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BY ELECTRONIC SUBMISSION AND COURIER

August 28, 2008

Ms. Kirsten Walli
Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON.
M4P 1E4

Dear Ms. Walli:

EB-2007-0681 – Hydro One Networks' 2008 Distribution Rate Application – Hydro One Networks Reply Argument

I have attached three paper copies of Hydro One Networks' reply argument. An electronic text-searchable Acrobat copy of the reply argument has been filed using the Board's Regulatory Electronic Submission System (RESS) and the proof of successful submission slip is attached.

A copy of the redacted form of the Reply Argument is being provided today to intervenors by email. Intervenors who require a paper copy should contact Ms. Namita Moolyil of Hydro One Networks at 416-345-6392 or by email (Namita.Moolyil@HydroOne.com).

Sincerely,

ORIGINAL SIGNED BY DON ROGERS

Don Rogers

Attach.

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Introduction

Hydro One is pleased to file its reply argument in relation to its Distribution application EB-2007-0681.

Following the conclusion of the hearing phase and Hydro One's argument in chief, Hydro One received final argument submissions from the OEB Staff as well as the following Intervenors:

- Association of Major Power Consumers of Ontario (AMPCO)
- Consumers Council of Canada (CCC)
- Energy Probe (EP)
- Power Workers Union (PWU)
- School Energy Coalition (SEC)
- Vulnerable Energy Consumers Coalition (VECC)
- Rogers Cable Communications Inc. (ROGERS)
- Canadian Manufacturers & Exporters (CME)
- Energy Cost Management Inc. (ECMI)
- Pollution Probe (PP)
- Green Energy Coalition (GEC)
- Milton Hydro (MH)
- The HOPPER Foundry (1977) Limited (HOPPER)

Some submissions focussed on limited special interest areas, whereas other submissions were extensive and covered a broad range of topic areas.

Hydro One's reply argument is structured to address the key topic areas raised by OEB Staff and the Intervenors in their argument submissions.

This document is complementary to the oral argument presented on July 22, 2008 by Hydro One to the OEB. The intent of this document is to respond in some detail to the main arguments of the OEB Staff and Intervenors. Failure to comment on all points raised by parties does not imply agreement from Hydro One. In addition, some Intervenors have commented on settled issues (such as VECC's comments on external revenues and costs), and thus the company has not commented. The intent is not to summarize or repeat the vast body of evidence which has already been put forth.

Hydro One is pleased to note broad support for capital expenditure levels, cost allocation and rate design and many aspects of the harmonization proposal.

However, the Intervenors have been critical in a number of disparate issues, many of which were raised by them neither in the stakeholdering effort, the multitude of written interrogatories, or the oral phase of the hearing. As a result, it is difficult to address some of them as no evidentiary basis exists on which the Board could base a decision.

Some of the arguments are based on misunderstanding of the evidence, probably because the points were not directly raised during the hearing. An effort will be made to correct those misapprehensions below.

The Applicant will do its best to direct the Board to the evidence, where it exists, in the arguments to follow. However, before doing so, it must be observed that there are several fundamental principles which the Intervenors appear to misunderstand in view of some of the arguments they advance. It is respectfully submitted that the Board should be mindful of these principles when assessing the merits of the Applicant's case and the criticisms levied by the Intervenors.

VECC makes the startling assertion that Hydro One's actual expenditures in 2007 are "irrelevant" to a consideration of the appropriate revenue requirement for the test year,

2008. It appears to argue that Hydro One intentionally overspent in 2007 in order to “pad” or “stuff” its base revenue requirement for 2008.

VECC’s argument is that Hydro One intentionally overspent in 2007, presumably purposely reducing its net return. To assert that the shareholder would intentionally orchestrate a large reduction in net revenue in order to “pad” the revenue requirement for a future period is either disingenuous or naïve in the extreme.

A similar theme is advanced by the SEC where counsel states:

“The Applicants 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.”

While this utility cannot speak for others which appear before the Board, it can state categorically that it does not, and never has, engaged in such a practice.

Other utilities may. This one does not.

The fact that Intervenor, which are essentially the same in all cases before the Board, have come to that belief is distressing and may help to explain the common thread in the Intervenor arguments that the Board should make an across the board cut of approximately \$44 million to OM&A expense, as proposed by CME and adopted by others.

If one starts the process with the belief that actual 2007 costs are “irrelevant” and that Hydro One has intentionally overspent in 2007, thus intentionally under earning, and has schemed to inflate its budgeted costs for this case, it is no wonder Intervenor urge an “envelope” reduction in OM&A costs.

It is understood that Intervenor see their mandate as essentially to reduce rates for their constituents. However, it is not appropriate to approach the case with a presumption of guilt.

Such an approach is not only unfair but contrary to long-established regulatory and legal principle.

It is not enough to argue that costs have increased in percentage terms which the Intervenor may find unacceptable. The task of the regulator is to determine why costs have increased and then to make an informed judgment as to whether the increases are appropriate.

In making this determination it is settled law that a utility's expenditures are deemed to be prudent unless shown to be otherwise. This Board confirmed the established legal test of prudence in Enbridge Gas proceeding; RP-2001-0032. The Board held that decisions made by the utility's management should generally be presumed to be prudent unless challenged on reasonable grounds [para. 3.12].

Hence the actual level of 2007 expenditures are, by law, deemed to be prudent at first instance, contrary to the opposite view of "irrelevance" proposed by VECC. Accordingly, costs actually incurred in 2007, a period of incentive regulation, are an important factor for the Board to take into account.

There are two critical main issues in this case. First, the Company asks that its revenue requirement be adjusted to reflect its current level of costs. This is obviously of paramount importance to the Applicant.

The proposed revenue requirement is not padded. It does not contain a "cushion" to absorb a Board ordered reduction. It represents the Company's critical need to recover

its costs, to earn a fair return and to carry out its mandate. It does not represent a drastic increase over the approved 2006 revenue requirement. The evidence shows why every increase in costs is reasonable and justified.

Second, the Applicant seeks to harmonize rates based upon an extensive cost allocation exercise. It is time that we got on with this task.

On the second issue of cost allocation and rate design, there is a historical background that Intervenor has overlooked, particularly in their criticisms of the Company's rate harmonization and rate mitigation proposals.

The Hydro One proposals are not the product of Hydro One alone. They represent the combined effort of the Company, the Ontario Energy Board and its staff, consultants for the Board and Intervenor, and Intervenor themselves, starting back in 2003. Then, work groups were established to work collaboratively towards a cost allocation methodology, and, later, a Distribution Rate Handbook which included the very rate mitigation guidelines followed in this application.

To suggest that the Hydro One proposals are put forward without serious analysis and forethought ignores history and the facts. While it is acceptable for Intervenor to oppose certain proposals which may run contrary to their interests, it is not appropriate to deny the extensive effort put forth to develop those proposals. Furthermore, it is wrong to ignore the extensive opportunity the Board processes have afforded stakeholders (and funded) to have meaningful input into the development of Board guidelines over the past five years.

More will be said of this in the cost allocation and rate design section of this argument.

In the detailed evidence the Applicant has explained the reasons for any increases in cost underlying the present proposal. Further, in the argument-in-chief, we addressed head on the reasons for the increases in costs from approved 2006 levels to proposed 2008. Remember, this is the comparison which the Intervenor urge upon the Board.

The \$102M increase from the Board approved 2006 revenue requirement to the proposed 2008 revenue requirement is largely driven by the return on the increased rate base and a \$45M increase in OM&A.

Of the \$63M increase due to rate base, about \$45M directly flows from this Board's 2006 decision. Another \$5M is due primarily to storm damage. The remaining \$13M results largely from increased customer connection and IT initiatives, including Cornerstone.

Of the \$45M increase in OM&A from 2006 approved to 2008 proposed, about \$26M arises from the more aggressive vegetation management proposals. The balance of the increase in OM&A expense (\$19M) represents an increase of approximately 4.5 % over the two year period, which is less than inflation.

Intervenor have suggested that the Board should reduce the requested revenue requirement to reflect selective updates to the evidence filed. For example, Intervenor believe that Hydro One should update its estimate of pension costs to be recovered through rates in the test year to match the figures provided in the actuarial valuation completed by Mercer in September 2007 [H.1.76]. Hydro One's position is that its overall revenue requirement for the test year is reasonable. Since it pre-filed its revenue requirement evidence in August 2007, there have been a number of changes in costing and planning assumptions, some to Hydro One's favour and some to the benefit of the ratepayer [Tr. Vol 6, pg 115]. For instance, the forecast revenue requirement does not reflect the tremendous increase in oil and gasoline prices in the past year, or the significant decline in Ontario GDP and its impact on forecast load, which has declined substantially [H.1.104]. Rather than "cherry pick" the factors to update, as Intervenor

would prefer, Hydro One's position is that the overall revenue requirement is reasonable and should not be updated. If it were to be updated, it would be appropriate to update for all factors, not just those that would decrease revenue requirement.

