's customer classes. For instance, we added subaccounts and the related cost allocators to accommodate the sub-transmission system currently referred to as the low voltage system or LV system." [Tr.4:13]

7.7.41 Later, during cross-examination, this was repeated, with no reference to density changes until that was actually put to the witness. In this interesting exchange, the witness starts with the use of an approved Board cost allocation methodology, and ends up admitting that the key item under discussion, ie. allocations based on density, are to be approved by this Board in this proceeding.

"[MR. SHEPHERD:] And you've said, you said a number of times that you're using a recognized methodology; is that right? The Board-approved methodology.
MR. ROGER: Correct.
MR. SHEPHERD: Okay. But, in fact, you changed the Board's methodology; right?
MR. ROGER: We modified the methodology to reflect that we have a sub-transmission system, the LV system, but the intent of the model is being kept: Of trying to track assets and assign those assets to the customer classes that utilize them.
So the modifications are minor, to reflect our unique circumstances. The rest of the model is still the same.
MR. SHEPHERD: So the Board's model has a density test?
MR. ROGER: The Board model allows for density tests.
MR. SHEPHERD: Nobody else in the province uses a density test, only Hydro One; right?
MR. ROGER: Correct.
MR. SHEPHERD: So, in fact, the density test is something that Hydro One developed for Hydro One; isn't that true?
MR. ROGER: And that has been approved by the Board previously. We did not change it to this, in this submission. It is still the same test that has been approved before.
MR. SHEPHERD: No, sorry. Let's just back up a stage. The test you are using, 3,000 customers, 60 customers per kilometre, has been approved by the Board. True?
MR. ROGER: True.
MR. SHEPHERD: The cost allocation decisions you have made, about how you allocate based on density, that has never been approved by the Board, has it?
MR. ROGER: The density --
MR. SHEPHERD: Cost allocation now.
MR. ROGER: The density weights that we are applying are presented here as in evidence, how we developed them. And they're used to allocate costs to the various customer classes.
MR. SHEPHERD: Okay. So the allocation between urban classes and general classes within your residential or within your general service levels, those allocations between urban and non-urban, this Board has never reviewed them. This Board as never approved them, have they?
MR. ROGER: These would be the proceedings to approve them.
MR. SHEPHERD: Exactly. So in the context of allocating between those areas, this is not a recognized methodology at all, is it? This is new.
MR. ROGER: The old rates that Ontario Hydro have for a retail system also have density weights to develop the rates for urban residential, R1, and R2 customers.
MR. SHEPHERD: My question is about cost allocation, not about rate class design or classification. The cost-allocation methodology is not recognized methodology, is it?

It's new.
MR. ROGER: The cost-allocation methodology is a one established by this Board and we modified it to take into account the density rates, and the sub-transmission system.
MR. SHEPHERD: Okay. So when I asked you earlier whether you modified it, you said the only modification you made was the sub-transmission system. That wasn't true, because, in fact, you also modified it to add density; isn't that right?
MR. ROGER: That's correct." [Tr.5:162-164]

7.7.42 To the best of our knowledge, this is the only reference in this proceeding in which Hydro One directly requests the Board's approval of its cost allocation methodology based on density. In every other place where the Applicant refers to its modifications to the cost allocation methodology, it is careful to refer to sub-transmission, but not to density.

7.7.43 It is submitted that this Board should not approve this modification to the cost allocation methodology currently in use by the Board, for two reasons. First, because of how it was presented to this Board, this Board has not had an opportunity to review it in any detail. Second, for the reasons set forth below it is likely to be wrong.

7.7.44 ***Cost Allocation– Original Proposal.*** We note that Hydro One did not originally plan to make any distinction between general service customers in the towns and in the rural areas at all. They are proud of saying, in their direct evidence:

"Originally we proposed ten customer classes but based on feedback received at the stakeholder session, we added two more classes, urban general service energy, and demand billed."[Tr.4:12]

7.7.45 Indeed, there is no question that Hydro One uses stakeholdering extensively, and listens during those sessions. They cannot be criticized for that. (We note that they can be criticized for letting their counsel, at Tr. 7:33, engage in hyperbole by referring to "its customers who are actively engaged in the development of the new rate classes." Would that were true!)

7.7.46 But the other side of this is that they originally planned to lump urban general service customers in with rural, with no thought as to whether that would result in sensible rate classes or rates based on cost causality. Indeed, Hydro One was fully aware that the customers in the acquired areas were more urban and less rural than the legacy customers, so it made little sense to lump them all together, especially while at the same time breaking residential customers up between urban and rural.

7.7.47 It is submitted that, when this Board is considering whether to give them the benefit of the doubt on their woefully inadequate cost allocation and rate design proposals for harmonization, this Board should remember that if it had not been for ratepayer input, they would have thought it perfectly OK to bill urban general service customers at the same rates as rural general service customers. The lack of fairness inherent in that structure simply did not occur to them. In our submission, the current proposal is, for different reasons, equally unfair, as we set out below, and the sequence of events demonstrates that Hydro One has not committed itself in this process to the sort of intellectual discipline that would produce a good plan. Indeed, the fact that it went in a very short time from a plan that lumped everyone together to a plan that used an existing and undocumented test to differentiate customer classes is further demonstration that no serious analysis was done.

