August 18, 2008

BY EMAIL & COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Dear Ms. Walli:

Board File No. EB-2007-0681
Hydro One Networks Inc. – 2008 Rates Rebasing Application
Argument of Energy Probe

Attached please find two hard copies of the Final Argument of Energy Probe Research Foundation (Energy Probe) in the EB-2007-0681 proceeding. An electronic version of this communication will be forwarded in PDF format.

Should you require additional information, please do not hesitate to contact me.

Yours truly,

David S. MacIntosh
Case Manager

cc: Glen MacDonald, Hydro One Networks Inc. (By email)
D.H. Rogers, Q.C., Rogers Partners LLP (By email)
Peter Faye, Energy Probe Counsel (By email)

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EB 2007-0681

ONTARIO ENERGY BOARD

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

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

Final Argument On Behalf Of

Energy Probe Research Foundation

August 18, 2008

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Final Argument On Behalf Of
Energy Probe Research Foundation

How these Matters came before the Board

1. As part of its regulation of the electricity distributors, the Ontario Energy Board established a multi-year electricity distribution rate setting plan, which indicated that, commencing with the 2008 rates, each year a limited number of distributors would be identified and if any of them sought a general change in their distribution rates, the application had to be based on Chapter 2 of the Board's Filing Requirements, issued November 14, 2006 (EB-2006-0170). This required the distributor to submit a forward test year, cost of service based application.

2. On May 4, 2007, the Board identified a list of electricity distributors that would be subject to this process, should any of them seek changes to their distribution rates for 2008. The letter requested that each of these distributors file a letter with the Board confirming they will file a forward test year rate application by August 15, 2007 for rates to become effective May 1, 2008.

3. On August 15, 2007, Hydro One Networks Inc. (the "Applicant" or "Hydro One", filed a partial Application to support its 2008 revenue requirement request and indicated that a second portion would be filed in October 2007 to support its 2008 customer rates.

4. By letter of September 6, 2007, the Board requested additional material from the Applicant relating to the harmonization of rates for Hydro One's acquired distribution customers, cost allocation and rate design to support the 2008 Application, resulting in a more complete filing to the Board on December 18, 2007. Subsequently, on January 14, 2008, a Notice of Application and Hearing was issued.

5. Energy Probe Research Foundation ("Energy Probe") participated in a series of three Stakeholder Consultations undertaken by the Applicant during the summer and fall of 2007 which introduced its plan for its revenue requirement request and filed an introduction to its rate harmonization approach.

6. Energy Probe filed its Notice of Intervention on January 21, 2008, as a full time intervenor and took parting both the Issues Conference of February 13th and Issues Day of February 15th as was ordered in Procedural Order No. 1, issued February 6, 2008. Energy Probe took an active part in the settlement conference.

7. During the Oral Hearing, Energy Probe took an active part, with cross examination of three Hydro One Panels.

Argument Overview

8. The Applicant has requested a total revenue requirement of $1,067 million from its customers for the 2008 test year through a cost of service review by the Board.

9. Of particular concern to Energy Probe is the significant increase in Hydro One's requested OM&A costs for the 2008 test year as compared to the Board approved OM&A for 2006, the last cost of service review for the Applicant. Of more concern is the very significant increase in its requested OM&A costs for the 2008 test year as compared to 2006 actuals.

10. While noting percentage increases in the year to year requests of the Applicant is in itself of less value to the Board Panel than a thorough examination of the cost drivers, if any, of those increases, Energy Probe has been made privy to insightful arguments being put forward by a number of intervenors with similar concerns which undertake just those examinations of cost drivers.

11. There is an observable trend which seems to occur when utilities are preparing for periods of incentive based regulation. Mr. Thompson, counsel for the Canadian Manufacturers & Exporters ("CME"), has on a number of occasions noted that this phenomenon is identified as "base-year stuffing". It occurs when utilities are unwilling to wait until their formal incentive period begins before planning ways to secure their incentive rewards.