The Company's proposals are presented to the Board after considerable thought and effort by Company management. The Applicant submits that the revenue requirement is entirely appropriate and fully justified by the extensive body of evidence before the Board.

The Applicant will deal with various categories of increased work programs which are the sole reason for the increase in costs in the argument which follows.

There are 13 Intervenor who have filed arguments and a number of them have banded together to urge arbitrary reductions in costs, particularly to OM&A expense. Erroneous arguments, if repeated often enough, can take on an air of reality.

Hydro One asks that the Board view with some caution the various statistics provided in some Intervenor arguments. Statistics are often selected on an inconsistent basis. Further, inconsistent comparator dates are sometimes chosen in an attempt to yield the highest percentage increase possible.

For example, Intervenor arguments were inconsistent in the choice of the comparator against which to measure the proposed 2008 expenditures. Hydro One is of the view that the best comparator for proposed 2008 expenditures is those that were actually incurred in 2007 together with the evidence put forward by Hydro One to explain the "why" for any material increases.

The Applicant will now address the Intervenor's arguments, organized by issue.

Operations, Maintenance and Administration

Issues Not Settled:

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

3.2. Is the 2008 vegetation management budget appropriate?

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

3.4. Are the methodologies used to allocate Shared Services and Other O&M costs to the distribution business for 2008 appropriate?

Hydro One notes that OEB staff did not take issue with the overall level of OM&A expenses requested by Hydro One for the 2008 test year. The Intervenor (VECC, CCC, SEC, CME and AMPCO) have all argued, in one form or another, that the requested level of OM&A expenditures are excessive when compared to either 2006 Board approved levels or 2006 actual expenditure levels. Specific areas identified included the proposed vegetation management program and shared service expenditure levels.

The arguments focused on the following themes to varying degrees:

1. Overall OM&A Levels
2. Vegetation Management Costs
3. Benchmarking
4. Other OM&A Costs

On the basis of these arguments the Intervenor argue that the budgeted OM&A expenditures should be reduced.

The following responds to each of these areas in turn:

Overall OM&A Levels

As stated in the opening comments, Hydro One's position is that its 2007 actual costs were prudently incurred and must be considered when reviewing 2008. Hydro One also agrees that 2006 approved costs are relevant.

The Board will ultimately determine what the appropriate base comparator is. Hydro One submits that what is key is not the comparator, the percentage increase or the dollar increase, but rather whether the Board is satisfied that the Company has provided adequate evidence and explanation in areas where spending has increased.

As Mr. Sommerville said, "What is of interest to us, and what is important, is the -- is what drives those changes, what is in behind those. And what is the cause and effect relationship. Not the percentage changes per se." [Tr.Vol 3, pg.79-80].

Simply looking at the overall increase completely disregards the detailed evidence put forward by the Company about the elements of OM&A programs that drive the increase.

Let us review the evidence concerning those few work programs responsible for the increases. As stated in the argument in chief, and earlier in this argument, the increase in OM&A from 2006 is largely attributable to the vegetation management program.

Vegetation Management Program

Hydro One has proposed increased costs in this area based on the Company's plan to move from a 10 year clearing cycle to an 8 year clearing cycle.

There is relatively no disagreement among Intervenor or Board staff that Hydro One should move to an 8 year cycle. Hydro One has provided an abundance of evidence of the benefits of moving to an 8 year cycle and explained that the benefits are not only

from improvements to reliability performance, but for a range of reasons as articulated by Mr. Juhn [C.1.2.2 pg. 35-7; H.1.15, Part A; H.1.49 Parts A & B; H.1.51, Part B; H.1.55 Parts B & C; H.6.3; H.11.17; H.13.8 Part D].

As Mr. Juhn testified in response to a question from Mr. Sommerville, the reasons for the more aggressive vegetation management program include increased reliability, reduced costs over time, safety considerations, and compliance with “good utility practice” as contemplated by the Distribution System Code [Tr. Vol.2, pg.34].

The Board is reminded that the proposal to move to an 8 year cycle was discussed in the 2006 distribution rate case (EB-2005-0378). The Company followed through with its proposal in 2007 and increased the work (e.g. clearing over 12,000 km) and spending as planned (in an IRM period).

Although planned work continues to increase, spending in 2008 is forecast to be almost identical to actual 2007 (\$280M compared with \$278.8M).

Hydro One has looked at the resource requirements and costs associated with moving to an 8 year cycle, which are reflected in the requested funding for the 2008 test year. There has been interest in moving to a 6 year cycle but there are significant challenges in doing so. There are resource challenges in implementing a 33% increase in line clearing consistent with a 6 year cycle [J2.7]. Hydro One agrees with Board staff that a move to a 6 year cycle may be advisable and ought to be phased in. Mr. Juhn explained that the program will be monitored and adjusted as appropriate.

Contrary to the suggestion of some Intervenors (SEC & VECC), cost cutting efforts have been effective in controlling vegetation management costs as evidenced by the unit costs for line clearing and brush control (88% of the 2008 vegetation management program costs). This is illustrated in the table below (utilizing information from C.1.2.2 and H.1.63).

Line Clearing and Brush Control Spending and Accomplishments

Item	2004 Actual	2005 Actual	2006 Actual	2007 Actual	2008 Budget	2004 to 2007 Avg	Change 2008 over Avg
Line Clearing Cost (\$M)	55.6	52.9	50.6	74.1	76.8	58.3	31.7%
Accomplishment (KM)	10,361	8,746	8,889	12,211	12,500	10,052	24.4%
Cost per KM	\$5,366	\$6,048	\$5,692	\$6,068	\$6,144	\$5,800	5.9%
Brush Control Cost (\$M)	19.6	21.1	25.2	26.9	28.2	23.2	21.6%
Accomplishment (KM)	10,731	9,076	10,246	10,777	12,500	10,207	22.5%
Cost per KM	\$1,826	\$2,325	\$2,459	\$2,496	\$2,256	\$2,273	-0.7%

VECC wrongly claims that the 2006 unit costs are “in the order of \$5,000/km” (the actual figure is \$5,692 per the table above) and argues that unit costs are increasing by 20% between 2006 and 2008. It then goes on to suggest that this misstated \$5,000 unit cost be used as the basis for setting the 2008 budget. This is clearly inappropriate.

However, as Mr. Juhn clearly stated that line clearing and brush control costs fluctuate from year to year depending on the area being cleared [Tr. Vol.2, pg.20].

The evidence shows that the 2008 increase in line clearing unit costs is only 6% over the average in the table above and brush control unit costs have actually decreased by 1% over the average. These cost changes occurred during a period when escalation exceeded 20%. Recent significant increases in fuel costs will have a big impact on the vegetation management program spending. This demonstrates that there are cost efficiencies built into the proposed 2008 spending levels [A.14.2, Table 2].

Benchmarking

VECC distorts the PA benchmarking data to argue that Hydro One’s costs are much higher than their comparators. That is not correct. Hydro One’s OM&A and capital

spending, when looked at on a “per pole km” or “per GWh distributed” are in fact lower than most other utilities’ costs. Intervenor chose to disregard the very clear statement by the author of the PA benchmarking study:

“Hydro One’s costs compare favorably to the peer group, particularly when measured on a per-kilometer basis. This is also true when the measurements are made on a per-asset basis or a per-kWh transported basis. As a result of Hydro One’s low customer density, costs are noticeably higher than average when they are compared on a per-customer basis.” [A.15.2. Attach.A, pgs.4-19]

Some Intervenor used the PA Benchmarking study [A.15.2, Attach.A] and the CN Utility Vegetation Management Benchmarking study [J.2.5] results as a basis for adjusting Hydro One’s vegetation management spending. Hydro One submits that Intervenor have misapplied the data.

The main reason for the differences between Hydro One’s costs and those in the PA benchmarking study is obvious: in 2006, Hydro One was on an 11 year clearing cycle, the others were not.

Of course unit costs will decrease with a shorter clearing cycle. That is a principle reason for Hydro One’s proposal as outlined in the evidence [H.1.14, Attach. C]. It is completely nonsensical to compare Hydro One’s costs on a 10 year cycle with utilities on a 5 or 6 year cycle.

Further, the authors of the PA Benchmarking study concluded that:

The costs for Hydro One would be expected to be high, given the long distribution lines through substantially forested areas. With average tree density, the exposure levels for the extensive system would create large amounts of tree-trimming requirements. With the high tree density levels in the Hydro One territory, the exposure is that much greater [pg.4-21].

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Other OM &A Costs

Although most Intervenor concentrated on the vegetation management OM&A costs, there were some comments on other areas which will be commented on briefly.

Customer Notification

Customer notification costs will vary in accordance with work undertaken, but not in “lock step” as SEC claims.

As shown in Table 9 of C.1.2.2, the average historical spending on this program has been about \$6.8M even though the volume of line clearing and brush control has varied year-over-year [H.1.63]. Hydro One’s proposed 2008 level of notification costs is about 16% over historical spending. This is considerably below the 23-24% increase in line clearing and brush control over 2004-2006. Therefore customer notification costs are reasonable when compared with the work undertaken.