7.7.48 ***Cost Allocation– Cost Causality.*** Hydro One agrees that costs should be allocated based on cost causality [Tr.4:46], and many times during the proceeding they argued that the harmonization plan was targetted at improved tracking of cost causality [Tr.4:13, 34, 36]. In Argument in Chief, the Company again emphasized this goal [Tr.7:34]. It is submitted that, while accepting the goal, the Company has made no serious effort to meet it in the cost allocation proposal it has made to this Board.

7.7.49 The proper way to establish a new rate structure is to investigate how costs are caused by the customers affected, and select both rate classes and a method of allocating costs to those classes that fairly tracks the amounts customers pay to the costs they cause. The key here is that rates cannot be set capriciously. They must be set after due consideration of empirical data on the costs customers cause.

7.7.50 In this case, Hydro One has done no study or analysis of whether the rates being charged to the acquired LDC customers are covering the costs they cause [Tr.5:164, Tr.5:188, Tr.4:103, and several other places].

7.7.51 In fact, it is worse than that. The Applicant modified the Board's cost allocation methodology precisely "to better reflect cost causality" [Tr.4:36], but in fact did no cost allocation study or analysis as to what cost allocation method would best reflect cost causality.

7.7.52 Despite having not done any analysis or study of the costs caused by the acquired LDC customers, Hydro One has testified before this Board under oath as follows:

"That refers to the results of the cost allocation, and when you compare that versus the rates, it shows that the acquired LDCs are not paying their fair share of the costs." [Tr.4:103]

That is, Hydro One has not done any review of the actual costs being caused by the customers in the acquired LDC areas, but has instead assumed both class definitions and cost allocation method without any analysis, and based on those assumptions has done a cost allocation that shows that acquired customers are undercontributing. The conclusion is based on a false premise, one that builds in the result, ie. it begs the question in an obvious way. Instead of assuming the result, Hydro One should have investigated the facts, and thus found the correct result by analysis and study.

7.7.53 The key to understanding the flaw in Hydro One's reasoning lies in the following statement by their main witness on this point:

"MR. THOMPSON: So what's driving the disproportionate increase of costs to acquired customers?...
MR. ROGER: The explanation is that their rates are low compared to our legacy rates. Their rates are not based on cost of service study. So the rates, to begin with, are much lower than our legacy rates, but now they're getting the same service from us, <u>same customer service</u>, <u>using the same assets</u>, and now we have a cost allocation study that allocates those costs to the customer classes." [Tr.4:105] [emphasis added]

7.7.54 This is the reason why Hydro One thought it was perfectly OK to charge a customer in Brockville the same as a rural customer. Hydro One started from the premise that the costs to serve both were the same. This, of course, is patently not the case. They do not in fact use the same assets. They do not in fact get the same customer service, at least in terms of cost. <u>And Hydro One never investigated what those differences would be, because they started from an incorrect assumption that there were no such differences.</u>

7.7.55 Then, when it was pointed out to them in stakeholdering that the costs to serve customers in Brockville are not the same as those to serve a rural customer, Hydro One did not see that as a fatal flaw. Instead of investigating what the costs actually are to serve one group of customers vs. another, they hastily added another two classes without any analysis whatsoever, and figured that the problem was solved. It was not.

7.7.56 Mr. Thompson raised what is the most telling point on cost causality in cross-examination. He sought to determine whether the acquired LDCs were recovering their costs before acquisition. The key exchange is as follows:

"MR. THOMPSON: Is your legacy plant newer than this acquired stuff? Is it gold-plated compared to this acquired stuff?
Is there anything in the costs of legacy versus the net book value of acquired that accounts for this jump-up in rates? Are you telling me the rates being charged by utilities you acquired were recovering less than what those utilities were spending to provide service?
MR. ROGER: The rates of the acquired utilities who are charging their customers were not based on cost-allocation studies, so I cannot say if they were or were not recovering all of their costs.
I think your assumption is that the current rates are based on cost-allocation studies. They're not. They are a result of the unbundling exercise.
MR. THOMPSON: Well my assumption is that -- you know, it's a zero-sum game. My assumption is that acquireds were at least, as a pool, were recovering the costs that

they were incurring to provide service to their customers.
And so I am speculating that their plant must have, on balance, been older than what you folks have or they spent less per kilometre or something like that to account for this jump-up.
MR. ROGER: I think the assumption that the rates were recovering the costs may not be correct for all of them. In some cases, their rates are extremely low, so it is very hard to understand how they could be recovering their costs." [Tr.4:105-106]

7.7.57 It should be noted that neither legacy nor acquired rates were based on any cost allocation studies. But that wasn't Mr. Thompson's point, in any case. Whether or not an individual rate structure was correct, the overall revenue requirement for a given acquired LDC would in general have had to cover the costs to operate that LDC. While there were some anomalies, it is unreasonable to assume – without any evidence or analysis - that, as a group and consistently across the board, the acquired LDCs were not earning sufficient revenue to cover their costs of operation. No evidence has been led to support this, but in fact, unless it is true, Mr. Thompson's point is right, ie. it is more reasonable to assume that they had sufficient revenue requirement to cover their costs of operation.