12. For that reason, among others, Energy Probe submits that it will be of more value when examining 2008 OM&A requests of the Applicant, for the Board Panel to place greater weight on comparisons to 2006 Board Approved and 2006 Actuals than on either 2007 formula-based approved OM&A costs or 2007 Actuals.

13. In its Argument, Energy Probe will not seek to explore all outstanding Issues before the Board, but will be examining those Issues of concern to Energy Probe where we believe we can be of most assistance to the Board.

COST OF SERVICE

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

Issue 3.2. Is the 2008 vegetation management budget appropriate?

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

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

14. During its consultation with other customer intervenors leading up to the filing of Argument in this proceeding, Energy Probe was given the opportunity to review the submissions of the Canadian Manufacturers & Exporters ("CME") in respect of the Cost of Service Issues listed above. Energy Probe found those submissions to have merit and supports those arguments.

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

15. It is the submission of Energy Probe that Hydro One has taken appropriate initiatives in its 2008 pursuit of Conservation and Demand Management ("CDM") goals. It has been utilizing its $39.5 million 3rd tranche funding over the period from 2004 to 2007.

16. Consistent with the Ontario Government's plan to have the Ontario Power Authority ("OPA") responsible for delivering its CDM targets, Hydro One is relying on the CDM funding from the OPA to fund its own initiatives from 2008 forward. Hydro One's CDM budget for 2007 was $27.3 million, its current 2008 budget, including OPA funding is some $20.2 million with a number of CDM projects awaiting the OPA's approval. The following exchange took place during the questioning of Mr. Stanley But of the Applicant's Panel 4:

> **MR. KLIPPENSTEIN: My questions, Mr. Chairman, are directed to where this trend is going, because there have been significant increases, as you can see in the table, in the budget levels and the savings levels, and then for 2008 we have dropped in the figures we've got, dropped quite dramatically.**
>
> **So we've been making a lot of progress by that criteria and now suddenly we're at sea, and Pollution Probe wants to understand what the problem is and specifically whether there is a solution.**
>
> **MR. KAISER: Part of the problem, I suppose, is there is another 12 million that is in the wings.**[1]

17. Pollution Probe and possibly the Green Energy Coalition are concerned that there is a dramatic drop in CDM funding for the Test Year. The evidence appears to indicate that the Applicant's CDM funding source is in transition from rate base to the OPA. If half of the additional applications to the OPA are funded for 2008, it appears that funding during the transition is more or less flat. Should Hydro One be of the opinion that it has effective CDM programs that are not approved by the OPA, it may come to the Board with a funding application.

18. Energy Probe supports the Applicant's decision not to apply for a Lost Revenue Adjustment Mechanism ("LRAM") for the reasons given.

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[1] Transcript Vol. 4, p. 132

COST ALLOCATION AND RATE DESIGN

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

Issue 7.2. **Is Hydro One's cost allocation appropriate?**

Issue 7.3. **Are Hydro One's proposed rates appropriate?**

Issue 7.4. **Are the proposed revenue to cost ratios appropriate?**

Issue 7.5. **Are the fixed-variable splits for each class appropriate?**

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

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

19. Energy Probe wishes to address the above issues together.

20. During its consultation with other customer intervenors leading up to the filing of Argument in this proceeding, Energy Probe was given the opportunity to review the submissions of the School Energy Coalition ("SEC") in respect of Cost Allocation and Rate Design. Energy Probe found those submissions to be both thorough and insightful, and supports those arguments.

21. In support of the SEC submissions, Energy Probe wishes to draw the Board's attention to an exchange with the Applicant's Panel 4, dealing with Cost Allocation, Rate Design, Load Forecast and CDM, Regulatory Assets, and more specifically with Hydro One Witness Mike Roger. The exchange was focused on the contribution to costs made by Acquired LDCs compared to the costs they incurred within Hydro One Distribution.