Customer Care Management

Contrary to the suggestion by SEC, Hydro One provided evidence in H.1.66 about the other factors, over and above changes related to cost allocation that contributed to increasing costs. These include labour escalation, modest increase to staff complement (to improve customer care practices and service delivery) and minor increases in third

party contracts (to ensure the completeness and accuracy of settlement of accounts with the Independent Electricity System Operator).

Lines Trouble Call

SEC's claim that Lines Trouble Call costs are increasing at a faster rate than the forecast of work accomplishment is contrary to the evidence presented. As noted in C1.2.2., pg.12 and H.13.1, part f, the Trouble Call budget includes spending associated with non-capital storm expenditures. As noted in the table below, there was \$2.0M budgeted in 2006 and \$6.0M budgeted in 2008 for non-capital storm related costs. As these costs have no bearing on the number of trouble calls accomplished, any comparison of the unit costs to complete a Trouble call must exclude these non-capital storm related costs. As shown in the Table below, the forecast unit cost for responding to Trouble Calls actually increases by only 1.2% over 2 years. This increase is well below the escalation of labour and material costs over those two years and reflects Hydro One's ongoing efforts to become more cost efficient.

Trouble Call Spending and Accomplishments

	Projected # of Trouble Call		Projected Cost (\$ M)		Projected Unit Cost		% Change
	2006	2008	2006	2008	2006	2008	
Trouble Call	47,000	49,100	\$52.0	\$52.9	\$1,064	\$1,077	1.2%
Non-Capital Storm			\$2.0	\$6.0			
Total Est. Cost			\$54.0	\$58.9			

References:

1. See EB-2005-0378, C1.2.2. pg.12.
2. See C1.2.2, pg.12 in this application.

Development OM&A

Hydro One has detailed the increase in Development OM&A costs associated with the need for increased electrical system modeling and added research and development costs

associated with generation connections [C.1.2.3., pg. 3&5]. VECC has drawn a link between these OM&A costs and the preparation of generation connection assessments that generate external revenues for Hydro One. This link is not appropriate as the costs referred to are not directly associated with the referenced external revenues. Further, the appropriateness of 2008 external revenues was settled issue 5.2.

Intervenors also challenged the inclusion of the proposed 2008 costs associated with the evaluation of Long Term Load Transfers (LTLT). These costs, which account for \$1M of the Development OM&A budget [H.13.10], are costs which will be incurred in 2008. VECC suggests that because these LTLT costs were identified as one time costs they should be amortized over a 4 year period, thereby reducing the 2008 Development OM&A budget by \$800,000. VECC's suggestion completely ignores the evidence provided in H.1.64. Although the specific LTLT costs incurred in 2008 are one-time, the Company's expectation is that there will be other LTLT costs incurred through 2009 [H.1.64, part B]. The Company also provided a number of specific examples of costs that are expected to be incurred in future years, over and above the amounts budgeted for in 2008 [H.1.64, part C]. As such, it would be inappropriate to reduce the 2008 funding of the Development OM&A budget in anticipation of a reduction in future costs which are not anticipated to materialize.

Reduction in the Cost of Other Programs due to Smart Meters

Hydro One has fully accounted for the anticipated reductions to the cost of other programs as a result of the installation of Smart Meters. These reductions include a \$2.8M reduction in the meter maintenance costs, a \$1.5M reduction in meter reading costs and approximately \$400k in meter inventory savings [H.13.7, part B]. The reduction in meter reading costs reflects a number of assumptions: 1) the systems necessary to fully implement the electronic meter reading will only be available for 25% of 2008, and 2) meter reading savings apply to only ½ of the 370,000 meters to be

installed in 2008 since the meters are assumed to be installed in a uniform manner across the year [H.13.7].

It is not appropriate, as SEC has done, to tie expected 2008 manual meter reading savings with a change in a calculated “unit cost” based on the total meter reading budget. The total meter reading budget includes more than just the cost of manual meter reads. As explicitly noted in the evidence, the meter reading budget also includes the cost of interval meter reading [C.1.2.5., pg.9]. These interval meter reading costs are increasing due to anticipated growth in customers with interval meters due to a lowering of the threshold at which customers can get interval meters, from 500 kilowatts to 200 kilowatts.

Shared Services Costs

Intervenors suggest that Hydro One has not provided justification for the requested increase for Common Corporate Functions and Services (CCFS) and Asset Management costs outlined in C.1.2.6., Table 1, pg. 3.

With respect to CCFS costs, Hydro One’s Argument-in-Chief summarized the key drivers for the \$7M increase over 2006 actual levels [Tr. Vol.7, pgs.22-3].

Asset Management costs increased by approximately \$5M over the same period. These increases are primarily driven by the need to respond to government initiatives and to address staff demographic issues. As noted by Mr. Van Dusen, staff levels have increased as a result of the dramatic increase in core work programs over this period resulting in the need to acquire additional resources [Tr. Vol.1, pgs.110-12]. Resources have also been required due to the evolving government direction on its energy policy for such items as distributed generation and smart meters. Mr. Van Dusen elaborated on the increase in work required associated with distributed generation within the asset management group

[Tr. Vol.1, pg.113].

2008 Cost of Living Adjustment (COLA) for Inergi Outsourced Services

Hydro One disputes VECC's argument that the COLA adjustment in the Inergi outsourcing agreement should not be allowed in full.

First, Hydro One is legally bound by contract to the COLA adjustment. The agreement was reviewed carefully in the 2006 distribution rates application and approved by the Board (EB-2005-0378). There is no reason for the Board to disallow the negotiated COLA adjustment.

In any event, the Applicant disagrees with the escalation calculation in the VECC argument. The actual escalation is shown in J3.8 and is based on a term of the approved negotiated contract, and is a reasonable amount.

CME Allegation of Inconsistency re 2006 OM&A

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Compensation and Human Resource Costs

Issues Not Settled:

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

Overall Compensation Levels

Several Intervenors support the claim put forward by SEC that Hydro One's "personnel costs are out of control", that Hydro One disregards Board concerns regarding these costs, and as a result should be arbitrarily slashed by \$30 million in OM&A.

This allegation has been made by the same Intervenors in previous cases but is not supported by the evidence. If repeated often enough such misconceptions can take hold.

Hydro One's employment costs are not unreasonable in its circumstances. There is no reliable evidence that its labour costs are higher than comparable companies on any fair comparative basis. In fact, the available evidence is quite to the contrary.

Hydro One is engaged in a benchmarking study which will provide more reliable evidence concerning its labour costs. However, the evidence to date suggests that it is within a reasonable band.

Further, it is absolutely incorrect to say that Hydro One does not take Board directions seriously. Nothing could be further from the truth.

The pre-filed evidence and Ms. McKellar's testimony set out in detail the numerous steps Hydro One has taken to control its costs in a highly unionized workplace and in the face of heated competition for skilled labour.

For example, the company has:

- Negotiated with the Society to lower pay bands and reduce pension and other benefits for new hires [C1.3.2, pg. 6-7];
- Lowered pension and other benefits for new management hires since 2004 [C1.3.2, pg. 2];
- Negotiated more flexible work terms with both the PWU and the Society to improve efficiency and reduce costs;
- Increased the percentage of lower paid and lower skilled temporary and casual staff from 21% in 2004 to 30% in 2008 [H.13.31, Attach. A; J3.4];
- Utilized a variety of labour resources including temporary, hiring hall and contract staff, which avoids costly pension and other benefits (about half of the staff increase since 2006 is temporary and casual staff) [H.13.31, Attach. A; J3.4];
- Use of lower skilled and lower paid staff for simpler work [Tr. Vol. 3, pg.52];
- Use of more casual, temporary and contract staff in the vegetation management cycle; and
- Limited negotiated increases with the powerful PWU to 3% per year between 2006-2008.

These and other measures are working to control labour costs. For example, the average labour cost for Hydro One has actually decreased by 1% from 2004 – 2008 [H.13.3, Attach A]. Further, as explained by Ms. McKellar in an example given to Mr. Kaiser in testimony, Hydro One rates for regional maintainers are about 17 – 21% less for the comparable position of mechanical maintainers at OPG and Bruce Power. This is one tangible example of how Hydro One’s strategy is keeping costs down [Tr. Vol 3, pg 187-88].

Some Intervenors have argued that the Board should arbitrarily cut payroll costs “to send a message”.

It is submitted that such an arbitrary cut would be completely inappropriate.

It is not the rise in payroll costs that is leading to increased OM&A costs, but an increase in required work such as vegetation management.

As outlined in the evidence [C1.3.1, pgs. 1-2] and as further explained in the oral hearing [Tr. Vol. 3, pg. 24-5], Hydro One employs a work based approach to the planning and execution of its work. This is a well recognized and widely used system of accounting which is employed across a broad cross-section of industries and is an acknowledged “best practice” methodology. It is a superior cost control methodology entirely appropriate for use within Hydro One. It incorporates a work based approach to staffing whereby the Company resources according to work programs. This system is effective.