7.7.58 As we will note later, the best evidence on whether the acquired LDC customers are covering their costs demonstrates that they are in fact covering their costs. Hydro One could have done a costing analysis to assess whether that is in fact the case. In the absence of that work, it is submitted that the Board should rely on the best evidence available, and conclude that the current rates for the acquired customers are just and reasonable.

7.7.59 ***Cost Allocation– Options Analysis.*** Having assumed instead of objectively determined that the acquired LDC customers were not covering their fair share of costs, Hydro One then compounded the problem by proceeding with a cost allocation study without any analysis of the options available to them. The exchange is as follows:

"MR. SHEPHERD: At some point, did you do any internal studies or analyses to determine what is the best way to assign costs between urban and rural customers?
MR. ROGER: Not that I am aware of.
MR. SHEPHERD: How did you come up with this line kilometres as a proxy approach? Was it just the first idea you had? Or did you do an analysis of what your choices were?
MR. ROGER: We thought that best reflected the density differences between different customers.
MR. SHEPHERD: But you didn't actually look at what costs are driven by density, did you?
MR. ROGER: Well, we tried to identify the US of A accounts, which is conductors and transformers to which we are applying the density weights.

MR. SHEPHERD: I haven't asked my question properly. Let me try it again. You didn't look at how your costs are actually affected by density, did you? You assumed that if you use line kilometres, that would be an effective proxy. You didn't study whether it was or not.
MR. ROGER: Correct.
MR. SHEPHERD: Okay. And the OEB cost allocation process didn't do that either, did it? There was no analysis in that process of what the best way was, to reflect the effective density on cost. True?
MR. ROGER: Correct." [Tr.5:173-174]

7.7.60 It is submitted that an Applicant that admits that its proposal is not based on any study or analysis, by itself or the OEB, should not be able to reasonably anticipate approval of that proposal by this Board. Cost allocation methods should not be "something somebody thought up", but should be based on objective analysis of the best method to be used. In this case, no attempt was made to do that.

7.7.61 ***Cost Allocation– Deficiences in the Methodology.*** The problem with the failure to do their homework is made far worse by the fact that, on its face, the methodology Hydro One proposes to use to allocate costs between urban and non-urban customers is intuitively incorrect in at least two ways. First, it is not correct that there is a linear relationship between line length and cost to serve. Second, Hydro One has assumed that almost all costs are the same between urban and non-urban, except for a small subset.

7.7.62 What is the likely relationship between line length and costs? Hydro One posits a relationship in which more kilometers of line means more costs to serve the customers on that line, in a linear relationship.

7.7.63 It is submitted that, in costs that are directly related to line length, such as line maintenance, poles, etc., the relationship is likely to be geometric. The reason for this is that there are two cost variables at work, and they are multiplicative:

(a) *Number of kilometers.* It costs more to maintain two kilometers of line than one. This is the impact that Hydro One has reflected in their methodology.

(b) *Cost per kilometer.* Each kilometer of line in a rural area costs more to maintain than a kilometer of line in an urban area, because of the extra cost of access, vegetation control, the extra costs associated with crews travelling to and from the location to maintain it, and many other factors.

7.7.64 Let us take a simple example, vegetation management. Assume that a crew in an urban area can meet all vegetation management requirements for two kilometers of lines in a single 8 hour working day. The daily cost of the crew is $1000. Thus, the cost per km. is $500. Now contrast the same activity in a rural area. There is more vegetation management to do in that rural area, because it is more overgrown, and it is not as accessible from the road, so the crew can only do 1.6 km in 8 hours. In addition, the crew has to travel one hour from their home base before starting work, so they can only actually work 6 hours in an 8 hour day, so the net done in a work day is only 1.2 km. The actual cost per km. is thus $833. But Hydro One's cost allocation methodology assumes that the cost per km. in both cases is the same. In this example, the two hypothetical crews deal with 3.2 km. in one day, at a cost of $2000, making the cost per km. for both urban and rural customers $625.

7.7.65 What Hydro One's methodology does is adjust for the number of customers on the line (ie. density). For example, if the urban lines have an average of 100 customers per km., and the rural lines have an average of 20 customers per km., the cost allocated to urban is $6.25 each, while the cost allocated to rural is $31.25 each. However, as the example shows, the correct numbers would be $5.00 each for urban and $34.71 each for rural.

7.7.66 Of course, this is only an example, and in fact Hydro One's methodology accomplishes the linear allocation goal in a considerably more complicated manner than the example shows. But the underlying principle is correct, ie. Hydro One assumes a linear relationship between kilometers of line and the affected operating costs. That linear relationship is unlikely to be correct.

7.7.67 In cross-examination, at Tr. 5:170-173, we took the witness through some of these impacts, and he admitted that there are cost per line differentials for various things such as repairs. But although given ample opportunity to show how their linear density factor accounts for those things, he did not. Instead, he continually referred to the linear density factor as a "proxy" for all those other costs, which it clearly is not.