> **MR. MacINTOSH: Because until now, they've -- many of them have operated on, basically, rates that were in place when you acquired them, with some increase for work you've done.**
>
> **But you would not have, then, that cost driver of the increase driven by the cost of -- the capital cost of purchasing them?**

MR. INNIS: We would not separately identify that from the overall revenue requirement.

MR. MacINTOSH: Would that also be true of the rate increases for acquired customers that would be result of capital improvements that Hydro One has made to the acquired systems?

MR. ROGER: I think it would require us, if I understand correctly, to have separate accounting for the costs that we are incurring in acquiring LDCs. And we don't do that. We record our costs for the whole system. We don't record costs separately of providing services to the acquired LDCs.

MR. MacINTOSH: That would be the same for OM&A costs for those systems?

MR. INNIS: Yes, that's correct.[2]

22. And again:

MR. ROGER: We have one set of books. We record our costs for both serving legacy and acquired customers in one set of books. We don't separate them.

So I don't think we could just now allocate a portion of the revenue requirement increase to acquired LDCs. We don't treat them separately. They use the same assets. They use the same call centre. So we don't track the costs separately.[3]

23. It is the submission of Energy Probe that additional analysis is required before the Applicant is in a position to determine that acquired customers are undercontributing and are being cross subsidized as a group by legacy customers.

24. In conclusion, Energy Probe submits that the Board should not give approval to the Applicant's harmonization plan, but rather reinforce the Decision given in Hydro One's previous cost of service review, EB-2005-0378, requiring supporting evidence that the plan's result will be fair and reasonable. Energy Probe does support harmonization and thus supports SEC's recommendation that Hydro One bring forward a separate application to deal only with harmonization.

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[2] Transcript Vol. 5, p. 145
[3] Ibid, p. 146

SMART METERS

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

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

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

25. Energy Probe notes that it was an intervenor in both the Combined Smart Meter proceeding EB-2007-0063 and the Toronto Hydro-Electric System Limited ("THESL") 2008 cost of service rates proceeding EB-2007-0680 and wishes to address the above three issues together.

26. Energy Probe does not oppose amount of the Applicant's 2008 smart meter O&M budget per se, nor does it oppose the Applicant's 2008 capital spending for the Smart Meter program. Rather, it is the submission of Energy Probe that the Operating Expenses and Capital Expenditures of the Applicant in respect of the smart meter program should not form part of rates but should receive the same treatment as was provided in the Decision issued May 15, 2008 in the THESL 2008 rates case.

27. A number of proceedings before the Board have dealt with those distributors that were authorized by the Ontario Government to undertake smart meter related installations and supporting activities. Audited smart meter costs to December 31, 2007 have been approved by the Board to go into rate base. Forecasted test year costs are may be tracked in smart meter deferral and variance accounts.

28. **In the Applicant's Argument-in-Chief, Hydro One's counsel, when opining on what his client is asking for, offered a Plan B for dealing with these costs that Energy Probe can support, at least in part:**

> **It asks that all of these costs be approved for recovery as a regulatory asset up to April 30th, 2008 and be included in its core work program beyond that time for recovery as part of its revenue requirement.**
>
> **However, my client is mindful of the Toronto Hydro decision, and we talked about that during the hearing. If the Board chooses to follow the approach which it applied to the Toronto Hydro case, the applicant asks that both minimum and "exceed minimum functionality", in quotes -- functionality costs incurred as of December 31, 2007 be approved for recovery through a rate rider and inclusion of the in-service capital in rate base.**
>
> **All subsequent smart meter costs would be tracked in a deferral account and the interim smart meter rate rider would continue under this proposal.[4]**

29. **The exception is, Energy Probe submits that those smart meter costs which are determined to "exceed minimum functionality" should not be approved for recovery and included in rate base at this time.**

Costs

30. **Energy Probe submits that it participated responsibly in this proceeding. Energy Probe requests the Board award 100% of its reasonably incurred costs.**

ALL OF WHICH IS RESPECTFULLY SUBMITTED

August 18, 2008

[4] Transcript Vol. 7, pp. 24 & 25