Specifically, Hydro One determines the nature and volume of work necessary to deliver a required level and quality of service and then evaluates the appropriate costing and resourcing needed to deliver this output; this is all balanced by affordability. This output based methodology is how Hydro One determines its staffing requirements, whereby the Company resources according to work program demands rather than plans the work around the number of internal resources available.

If there is to be a reduction in resources because of an arbitrary budget cut, some work programs must be eliminated or reduced.

Hydro One plans work necessary to meet the quality of service standards of this Board and the expectations of its customers. If the Board should decide to cut resources, it is respectfully requested to give direction to the Company as to which work programs should be eliminated or modified.

Hydro One has extensively stakeholdered its proposed work programs and the opportunity has been provided to examine them during the oral hearing of this application; and the Company has not received much in the way of suggestions as to where to reduce work and accordingly provide lower performance.

Staff demographics and succession planning is an issue. Hydro One believes that the Company is in the best position to determine how it should manage and staff for future requirements. Hydro One is responsible to determine how many operators and engineers it needs and when they are needed, and should be held accountable for this. Specifically, “Hydro One is at a crossroads where about one-quarter of Hydro One staff will be eligible for an undiscounted retirement at the end of 2008, increasing to 40% by the end of 2012 ” [Tr. Vol. 3, pg 169]; and recent studies have indicated that within five years, up to 50% of the workforce in the North American electricity industry will be eligible for retirement [C1.3.1, pg.1].

Due to the long lead times required to train staff, recruits must be hired well in advance of staff retiring. For example, as stated by Ms. McKellar, for power line maintainers “it is a very technical and very long training program that lasts five to six years to get to the top step” [Tr. Vol.3, pg. 38]. Literally, if Hydro One does not bring new staff in now and train them, it may not be in a position to operate the system in the next decade.

As outlined in evidence, and noted by Ms. McKellar in testimony, Hydro One is at the forefront in recognizing and implementing strategies for dealing with the demographic challenges facing the electricity industry [C1.3.1. pgs. 5-8; Tr. Vol. 3, pgs. 49-52]. She stated:

As stewards of Ontario’s transmission electricity system and the largest distribution system, we feel it would be irresponsible of us not to bring these people in advance while we still have the opportunity to coach and mentor them, so they can take over these jobs. [Tr. Vol. 3, pg. 142]

As outlined above, Hydro One is engaging the most cost effective mix of the necessary labour resources, to the benefit of both ratepayers and itself. This includes the increased use of temporary and contract labour, in conjunction with the appropriate balance of regular staff, taking into account the necessary hiring and training of new staff in preparation for the impending retirement of large numbers of current staff.

Transmission and Distribution Labour Charging

Board Staff suggests that the Board would be better assisted by a more precise proportion and allocation of compensation costs between transmission and distribution in order to determine the prudence of these costs.

For the majority of work completed of a transmission and distribution nature, labour charges are directly charged to the appropriate transmission or distribution account via time sheets. All other costs are allocated to transmission or distribution following the Board approved Rudden methodology. This methodology has been extensively reviewed and approved by the Board in the last Hydro One distribution hearing (EB-2005-0378) and the last transmission hearing (EB-2006-0501). This methodology is described in detail at Exhibit C1, Tab 4, Schedule 1. Given the integrated nature of the Hydro One workforce, the methodology employed by Hydro One is appropriate.

With respect to the Rudden study, Mr. Innis and Mr. Van Dusen both noted at Volume 1, TR 61-68, that although the Rudden methodology has not changed from the method last approved by the Board and the costs drivers are reviewed and updated on an annual basis to reflect the anticipated work to be done within the transmission and distribution businesses to ensure charges are appropriately recorded.

Overtime Levels

Board staff expressed concerns with the forecast level of overtime for the test year relative to 2006 levels. As outlined in evidence and in testimony [e.g. Tr. Vol. 3, pgs 28 & 158], due to the remote locations that much of the work is completed, whether on a planned basis or in emergency conditions, it is often more cost efficient and customer focused to have a work crew in the field complete the work that is initiated with overtime rather than send in a second crew. For example, under emergency storm conditions, Toronto Hydro can easily send in a second crew to complete needed work due to physical

close proximity, whereas it is more cost effective for a Hydro One crew in a remote location to complete the storm restoration work under overtime conditions [Tr. Vol. 3, pg. 161]. As the Hydro One distribution work program expands, as is the case for vegetation management and smart meter installations for example, the instances where completing work using overtime is cost efficient increases.

Rate Base and Capital Expenditures

Issues Not Settled:

- 4.1 Are the amounts proposed for Rate Base appropriate?
- 4.2 Are the amounts proposed for 2008 Capital Expenditures appropriate?
- 4.3 Are the 2008 sustaining capital expenditures proposed for Asset Replacement appropriate?
- 4.4 Are the 2008 amounts proposed for Development capital appropriate?
- 4.5 Is the 2008 budget for storm related capital expenditures appropriate?
- 4.6 Is the proposed level of 2008 Shared Services and Other Capital expenditures appropriate?
- 4.7 The narrowed is are the methodologies used to allocate Shared Services and Other Capital expenditures to the distribution business consistent with the methodology approved by the Board is previous Hydro One Rate applications?

Board staff and the Interveners have provided Rate Base arguments based on the following general themes:

- 1. Appropriateness of 2008 Rate Base
- 2. Capital expenditures for 2008

Appropriateness of 2008 Rate Base

Hydro One is requesting a 2008 rate base of \$4,382M [D1.1.1.] Board staff notes that Hydro One's response to interrogatory H-1-2 shows a rate base amount for 2008 of \$4,298M based on updating for 2007 actuals and has asked Hydro One to clarify the difference. This is another example of what Hydro One considers selective updating as discussed in the introduction to this Reply Argument.

The requested amount of \$4,382M at D1.1.1 includes forecast in-service additions, retirements, sales and transfers for the 2007 bridge year and 2008 test year per Table 2.

The amount of \$4,298M included in response to H1.1.2, provides actual amounts for the 2007 bridge year for in-service additions, retirements, sales and transfers.

Actual in-service additions were \$97.2M lower than forecast while retirements were \$25.3M less than forecast. These two variances are the main drivers of a lower opening balance for the determination of 2008 mid-year rate base.

The in-service variance simply reflects a timing difference between when capital was expended and when it was booked in-service. This is apparent by looking at the capital expenditure variance for the 2007 bridge year between the original white page filing on August 15, 2007 of \$515.7M and the blue page update filing of February 20, 2008 which shows actual expenditures of \$476.6M [D1.3.1]. Actual capital expenditures for the bridge year were \$39M lower than forecast versus the in-service additions variance of \$97.2M.

Since Hydro One did not provide an update to its capital expenditure, and in-service and retirement forecast for 2008, all things being equal, 2008 rate base would be as per the response to H.1.2. However Hydro One fully expects in-service additions in 2008 will be greater than forecast as delays in booking capital expenditures are caught up. Therefore the requested rate base of \$4,382M is still appropriate.

Capital expenditures for 2008

Hydro One is forecasting capital expenditures of \$566.2M for the 2008 test year [D1.3.1.]. Excluding smart meter expenditures, the requested amount would be \$401.4 million [J2.2].

Other than the continued treatment of smart meter expenditures to reflect the THESL Board decision, most parties did not raise many concerns with the requested capital amount.

CME's only issue was the approval of capital expenditures for the Cornerstone project without savings resulting from the project being reflected under the 3rd generation IRM regime.

Similarly CCC did not take issue with the overall level of Hydro One's 2008 capital budget, but like CME had concerns with how savings would be captured under 3rd generation IRM. CCC recommends the establishment of a deferral account to track savings for pass through to customers. CCC went on to suggest that if the Board rejected a deferral account treatment then an up-front adjustment should be made to ensure an annual level of benefits flow to ratepayers.

VECC shared similar concerns with Cornerstone expenditures and savings through the 3rd Generation IRM period. SEC support's CCC and CME's position.

The Board has almost completed its 3rd Generation Incentive Regulation for Ontario's Electricity Distributors (EB-2007-0673) in which many of the parties to this proceeding were represented. Given the level of rate adjustments under the 3rd generation IRM price cap formula, Hydro One expects to be able to manage its cost levels within the envelope set by the price cap formula provided it can retain the savings that are expected to flow through the implementation of programs such as Cornerstone [H1.38, pg.5].

The capturing of savings was extensively canvassed in the 3rd Generation IRM proceeding. Further special treatment as suggested by the Intervenor is not warranted as savings will be properly reflected in the final formula adopted by the Board from the EB-2007-0673 proceeding.

Revenue Requirement

Issues Not Settled:

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

No party took exception to the accounting treatment adopted by Hydro One for the treatment of OPA funded CDM programs. Costs for OPA funded CDM programs were totally offset by anticipated funding to be received from the OPA, thereby having no impact on revenue requirement.