7.7.68 But it is not just a question of positing a linear relationship where the relationship is not linear. It is also a question of what costs are assumed to vary based on density. Hydro One proposes that a very limited group of costs [H/12/66] actually vary based on density, essentially only those related to the building and maintenance of the physical system.

7.7.69 Of course, there are many other costs that may vary based on density Consider customer care costs. Is it more expensive to collect from a rural customer than an urban customer, because of the distance that needs to be travelled? Probably. What about emergency calls? In fact, it is possible to go down the list of USofA accounts and identify dozens that could vary based on density.

7.7.70 We do not suggest that these, or any other specific costs, vary based on density. Instead, we submit that some costs that are not differentially allocated in the Hydro One proposal probably do vary based on density, <u>but this Board has no way of knowing because the Applicant did no analysis and has filed no evidence on this.</u>

7.7.71 We note that we have only raised two deficiencies here. In fact, a proper study could well find many others. This Board cannot determine what additional flaws in the analysis might be uncovered, because no attempt was made to do any analysis of how to allocate costs based on density.

7.7.72 ***Cost Allocation– What Evidence Is There?*** It is submitted that the only evidence before this Board that could help the Board assess whether the customers in the acquired LDC franchise areas are bearing their fair share of costs can be summarized as follows:

(a) *Historical Reconstruction.* The Board can assess whether the current rates in the acquireds cover their costs by going back to the last time they did cover their costs, and working forward.

(b) *Comparative Analysis.* The Board can look at the current rates of LDCs that have similar characteristics to the acquired LDC franchise areas, to determine some rough benchmark costs to serve such customers.

7.7.73 *Historical Reconstruction.* We have alluded earlier to Mr. Thompson's pursuit of the question of whether the acquired LDCs were covering their costs before they were acquired. Logically, it is more likely that they were covering their costs than they were not, because the alternative is that they were losing money and somehow being subsidized, presumably through municipal tax revenues. While that is possible, there is no evidence to suggest that it is true, and it does seem improbable [see Tr.5:186].

7.7.74 But whether or not that was universally true, what is true is that Hydro One's proposal necessarily implies that the acquired LDCs' collective revenue requirements were signficantly less than their costs, by a percentage equal to the percentage increase in distribution revenue Hydro One is currently proposing for the acquired LDC customers today.

7.7.75 This is true because, starting from the revenue from the acquireds at the time of acquisition, Hydro One has adjusted the rates from those customers each time its own revenue requirement has been adjusted, by an amount similar to the adjustment to the legacy customers [Tr.4:109]. Unless there were specific anomalies (and there is no evidence in the record of any such anomalies), the mathematical result of increasing the rates of the acquireds at lock step with the legacy customers is that the acquired customers must currently be covering the same percentage of their costs as they were when acquired, except for changes from:

(a) Changes in numbers of customers or charge determinants between then and now and are different for legacy vs. acquired. For example, if acquireds have had higher growth, for example, then it is likely that economies of scale in serving them have

not been fully reflected in their rates, and their revenue to cost ratios have gone up. There is no evidence of any such affect at Hydro One.

(b) Increases in the costs to serve acquired customers that are greater than the increases in the costs to serve legacy customers. No evidence has been led to suggest that has happened, and it appears to be counter-intuitive in any case.

7.7.76 In the absence of either of these two affects, it is submitted that if the acquired LDCs' overall average revenue to cost ratio prior to acquisition was, say, .99, it is likely to be still close to .99 today.

7.7.77 The reason this is critical information is that the total increase in distribution revenues being proposed for the acquired LDC customers is very substantial, probably 30% or more. For this to result in just and reasonable rates, it would be necessary to conclude that the overall revenue to cost ratios of the acquired LDCs prior to acquisition was under by a similar amount, e.g. an RTC of .70 at that time. That many millions of dollars of undercontribution by the customers of this many utilities would have been, it is submitted, a major problem at that time. Could it have been the case? Yes, it is possible, but in the absence of any evidence that it was, it is more reasonable for this Board to conclude that such a massive undercontribution to costs by the customers of, say, Brockville PUC, did not occur.

7.7.78 However, if the Board concludes that the acquired LDC rates were in general covering theirs costs then, as logic and the evidence would suggest, the necessary conclusion is that to increase their rates today by so much would result in their new rates generating substantially more revenues than the costs they cause.

7.7.79 *Comparative Analysis.* If it is not possible to look at what actual costs are caused by the customers in the acquired LDCs (or by the urban customers, if the division is done that way), then another way to determine whether the current rates are covering the costs to serve those customers is through benchmarking.

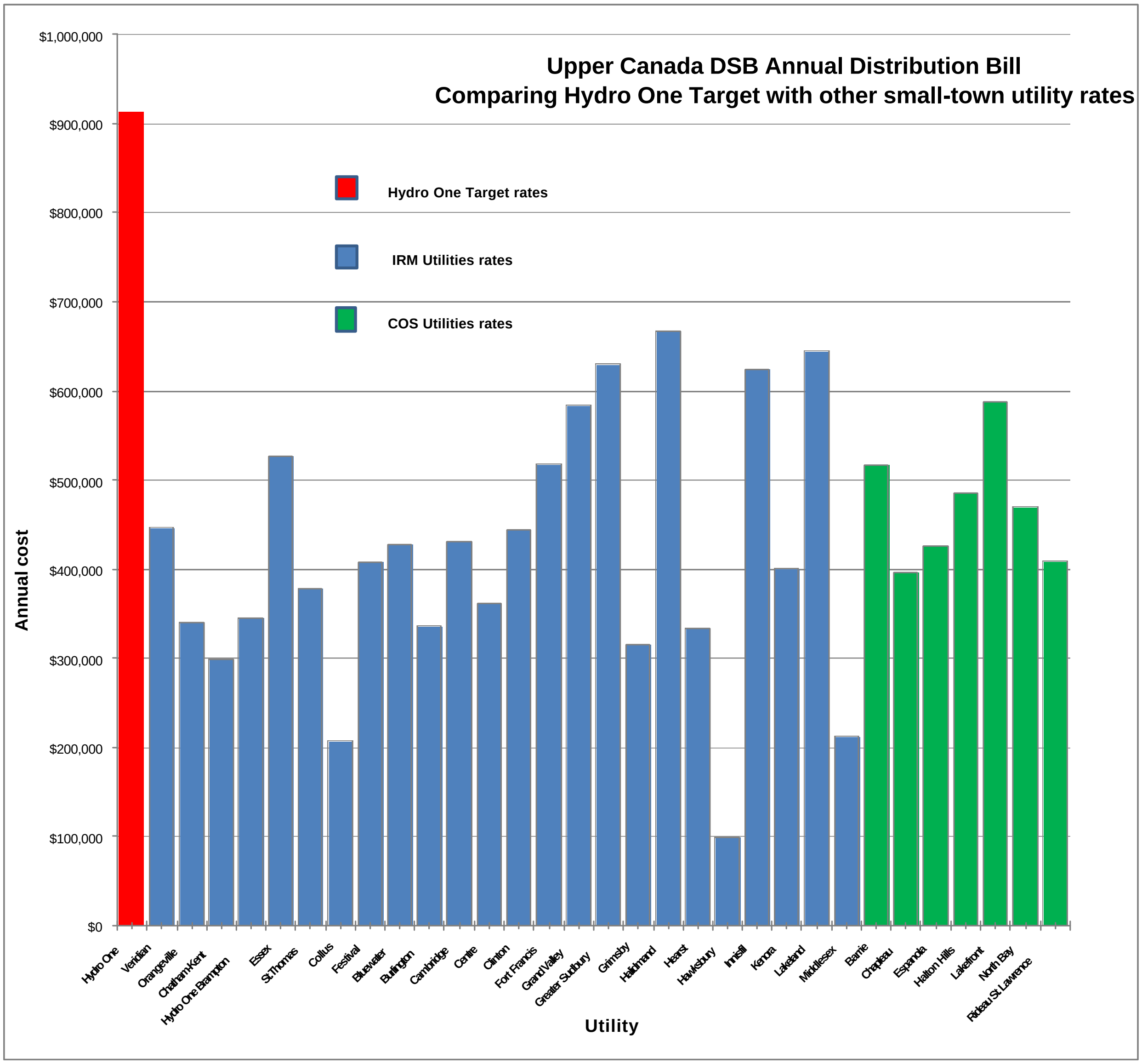
7.7.80 As we have seen in the Board's recent benchmarking consultation and study, benchmarking is a complex process in which many factors are at play. We do not suggest that any formal or disciplined benchmarking has been done in this case.

7.7.81 However, SEC did file Exhibit K5.7, which takes Hydro One figures from Exhibit H/13/66, Revised, and calculates the impacts of the proposed harmonization plan on 94 schools in the Upper Canada District School Board, with varying levels of actual demand and energy requirements, and coming from a number of different acquired LDCs. As noted by Hydro One [Tr.5:178], the calculations of annual distribution bills for the schools involved are based on actual 2006 consumption data from Hydro One's records, and were calculated by Hydro One, not by SEC. What those figures show is a reduction in the annual bills for the 40 schools in the legacy areas of 7.6%, an increase in the annual bills for the 54 schools in the acquired areas of 81.1%, and an overall annual bill increase of 31.3%, ie. an increase of about $218,000.

7.7.82 SEC included in the original exhibit comparative annual bills for those same schools using the rates for three other comparable utilities: Veridian, Chatham-Kent, and Orangeville. Hydro One complained that the rates of those utilities might not reflect their costs of service, because they had not yet gone through a cost of service rebasing application [Tr.5:133]. We therefore have attached an update to Exhibit K5.7, which is unchanged on the Hydro One, Veridian, Orangeville, and Chatham-Kent numbers, but adds a further 28 LDCs rates for 2008, including both IRM and COS utilities. A full spreadsheet showing all calculations has been filed with these submissions, and provided to Hydro One.