CDM Expenditures

Issues Not Settled:

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?

Hydro One has not included any requests for specific funding projects in the requested revenue requirement other than the \$1M referenced by Mr. Innis at Tr. Vol.1, pg. 83. Board staff questions the appropriateness of including this \$1M in CDM funding in Hydro One's revenue requirement for 2008 and questioned whether a deferral account should be created and the Company file separately for inclusion of these funds in rates.

Hydro One disagrees with Board staff's position that the \$1M noted above should be included in a deferral account and separately requested for inclusion in rates. All parties have had a chance to question the need for this level of funding in this proceeding and do not oppose it.

The \$1M requested was described by Mr. Van Dusen [Tr. Vol.1, pg. 79] and by Mr. Innis [Tr. Vol.1, pg.85; Tr. Vol.6, pgs. 179-80]. Given the value of government CDM initiatives, Hydro One has included funding to ensure the Company has the resources to continue the activities undertaken under the third phase MARR program to ensure they continue to bring value. The funding requested is also required to manage the CDM programs and work with the OPA and various utilities on joint programs. Further information is also provided in Hydro One's Argument-in-Chief [Tr. Vol.7, pg.32].

PP feels Hydro One should request additional funding from the Board if Hydro One is unsuccessful in obtaining all its requested CDM funding from the OPA. Hydro One notes that CCC, VECC, CME, SEC and AMPCO all support Hydro One's proposal to only undertake CDM programs funded by the OPA.

Smart Meters

Issues Not Settled:

- 8.1. Is the 2008 smart meter O&M budget appropriate?
- 8.2. Is the proposed 2008 capital spending for the Smart Meter program appropriate?
- 8.3. Are the amounts for Smart Meter related variance accounts appropriate?
- 8.5. Is Hydro One's regulatory treatment of Smart Meter costs appropriate?

Hydro One's evidence as filed requests the recovery of all smart meter OM&A and capital costs for 2008 in its rate application including costs related to exceed minimum functionality and the recovery of the regulatory asset balances up to April 30th, 2008. Hydro One maintained that its preferred option would be the approval by the Board of smart meter expenditures on a business as usual basis.

However the Company did acknowledge that the Board may wish to follow the same time period applied to Toronto Hydro Electric System Limited (THESL). If so, then Hydro One requests that the Board approve the costs for both minimum and exceed minimum functionality incurred up to December 31, 2007 as was done for Toronto Hydro. However, this implies that all regulatory assets would use December 31, 2007 balances for recovery through a rate rider and the inclusion of smart meter in-service capital in rate base.

Board staff has invited comments from parties regarding the timing of clearing the regulatory asset balances, particularly considering the potential positive effect on the mitigation plan. Intervenors have also commented on the advantage to ratepayers of utilizing the larger positive balance as of April 30, 2008. Although these costs have not been audited, they have been subject to review in this hearing just as in the case of THESL.

On reflection, a faithful application of the principle established in THESL would see these costs approved to the time of review. In the case of THESL that was December 2007. For Hydro One it would be mid-year 2008. This approach has the added advantage of maximizing the total credit balance to be returned to ratepayers when consideration is given to all regulatory assets. Therefore, for consistency of regulatory asset treatment, the Company proposes that smart meter costs be cleared as of April 30, 2008, along with all other regulatory assets, particularly given the mitigation benefits to customers of clearing all regulatory accounts as of that date.

The prudence of these costs is demonstrated in the pre-filed evidence and was available for testing and review during this hearing. Therefore it is quite appropriate that they be included in rate base and cost of service.

At a minimum, smart meter expenditures from January 1, 2008 onward would continue to be tracked in a deferral account and the interim rate rider would continue.

Regulatory Assets

Issues Not Settled:

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

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

Disposition and Continuance of Regulatory Asset Accounts

Hydro One is requesting the disposition of regulatory asset balances as of April 30, 2008. The amount originally to be refunded to customers over a 4 year period was \$48.7M [F1.1.1; F1.2.1]. The amount to be refunded was updated to \$65.5M to reflect actual April 30, 2008 balances [J.6.2]. The actual December 31, 2007 balance was updated to a credit balance of \$42.9M from the originally filed credit balance of \$30M.

There has been much discussion throughout this proceeding about the disposition of these balances including whether all or part of the components making up the total balances should be cleared and whether the balances should be cleared as December 31, 2007 or April 30, 2008. There was also some discussion as to whether a four year time frame was appropriate.

It is Hydro One's preferred position that the total actual credit balance of \$65.5M as of April 30, 2008 be cleared over 4 years. This would have the most benefit to customers in terms of the mitigation of the Company's harmonization proposal. Hydro One has received OEB approval to implement riders #1 and #2 over 4 years in previous decisions.

If the Board has concerns with clearing the regulatory asset balance as of April 30, 2008, Hydro One recommends that the only other sensible option would be to clear the actual December 31, 2007 credit balance of \$42.9M over 4 years.

Board staff provided additional comments regarding:

- the use of Account 1588
- the clearing of Account 1592 PILS
- the interest improvement of account 1555 Smart Meters

Board staff questioned why Hydro One does not use account 1588 to record line losses per the Board's previous directives. As part of this proceeding, Hydro One has complied with the above described OEB requirement "... or a second effort to evaluate line losses using current load data..." A.15.3, Attach.A updates using more up to date data, the losses study undertaken by Kinectrics and filed as part of proceeding EB-2005-0378. The fact that losses was one of the issues settled by Hydro One and Intervenors at the settlement conference leads Hydro One to conclude that the proposed loss factors are more acceptable and credible to stakeholders and the issue of how Hydro One records losses has been dealt with.

Given the composition and scale of the Hydro One's distribution system it is not economic to provide metering and the support processes to measure actual line losses. Therefore there is no need or ability for Hydro One to populate this account.

With respect to account 1592 – Tax Changes, Board staff questioned whether the balance in this account should be disposed of given the Board's recently announced combined PILS proceeding.

The Board recently announced a combined proceeding entitled "Review Initiative Account 1562, Deferred Payments in Lieu of Taxes (PILS) under Board file number EB-2007-0820. It specifically references electricity distributors subject to section 93 of the *Electricity Act*. Section 93 of the Act is entitled "Municipal electricity utilities, Payments

in lieu of federal corporate tax”. Hydro One is subject to section 89 of the *Electricity Act* so it is unclear whether this proceeding is intended for Hydro One participation.

As noted by Mr. Innis, Hydro One will follow the Board’s guidance with respect to this matter, but the Company’s preference would be to clear the \$7.2M credit balance as proposed in the evidence [J6.2, Tr. Vol.6, pg.109].

Finally, Board staff also questioned whether Hydro One should be interest improving the smart meter variance account 1555 since it already includes a full regulatory return on equity, PILS and long-term interest having based on Hydro One’s response to H.1.120.

Hydro One is calculating carrying charges (interest) on the smart meter variance account, and it is appropriate to do so. This interest is shown as the "Carrying Charge" in H.1.120, Attach.A, pg.1. A revenue requirement calculation (which has a long term interest component) is used to derive the principal balance of this account. Carrying charge interest is then calculated on this principal balance consistent with the manner in which other deferral/variance accounts are interest improved. This reflects the time value of money as Hydro One has had to finance the amount of the variance account to be received. The carrying charge interest is totally separate from the interest used in the calculation of revenue requirement and there is no double counting.

Appropriateness of Requested New Variance Accounts

Hydro One is requesting the establishment of three new variance accounts. They are described in F.3.1 and in Hydro One’s argument-in-chief [Tr. Vol 7, pgs 13-4]. The accounts are:

- A Pension Cost Differential Account;
- An OEB Cost Differential Account; and
- A Bill Impact Mitigation Account.

Board staff feels that the establishment of any new account must meet the regulatory principles of materiality, prudence, causation and the inability of management to control the required expenditure.

Hydro One believes all three requested accounts meet these four regulatory principles.

Pension Cost Differential Account

This account is requested to record the differences between forecast and the actuarially-determined pension obligations of Hydro One. Board staff is concerned that Hydro One has not updated its evidence to reflect the actuarial valuation filed with FSCO in September 2007 which would result in a reduction in revenue requirement of \$1.5M for the test year.

Intervenors are of the view that a Pension Cost Differential variance account should not be established as there is no regulatory precedent; that Hydro One neither requested nor was granted a Pension Cost Differential Account for its Transmission business as part of its EB-2006-0501 application for 2007 and 2008 test years; and the account would transfer the forecast risk associated with pension expenses from ratepayers to shareholders.

In fact, the Settlement Proposal in EB-2006-0501, which was accepted by the Board, established the same Pension Cost Differential Account for Hydro One Networks Transmission thus establishing a regulatory precedent. Supporting parties of this accepted variance account included AMPCO, CCC, EP, SEC and VECC [EB-2006-0501 OEB Decision With Reasons, pgs 2-3 & Appendix 1, pgs.17-9; H.1.123, part d].

As both ratepayers and Hydro One are being held whole on variations in actual pension costs, the two parties are in fact sharing the risk associated with pension expenses. This is similar to the sharing of risks with the tax rate changes variance account which has been established for both the Hydro One Networks Distribution and Transmission businesses in prior proceedings.

The Company is concerned that pension costs can vary significantly over time, with very large amounts potentially at risk. It simply seeks to eliminate the risk of loss or gain for its customers and the shareholder.

OEB Cost Differential Account

This account will track the difference between the annual OEB Cost Assessments, Intervenor cost awards, and costs associated with OEB initiated studies and the amount approved for these expenditures as part of the 2008 Distribution Rates.

As noted by Mr. Innis, this account has been requested to record for future recovery any variances with respect to the Board's annual assessment fees and other costs associated with the numerous other Board initiated proceedings that Hydro One tends to participate in more so than other LDCs [Tr. Vol.6, pgs. 134-6]. It is because of this increased participation level that Hydro One believes approval of this account is warranted.

Bill Impact Mitigation Account

This account was originally requested to record the sum of \$2.5M per year of revenue deficiency resulting from Hydro One's rate mitigation proposal for recovery in a future proceeding. Its purpose is to record revenue foregone as a result of maintaining rate increases for the R1 rate class at or below the 10% level as discussed with Mr. Vlahos [Tr. Vol.6, pg.129]. Hydro One notes that the Intervenor did not dispute the need for this account.

Hydro One also proposes to now use this account to record the revenue foregone and any incremental costs associated with implementing the additional mitigation measures discussed under its harmonization proposal.

Load Forecast and CDM

Issues Not Settled:

1.5. Have the impact of Conservation and Demand Management initiatives been suitably reflected in the load forecast? Is Hydro One's load forecast compatible with the OPA's load forecast? Is an LRAM appropriate at this time?

CDM Forecast

Hydro One notes that OEB staff, CME and PWU have raised no concerns with respect to the level of CDM incorporated in the 2008 load forecast. SEC, AMPCO and CCC support VECC's position that Hydro One's energy forecast for 2007 should be calculated using 800MW rather than the 1000 MW that VECC incorrectly assumes was used by Hydro One.

VECC's underlying assumption is incorrect. The Hydro One forecast does not use the 1000 MW estimate.

Hydro One has used OPA's assumptions for provincial CDM to be achieved in 2008, which is 0.8 TWh [K6.13, Table 4]. Hydro One has used its share of the provincial load as the basis for deriving the 126 GWh CDM forecast for 2008 [A.14.3, Table 4 437-311=126 GWh]. Mr. But described this as a reasonable assumption that reflects the fact that while Hydro One has a smaller share of the CDM savings in the GTA area, it has a larger share of the CDM savings outside of the GTA area [Tr. Vol.6, pgs.204-5]. VECC agrees with this calculation for 2008.

VECC notes that OPA's forecast of Demand Management savings includes Demand Response programs as well as time-differentiated and real time pricing programs. As clarified by Mr. But it is appropriate to include Demand Response programs as part of the forecast CDM savings [Tr. Vol.6 pgs. 202-3]. This treatment is confirmed in the OPA

information provided in Tables 1-4 of K6.13 and as shown in the OPA's report "Taking Action" [K5.1, pg.10, Table 3.2]. All of the OPA's 2007 CDM results include demand management program savings on a weather-normal basis.

VECC argues that while the OPA reported reductions for Demand Management likely include MW reductions from Demand Response programs under normal weather conditions this does not mean that the demand reduction will actually occur under such conditions. To the contrary, past experience with IESO actions has shown that weather normal peak-time conditions are extreme enough to trigger Demand Response programs.

Hydro One does agree with VECC that when Demand Management programs are activated it is generally for a short period of time during system "peak" conditions and consequently these programs will account for little or no energy reduction. In fact, Hydro One does not include the load impact of any Demand Management program in calculating the CDM reduction for energy [H.1.105, Attach.A pg.7]. The CDM adjustment to Hydro One's 2007 energy forecast is not based on 1,000 MW as implied by VECC because the load impact of Demand Management programs on energy is assumed to be zero. In fact, the CDM adjustment to Hydro One's energy forecast for 2007 is already based on about 500 MW which is 1,000 MW net of the load impact of all Demand Management programs. Consequently, no further reduction for the CDM impact on energy is required.

Hydro One has provided a report as Attachment A to H.1.105 which shows the detailed bottom-up analysis of the CDM savings achieved to the end of 2007. As shown on Table 1, page 2 of that report, Hydro One will have achieved 409 GWh on a cumulative basis by the end of 2007. This compares to a total of 437 GWh to be achieved by the end of 2008, showing that Hydro One only needs to achieve an additional 28 GWh in savings in 2008 in order to meet the 126 GWh of CDM impacts Hydro One is forecasting to achieve in 2008. As shown in J4.2, in 2008 Hydro One is expected to achieve about 60 GWh from OPA core programs alone. Over and above this amount, there will also be CDM

savings from Hydro One's custom programs, other federal and provincial government programs and conservation actions of Hydro One customers.

Hydro One therefore submits that its CDM impact assumption for 2008 used in the load forecast is appropriate and in all likelihood is conservative.

AMPCO argues that the weather corrected actual reported by Hydro One in H.11 for the years 2006 and 2007 is closer to weather-normal forecast of distribution load before deducting the load impact of CDM compared to the corresponding forecast after the deduction of CDM.

The figures in H.11 represent weather corrected actual with CDM added back in. This was necessary as the figures were used to measure forecast accuracy since 1997. This was to ensure consistency over time because forecasts made in late 1990's and early 2000's did not incorporate any CDM reduction as there was no initiative in that regard. This has led to AMPCO's misunderstanding of the results presented in response to interrogatory H.11.5.

The correct figures for comparison for 2007 are provided in the table below. The weather normal actual for 2007 was provided in H.1.105 page 4, table 3. This table shows the forecast variance is minimal.

Comparison of Load Forecast with Weather Corrected Load
(GWH)

Year	Forecast before CDM	Forecast after CDM	Actual (Weather Corrected)
2007	23,256	22,944	22,966 ¹

Note 1: 22,966 is the weather corrected actual retail level for 2007. Adding the estimate of CDM for 2007 from A.14.3, Table 4, of 311 GWh to 22,966 yields the amount shown by AMPCO in its argument of 23,278 MW.

LRAM

GEC is once again requesting a Lost Revenue Adjustment Mechanism (LRAM) be adopted by Hydro One to remove any disincentive of pursuing CDM programs.

Hydro One supports the Board's guidelines on LRAM as outlined in EB-2008-0037. LRAM submissions must be supported by LDC-specific program results and should account for all CDM impacts, including OPA and non-OPA program results. Given that major gaps in critical information required for an LRAM still exist at the present time, Hydro One submits it is not appropriate to include an LRAM proposal at this time. Other intervenors also support Hydro One's position.

Cost Allocation and Rate Design

The key concerns raised by Intervenor in the area of cost allocation and rate design dealt with Hydro One's harmonization proposal and the customer bill impacts flowing from the harmonization plan. Accordingly, Hydro One will deal with issues 7.7 and 7.8 first.

Issues Not Settled:

7.7. Is the proposal for harmonization of rates appropriate?

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

Board staff states that the harmonization approach proposed by Hydro One is generally consistent with accepted rate harmonization plans and is a methodical approach that recognizes annual bill impacts.

The concerns raised by Intervenor on these issues fall into two main areas. The first is a broad brush concern that the harmonization plan results in significant bill impacts and further studies are required before proceeding with rate harmonization. The second is a concern that the customer bill impacts relate only to "average" customers and that impacts on low use "outlier" customers have not been adequately addressed and may be excessive.

The first concern, which was raised by SEC alone, is the suggestion that more studies are required before proceeding with rate harmonization. This broad-brush rejection of the harmonization plan is "paralysis by analysis". The amount and nature of studies demanded by SEC simply cannot be done. As Mr. Roger testified, Hydro One does not track costs by Acquired LDCs in the form that would address SEC's questions [Tr. Vol.5, pg. 181].

SEC also makes the blanket statement that the harmonization proposal results in significant bill impacts. In fact, Hydro One's rate harmonization proposal and rate mitigation plan detailed in G1.8. Scheds. 1-2 meets the OEB guidelines with respect to keeping total bill impacts below 10% for the average customer, as required by the 2006 Distribution Rate Handbook, page 131, Ch. 13.1.

The bill impacts in this proposal are a direct outcome of following OEB guidelines with respect to cost allocation, target revenue to cost ratios and the need to harmonize rates. As noted by Mr. Roger in his testimony, cost allocation and rate design is a zero sum game and any proposed changes to existing rates will result in winners and losers [Tr. Vol.4, pgs.12-3]. In the case of SEC's constituency, the impact of Hydro One's proposal is a 0.8% total bill impact after 4 years, [H.13.66, pg. 2, Table 2].