7.7.83 **Because the full spreadsheet we have provided to the Board and to Hydro One contains information identifying individual schools by name and usage, we ask the Board to treat the full spreadsheet as a confidential document, to which the Board's Guidelines on Confidential Filings would apply.**

7.7.84 The updated K5.7 shows the following comparison for the sample of GSenergy, UGenergy, GSdemand, and UGdemand customers that comprises Upper Canada District School Board:



7.7.85 What can be seen from this chart, and from the detailed figures in the attachment, is that none of the 31 comparators, comprising about a third of all Ontario LDCs, have bills even close to the bills that Hydro One alleges cover the costs that these customers cause to Hydro One. In fact, the highest of the comparators is just slightly less than the existing rates applicable to these customers.

7.7.86 The Board can legitimately question whether this information is sufficiently rigorous to base cost allocation and/or rate design decisions. In our view, it is not. As noted earlier, the only appropriate way to determine the costs caused by an identifiable customer group is by a specific analysis of those costs in a disciplined way. But, that has not been done.

7.7.87 Further, we note that it is Hydro One that posits that the acquired LDC customers must be undercontributing <u>because their rates are so low</u>. This is not SEC's test. It is Hydro One's test, and indeed it is the only evidence they have offered this Board that acquired LDC customers are not paying their fair share relative to their costs.

7.7.88 It is therefore appropriate, it is submitted, for this Board to take them at their word, and test whether the proposition "their rates are too low" is correct. Hydro One could have profferred evidence as to the costs that should be borne by these customers, to demonstrate that those costs exceed their current rates. They did not do that.

7.7.89 Instead, Hydro One has said that the evidence supporting undercontribution is the fact that the rates for the acquireds are lower than the rates for the legacy customers. That is, in fact true, but EVERYONE'S RATES ARE LOWER THAN THE HYDRO ONE LEGACY RATES. The reason for that is the rural nature of the legacy customers [see, eg. Tr.5:190]. That does not apply to most of the customers in the acquired LDC areas.

7.7.90 If the issue is whether the rates for the acquired LDC customers are low, any comparison that is made must be like to like. Thus, we have compared the acquired LDC customers to customers in many other small towns around Ontario. The only reasonable conclusion from that comparison is that their rates are NOT too low right now. They are already higher than anywhere else.

7.7.91 It is therefore submitted that, on the basis of the only justification that Hydro One has provided, the evidence before this Board is that the rates for the acquireds are currently just and reasonable, and increasing them substantially in the absence of any cost increase would by definition make them no longer just and reasonable.

7.7.92 ***Impact.*** Hydro One admits that 13% of its customers will have substantial rate increases if its harmonization proposal is approved [Tr4:86], and those high impacts are on the customers in the acquired areas [Tr.4:14]. The impact is particularly painful for low use customers [Tr5:33], who have very high percentage increases even though their dollar increases are low (at least, to Hydro One, who as Hopper Foundry noted in their submissions, think that many amounts are low that are not as low for others).

7.7.93 Notwithstanding their proposal, Hydro One admitted that they were very concerned about the impacts [Tr.4:27], although their solution was not, as we are proposing, to get the numbers right, but rather to forge ahead and just delay the pain on those customer classes most heavily affected.

7.7.94 SEC has filed evidence [K5.7, and previously in L/13/1] to show the substantial impact of the proposed harmonization plan on schools. Schools are more likely to be in towns than in rural areas, as can be seen by the Upper Canada District School Board split. Thus, as in the UCDSB example, it is expected that half of the schools in some of the acquired LDC areas would have distribution bill increases of more than 100%, some approaching 200%.

7.7.95 We further point out that the overall net cost of harmonization to schools in the Hydro One franchise area is projected to be well over a million dollars per year, year after year into the future. This is not an insignificant sum. This is money that would otherwise be spent ensuring that a high school has a music program, and that an enrichment program for advanced students has specialized equipment, and that an energy conservation program can be implemented, or hundreds of other priorities which affect the quality of education in schools.

7.7.96 The Board is aware that the School Energy Coalition's position on rate levels has been consistent for years: 'Calculate the correct rates to reflect the costs we cause, and we will happily pay that amount.' Schools do not want any special treatment. On the other hand, schools do not feel it is fair to have their bills increased on the whim of a utility, not having done its homework, particularly where the increase would take them from being only slightly above the highest rates anywhere else in the province, to very substantially above the highest rates elsewhere. (Part of representing consumers in energy matters is thinking through how to explain Board decisions to them. In this case, we have no idea how we would explain to school boards that their rates, already higher than anywhere else, should be doubled or tripled, but there is no study or analysis or other empirical basis for that increase. If Hydro One wishes to provide some suggestions in their Reply Argument, we would be happy to consider them.)

7.7.97 We note that, in addition to the average and across-the-board increases in bills for acquired customers, which are substantial, there is a separate concern about the highest impacts. It is, frankly, shocking that Hydro One did not do any analysis of those impacts [Tr.4:97,100,102], even though this Board is aware they can be substantial. The only evidence the Board does have is some distribution charts [Ex. G2/2/1], which show many customers with very large impacts, and the SEC evidence, which shows some same general service customers (schools, in this case) with increases of around 200%.

7.7.98 It is submitted that it is not appropriate for this Board to approve substantial rate increases for many tens of thousands of customers, without evidence of, and a plan to deal with, the most serious of the rate impacts.