The second concern is broadly shared by CCC, CME, VECC and AMPCO. Contrary to CCC's assertion that there is a lack of information with respect to the impact to low use customers in this Proceeding, Hydro One submits that it has provided an abundance of evidence on the impact of its rate harmonization proposal. The evidence provided in G2.5.6 shows the total bill impacts for all customer classes using the consumption ranges specified by the Board, and illustrates how the impact at different consumption levels can vary from the impact at average consumption levels. These schedules also illustrate that while some customers could be seeing significant percentage bill impacts, the actual dollar impact on their bill could be small. Hydro One asks that the Board to keep this in mind.

Hydro One has also submitted evidence in this Proceeding that specifically shows the customers that could experience significant percentage bill impacts at low levels of consumption. H.12.61, Attach. A shows the number of residential Acquired customers at different levels of consumption, based on 2006 data. This information can be combined with the data in Attachment B of the same Exhibit to determine the impact on low use customers.

Using the example provided by the CCC, it can be seen that there are 9 customers in Woodville that consumed between 0 and 250 kWh per month. Therefore, the Company knows that at most there will 9 customers consuming less than 100 kWh. The impact of 2008 proposed rates over current rates for a customer in Woodville consuming 100 kWh, is 27.6% or \$3.60 per month on total bill [G2.5.6 pg. 5]. As Mr. Roger testified, for low use consumers the impact is largely driven by the change in the fixed charge. While the impacts can be high on a percentage basis, the impacts are typically relatively small in dollar terms [Tr. Vol.5, pg. 62].

CME suggests that Hydro One conduct an analysis of those customers in other classes that are most adversely affected by the rate proposal. Hydro One did so. Mr. Roger testified that the analysis done by Hydro One for the General Service customer classes in the Acquired LDCs that have the highest average impact show that the highest percentage impact are for customers with no consumption and the impact reflects the movement of the current fixed service charge to a fixed service charge derived based on Board guidelines in the cost allocation model [Tr. Vol.5, pgs. 62-4]. For Quinte West, Mr. Roger testified that the highest impact is 700%, and this is equivalent to an increase from \$3.70 fixed charge to \$31, or \$27 per month implemented over 4 years.

Hydro One believes its application meets the Board requirements of limiting the total annual bill impacts to 10% for an average customer, and further that the number of low use customers that could experience impacts greater than 10% within a year is very low. However, Hydro One recognizes the concerns expressed on this issue by a number of Intervenor and therefore suggests the following additional mitigation measure be considered to limit the impact to low use consumers. This mitigation measure should not be taken as a precedent and is solely related to addressing the concerns expressed with respect to the implementation of Hydro One's harmonization plan.

Additional Mitigation Proposal

- Acquired Residential customers with total bill impacts higher than 15% for 2008 would have the impact on their total bill limited to a maximum of \$3 per month. The impact mitigation would be in the form of a fixed dollar rebate based on the last actual annual billing data available, similar to the impact mitigation ordered by the Board in cases of transfer of customers to Hydro One as a result of eliminating Long Term Load Transfers.
- For Acquired General Service customers it is suggested that the total bill impact will be limited to the higher of 15% and \$10 for Energy Billed customers and 15% and \$100 for Demand Billed.
- The cost of this mitigation (revenue foregone and incremental costs associated with implementation of the plan) would be added to the proposed impact mitigation variance account.
- This proposal is not related to the issue before the Board with respect to low income customers being addressed under proceeding EB-2008-0150.

For 2008, based on bill impact information included in G2.5.6 and information included in H.12.61, Attachment A dealing with 2006 level of consumption, Hydro One estimates that less than 300 Acquired Residential customers consume less than 250 kWh per month and have impacts higher than 15% and \$3 per month for 2008. These customers would receive a dollar credit in the bill that would limit the bill impact to a maximum of \$3 per month based on their 2006 consumption.

Extending the harmonization plan over more than four years does not assist low use residential customers. It simply allows additional time for Acquired customers to pay back the subsidy they receive from Legacy customers. As shown in J.6.8, Acquired customers moving to the R1 class receive in 2008 a \$3.258M subsidy from Legacy R1 customers. In 2009 and 2010, the Acquired customers pay back \$1M and \$1.6M respectively to the R1 Legacy customers.

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

Hydro One notes CCC, AMPCO, VECC and Board staff support the 12 new rate classes proposed by Hydro One. SEC claims that Hydro One has not justified its proposed 12 customer classes and that they are not appropriate and other Intervenors have specific concerns within the 12 classes.

Board staff states that "Hydro One has filed information on only one way of classifying its customers, which gives the Board no opportunity to understand how the classification was chosen or what the implications would be of other ways of defining classes."

The 12 proposed customer classes were presented to stakeholders and were accepted as reasonable [G1.2.3., pg.1]. The proposed classes reflect the customer classes used by other distributors in Ontario as well as asset utilization [G1.2.3, pg.1]. Given this widespread acceptance Hydro One did not present alternative customer classifications. CCC commended Hydro One for seeking input and accommodating requests from stakeholders.

CME has introduced new evidence in its argument questioning the compatibility of the new proposed 12 customer classes with the consultation work undertaken by the Board on Distribution Rate Design. If CME would have raised this issue during the interrogatory process or even during cross examination, it would have been told by Hydro One that the proposed customer classes are compatible with the classes mentioned in the Board Staff discussion document. As Hydro One stated, the proposed classes are also consistent with the customer classes being used by other distributors and stakeholders were consulted and provided input into the new customer classes [G1.2.3., pg.1].

Density Criteria

Board staff questions if it would be prudent for Hydro One to reconsider its criteria for urban density to reflect the change in the nature of its service territory with the acquisition of the LDCs.

As can be seen from the evidence filed, the Acquired LDCs represent only 14% to 15% of Hydro One Distribution's total customer base [G1.2.3 Tables 1-9 show the number of Acquired customers and total number of customers]. A reconsideration of the urban density criteria is not warranted given the relatively small impact the acquisitions had on the customer base. Given densities do not change significantly over time as testified by Mr. Roger, an update to the criteria is not expected to produce different results [Tr. Vol.6, pg.158].

Hydro One's proposed criteria to determine Urban density are unchanged from the criteria approved by this Board and that is the basis for the current Urban Residential customer class: a cluster of at least 3,000 customers with a density of at least 60 customers per kilometre. Hydro One's view, , is that when better data is available, like GIS information, Hydro One can undertake a full density review of Hydro One Distribution's entire service territory [H.1.41, pg.2] . Hydro One repeated the position that having GIS data would enable Hydro One to update the density criteria in a more efficient manner as it is applied to Urban and R1 customer classes [Tr. Vol.6, pg.158].

Unmetered Scattered Load (USL)

The only party with an issue with respect to Hydro One's proposed treatment of USL accounts was ROGERS. Its main concern was with the level of the meter credit proposed.

ROGERS' argument states that Mr. Roger agreed during cross examination that the distinct rate treatment for USL customer is intended to reflect the difference between the nature of USL customers and that of other types of distribution customers. This is not what Mr. Roger said. Mr. Roger said that the different rate treatment for USL is to reflect

the fact that there is no meter, nothing else [Tr. Vol.5, pg.107]. Nothing was said with respect to different nature of USL. In fact, the Load Factor for USL is 0.654 which is within the range of Load Factors for customers in the proposed General Service energy billed class [H.8.3].

ROGERS argues that it is not asking for USL to be treated as a separate rate class and yet, throughout its final argument ROGERS is requesting the Board to do just that. ROGERS is asking the Board to set USL rates that fall within the Board's directed revenue to cost ratio range for USL customers. This implies that USL is a separate customer class since the Board's guidelines for revenue to cost ratios are for customer classes only, not for a subgroup of customers within a class. The much larger credit proposed by ROGERS for USL is based on the presumption that USL is a separate customer class. Mr. Roger's evidence is that USL was never a separate customer class in Hydro One and is not proposed to be in the future a separate customer class [Tr. Vol.5, pg.107].

The USL meter credit proposed by Hydro One is a direct result of the approved OEB Cost Allocation Methodology to compensate USL customers for not having meters [Tr. Vol.5, pg.107. AMPCO and VECC support this treatment.

ST Class

The vast majority of Intervenors with the exception of ECMI supported the ST class as proposed by Hydro One.

ECMI argues that all embedded distributors should be grouped in a separate class and not in the ST class. Contrary to ECMI's assertion that all delivery points to LDCs have stable loads and are homogeneous, one LDC delivery point has a load factor of 9%, illustrating the fact that not all LDCs' delivery points have similar patterns of consumption [H.1.132]. The exhibit shows that the largest ST customer is an embedded distributor with a demand of 265 MW and the smallest ST customers is also a distributor

with a demand of 100 kW. This illustrates again the fact that LDCs are not that similar and do not require their on separate customer class as ECMI claims in its argument.