7.7.99 ***Hopper Foundry.*** The Board heard specific evidence with respect to the combined effect of the harmonization proposal, and the removal of TOU rates, on one small customer in the town of Forest, Ontario, Hopper Foundry. The Chairman, during questioning, referred to this as a "double whammy", and indeed it is.

7.7.100 The evidence of Hydro One is that the primary cause of the increase is the removal of TOU rates. This is not correct. Here are the facts:

(a) Removal of TOU rates causes the monthly demand to increase from 45 KW to 719 KW [Tr.4:66], which at the current per KW charge of $4.44 is an increase of $2,992.56 per month, or $35,910.72 per year.

(b) Increase in the per KW charge from $4.44 to $8.48 is an increase of $2,904.76 per month, or $34,857.12 per year. There is also an increase in the monthly fixed charge, which has a small additional impact.

7.7.101 It is submitted that the Applicant's evidence, which portrays this as a TOU problem, is incorrect. In fact, if TOU rates are ended, but the harmonization plan is rejected, as we propose below, the impact on Hopper Foundry is cut roughly in half.

7.7.102 ***Mitigation***. The Applicant relies heavily on their four year mitigation plan to deal with the many problems in their harmonization proposal. We have two comments on that.

7.7.103 First, and perhaps most obvious, until the Applicant has a plan for mitigating the impact on those most affected, there is no sensible mitigation plan. A plan that doesn't mitigate an increase that will knowingly put a company out of business is not true mitigation, in our submission.

7.7.104 Second, and more important, mitigation only arises once the goal is determined to be correct. It is submitted that this Board must first determine, on the evidence, that the target rates are just and reasonable rates. If it cannot reach that conclusion on the evidence before it – as we believe it cannot – then the topic of mitigation does not arise. There is nothing to mitigate. It is only <u>after</u> the Board determines that the target rates are just and reasonable, that it then has the duty to ensure that the plan to get to the right answer is itself just and reasonable.

7.7.105 It is therefore submitted that, in the context of the evidence before the Board in this case, the subject of mitigation does not arise, because the target rates are not justified by the evidence.

7.7.106 ***What Should the Board Order?*** It is therefore submitted that this Board should not approve the Applicant's harmonization plan. Since the fundamental reason for that non-approval would be lack of evidence justifying it, the Board is not in a position to approve a modified version, or to approve a partial solution. Either the Applicant has filed sufficient evidence on which to approve a harmonization plan or some kind, or they have not. It is submitted they have not.

7.7.107 That having been said, we continue to support the principle of harmonization, as does the Board. But the fact that the goal is a good one does not mean that a bad plan should be approved. If we all agreed, for example, that increased vegetation management is a good idea, and Hydro One proposed Agent Orange as a quick and easy solution, it would not be appropriate to approve the plan because "increased vegetation management is a good idea".

7.7.108 We believe that the Board in its decision, in addition to rejecting the plan, should do two things:

- ***(a)*** Provide the Applicant with guidance on what the Board would like to see in a harmonization application, eg. studies on class design, cost allocation drivers and methodologies, and impacts. We recognize that the Board attempted to do that in the 2006 Decision, and ended up with a proposal that is still woefully lacking, but we believe that if this Board is more specific in its criticisms, in light of the discussion that has taken place throughout this proceeding, Hydro One will likely be in a position to present a more sophisticated and acceptable plan to accomplish the harmonization goal.

- ***(b)*** Invite the Applicant to apply in 2009, outside of a rate case, for harmonization of its rates as between its various customer groups. This would not only have the advantage of giving Hydro One time to do the studies and analysis necessary to ground a proper plan, but it would also allow this Board to consider the harmonization plan on its own merits, separate from the complications of cost increases and other rate case distractions

7.7.109 We note that, in proposing denial of approval, we are dealing only with the basic harmonization plan itself. There are a number of implications of this, including the following:

- ***(a)*** The Applicant has proposed a distributed generation rate. This is consistent with Board policy, and is not affected by the harmonization plan.

- ***(b)*** The Applicant has proposed a sub-transmission rate, and other changes not affecting the general service classes in the acquired and legacy areas. We have no specific submissions on whether those changes are appropriate or not, but we see no reason why those changes must be delayed pending the work that needs to be done to produce a proper harmonization plan for residential and general service customers

7.7.110 We anticipate that Hydro One will argue that it is too complicated to revert to anything close to its existing rates, ie. it has come too far down the harmonization path, and that train can no longer be stopped. With respect, this is not true. In fact, the revenue requirement being sought in this proceeding has already been allocated to the old classes [Tr4:93], and it is not a difficult task to make the smaller number of adjustments necessary to implement changes that do not affect the residential and general service customers.

7.7.111 We note that we are not proposing that this be delayed for many years, or scrapped entirely. We are, instead, proposing that Hydro One go back, do their homework, and come to this Board next year with a proposal that has a real evidentiary base. Assuming some form of harmonization is indicated when the empirical work is done, it can be implemented less than eighteen months from now.

7.7.112 ***Conclusion.*** In summary, in determining whether to approve the harmonization proposal, the Board should ask and answer three questions:

1. **Has Hydro One filed evidence on which the Board can determine that the acquired customers' rates are too low?** It is submitted that the answer to this question is no, and the necessary implication is that this Board has no basis on which to order that the rates for the acquired customers be increased. The only evidence that has been filed to this effect is the cost allocation study, but as noted previously that study assumes that the problem exists, and thus adopts class definitions and cost allocation rules that will necessarily produce that result. It is circular, and thus of no value to this Board. No study of any type was done of whether the customers in the acquired communities are covering the current costs to serve them, and the only evidence this Board has, comparisons with historical revenue requirements, and comparisons with like utilities, are uniformly consistent with the conclusion that the current rates for the acquired customers are just and reasonable.

2. **Has Hydro One filed evidence showing that their proposed new customer classes group like customers together based on cost causality?** It is submitted that the answer to this question is also no, as Hydro One has admitted that a) they did no study or analysis to determine how the cost to serve customers in towns differs from the cost to serve customers in rural areas, or to determine what an appropriate break point or test would be if density is in fact the appropriate differentiator, b) their original proposal would have lumped town GS customers in with rural GS customers, even though they had already recognized this was inappropriate in the case of residential customers, and c) their proposed result would allocate to GS customers in Hydro One towns by far the highest cost to serve of any Ontario LDC, without any evidence that their cost to serve is in fact higher than towns served by other LDCs.

3. **Has Hydro One filed evidence showing that their proposed method of using density to allocate costs between customer classes is an appropriate allocator, and captures all costs that vary by density?** It is submitted that the answer to this question is also no. Hydro One admits they did no study or analysis of any type to determine if their proposed density weighting method is correct, and we have provided simple examples to show that it is likely not correct, in more than one material way.

7.7.113 It is submitted that, if this Board answers any one of these three questions with a "no", then it is inappropriate for this Board to approve the harmonization plan. Since, in our submission, the answers to all three questions are "no", approval of this plan would be contrary to this Board's ratemaking principles, and would result in rates to customers in the acquired LDC areas that are not just and reasonable, and are therefore contrary to law.

7.7.114 It is submitted that the Board told Hydro One in 2006 that a harmonization plan should be prepared, but only based on certain key principles:

"A harmonization plan needs to be supported by evidence that harmonization is necessary and the rates, which result from harmonization, will be reasonable. While the Board supports the harmonization of distribution rates in principle, the timing of harmonization is important. This is particularly true when the applicant is requesting approval for a harmonization process with significantly high bill impacts extending over a two year period.The Board finds that Hydro One's proposed rate harmonization plan for the Acquired LDCs is premature. There is insufficient evidence to determine that resulting changes to individual Acquired LDC customers would be fair and reasonable based upon costs."

We think that the Board should reiterate that advice, but provide additional guidance on how Hydro One should follow those principles in producing a viable plan.

7.8 *Rate Impact Mitigation Plan*

See our submissions under Issue 7.7 above.

7.9 *Retail Transmission Service Rates*

Settled Issue.

7.10 *Proposed Rate Rider #3*

No submissions.

8 SMART METERS

8.1 *All Issues 8.1 through 8.5*

8.1.1 We adopt the submissions of CCC on the recovery of Smart Meter costs and the continuation of appropriate smart meter deferral accounts.

9 OTHER MATTERS

9.1 *Effective Date of Rate Order/ Deficiency Recovery*

9.1.1 The Board will be aware that the School Energy Coalition generally opposes retroactive recovery of deficiencies by LDCs unless there is some good reason why their rate order was not timely.

9.1.2 In this case we believe that Hydro One failed to file a complete application when they were directed to do so, August 15, 2007, and it took a further four months for them to complete their filing. While this was in part because they wished to phase their proceeding, the fact is that they did not comply with the Board's direction. If this were any other year, we would take the position that Hydro One should have new rates set only from the date of the order, and should not recover any deficiency in the meantime.

9.1.3 However, in light of the complexity of this application, and the extensive stakeholdering that Hydro One did prior to filing, it is our view that in this case an exception should be made, and Hydro One should be allowed to recover any deficiency from May 1, 2008 onward.

9.1.4 We submit that the appropriate way to handle any deficiency or sufficiency for the period from May 1, 2008 to the date rates are actually changed is to calculate the rates as if they were being implemented May 1, 2008 (so they are correct on a going forward basis into IRM), and determine the difference for the interim period between revenues at the new rates and revenues at the existing rates. That difference should be collected through a positive or negative rate rider, to end December 31, 2009. We would normally propose a rider ending April 30th, but given that the rider would not likely start until November or December, we believe that spreading it over the longer period is appropriate.

9.2 *Costs*

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

9.2.2 In the context of the ADR, oral hearing, and final argument, we note that active cooperation and allocation of responsibility by the intervenors caused the process to be more efficient than it otherwise might have been, with different intervenors taking the lead on different issues, to maximize productivity. While the case ended up being very complex, the oral hearing was handled with considerable efficiency, and argument has been done with excellent co-operation between parties.

All of which is respectfully submitted.

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