ECMI proposes the concept of business risk as one of the required customer classification criteria. It did not explore this concept with the witness during this Proceeding. There is no evidence in this or past proceedings as to where this criterion is currently being applied in Ontario or any other jurisdiction in determining customer classification. The Distribution Rate Handbook released by the OEB in the year 2000, Chapter 9, Section 2, defines the customer classes to be used for distribution rates and in the description of customer classes there is no reference whatsoever to a customer class being determined based on business risk.

ECMI also suggested that wholesale market participation should also be a criterion in determining customer classification. From a distributor's perspective, whether a customer is a market participant does not determine the assets required to deliver power to the customer. Therefore, it is not a relevant criterion in establishing customer classification and does not reflect asset utilization.

Acquired Rates

Both CME and SEC argue that a logical assumption would be that Acquired LDCs recovered the costs to operate based on their total revenue requirement. Therefore the Acquired LDC rates are said to be just and reasonable and Acquired customers are not being subsidized by Legacy customers. This is not a logical assumption.

The Acquired LDCs at the time they were purchased by Hydro One had bundled rates like all other distributors in Ontario. Since rates were bundled it is not possible to state that each individual cost component that made up the bundled rate was recovering costs properly. It is quite possible that some charges were over recovering for costs, while other charges were under recovering for costs. For example, charges to recover

commodity costs may have been overstated while charges to cover distribution costs may have been understated. The only way to be able to demonstrate if each cost component is properly reflected in rates is by doing a cost allocation study for the unbundled components, for example distribution costs. This is exactly what Hydro One has presented in this Proceeding, a cost allocation study that determines how to establish cost based rates to recover distribution costs by customer class.

There is no basis for treating Acquired LDCs as a separate group and demanding, like SEC does, that a cost of service be done just for Acquired LDCs. There is no asset utilization basis to treat all Acquired LDCs as one group. The only common feature of the Acquired LDCs is that they were purchased by Hydro One. This is not a criterion that reflects asset utilization that warrants separate treatment.

The facts are that Acquired LDCs decided to sell their assets to Hydro One. One can speculate as to what the reasons might have been for selling the distributors. It is likely that the distribution system in the Acquired LDCs may not have been kept up, or that the Acquired LDCs would have had to invest money in upgrading their assets to be able to operate under a new electricity market environment, or that the distributor may have been incurring losses and not be recovering their operating costs. For any one of these reasons, the Acquired LDC rates would have been lower than what they should have been, and it is Hydro One's view that the shortfall in rates has now been demonstrated by determining cost based target distribution rates using the OEB cost allocation model.

7.2. Is Hydro One's cost allocation appropriate?

Board staff accepts the cost allocation study filed by Hydro One and submits that the modifications applied by Hydro One improve the accuracy of results. Board staff states that the study filed by Hydro One improves the quality of the cost allocation study. Having developed the cost allocation methodology, Board staff is in the best position to judge the cost allocation study filed by Hydro One. Hydro One provided in the pre-filed

evidence all the modifications to the OEB cost Allocation Methodology that it needed to do to reflect Hydro One's circumstances [G2.1.1].

CCC submits that Hydro One has met the Board's directive in conducting a cost allocation study on the proposed 12 new customer classes by applying the OEB cost allocation model. VECC summarizes its comments with Hydro One's Cost Allocation methodology by stating that the "...methodology is likely sufficiently robust to be used in conjunction with the Board's Guidelines."

Board staff questions "Should there be a reconsideration of cost information after two years to support or to modify the further changes beyond the half-way point of the proposed harmonization?. Hydro One is of the view that it has provided support for its harmonization plan and it has followed current OEB guidelines in its 4 year implementation plan and a mandatory mid term review is not warranted.

CME states that Hydro One should have determined what costs and revenues would be allocated to Acquired LDCs on a stand alone basis. Hydro One testified that this exercise is impossible to do, since Hydro One does not track costs separately for each Acquired LDC [Tr. Vol.5, page 181, lines 20 to 28). In cases where utilities merge, the OEB requires a cost allocation study for the consolidated entity.

SEC takes issue with the density factors proposed by Hydro One to reflect the different costs incurred between urban and rural customers. Hydro One's proposed factors are a proxy to reflect different costs (TR Volume 5, page 166, lines 26 to 27). The study demanded by SEC instead of using the proxy approach can not be done. Hydro One does not record costs separately for its Acquired LDCs versus the Legacy customers. Hydro One runs an integrated system ((TR Volume 5, page 181, lines 20 to 28).

The density weights developed are not based only on assigning distance to the various customer classes, as SEC wrongly states. Energy and net book value are also used in determining the density weights, [G2.1.1, pg. 2], not just distance.

VECC suggests that density weights should have been applied to the split of LV assets and Primary assets between the ST and other classes and that the ST, DG, Street Light and Sentinel Light classes should also have been considered when developing the density weights. Hydro One disagrees. DG, ST, Street Light and Sentinel Lights are not classes that are divided using density between Urban and Rural, like Residential and General Service, therefore, density weights are not applicable, (TR Volume 5, page 53 line 28 to page 54 line 6). The density weights are taken into account when allocating costs within the residential and general service customer classes (TR Volume 5, page 52, lines 23 to 25).

7.3. Are Hydro One's proposed rates appropriate?

SEC has concerns that Hydro One's proposed rates are not just or reasonable. Contrary to SEC's claim, the proposed rates are just and reasonable and comply with Board guidelines. The fixed and volumetric charges were developed following Board guidelines and all Intervenors agree with the proposed methodology to establish rates to recover the allowed revenue requirement.

SEC again tries to compare the rates of Hydro One Acquired LDCs with the rates of other LDCs. As stated by Mr. Roger, the rates are the result of the approved OEB revenue requirement (TR Volume 5, page 178, lines 1 to 5). Comparing rates of various LDCs, some of which are cost based (TR Volume 5, page 178, lines 20 to 26), while others are not does not produce a credible basis of comparison.

7.4. Are the proposed revenue to cost ratios appropriate?

Board staff notes that all the proposed ratios are in the Board's target ranges. CCC supports the proposed target rates and the implicit revenue to cost ratios.

VECC suggests that the revenue to cost ratio for the ST class be set at 1.25, because the ST class includes customers below 5 MW and because the Board did not set a recommended range of revenue to cost ratio for Embedded LDCs (paragraph 255). The

ST class is made up of mostly embedded LDCs and Direct delivery points that until now are part of the LV class. The current LV class for Hydro One is the equivalent of the Large User class for other distributors, therefore, it is reasonable to apply the revenue to cost ratio ranges for Large Users to the proposed ST class. AMPCO supports the proposed revenue to cost ratio for the ST class as long as a commitment is made to move the ratio towards unity in the near future (Issue 7.4).

AMPCO states that because there are very few distributed generation actually completed to date, the DGen class does not have good data and that the revenue to cost ratio for this class should not be set to 1. As can be seen in Exhibit G1, Tab 2, Schedule 3, page 7, lines 6 to 10, there were 81 distributed generation customers in 2006, so AMPCO's assertion that there are few is not correct. The DGen class was established as a direct result of Board direction.

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

7.6. Is Hydro One's proposal to have both fixed and variable service charges for sub-transmission customers appropriate?

There was general support for Hydro One's proposal by those parties that commented on these issues.

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

Other than VECC all parties supported Hydro One's development of Rider #3. VECC suggests that the allocator used for OEB costs should include directly allocated costs not just Administrative and General Expense allocator. Hydro One disagrees and has used an allocator resulting from the application of the OEB Cost Allocation Model.

CONFIDENTIALITY

Hydro One filed undertaking responses for which the Company sought confidential treatment following the Board's Confidential Filing Guidelines with the added request that distribution of the undertaking J3.10 be restricted to members of the Law Society of Upper Canada (LSUC). The three undertakings were:

J2.5 – The CN Utility Study;

J3.3 – Acquisition Financial Model; and

J3.10 – Quarterly Management Reports.

The reasons for requesting confidential treatment were explained in Hydro One's Argument-in-Chief [Trans. Vol 7, pgs 3-9]. The Board panel agreed to treat the documents confidentially and limit their distribution to members of the LSUC on a provisional basis. Intervenors were to respond to Hydro One's position in their arguments and SEC provided a response which was supported by VECC in their submissions.

There was only agreement that J3.3 should be treated as confidential. Intervenors also disagreed with Hydro One's request for limiting distribution of J3.10 to LSUC members.

With respect to the CN Utility Study, Hydro One reiterates CN Utility's concern that the document contains proprietary information and has commercial value to them. Hydro One also wants to reiterate its concern that if the Board were to rule for public disclosure, it will become increasingly difficult to engage consultants or for consultants to gain utility participation in future studies. Hydro One respectfully submits that J2.5 should remain confidential.

Turning to J3.10, the Quarterly Management Reports. Counsel for the School Energy Coalition (the "SEC") is correct in its assertion in paragraph 0.3.11 that "[t]he essence of

the disclosure restrictions under the Ontario Securities Act [(the “Securities Act”)] is that disclosure should be available to all members of the public at the same time, rather than selective[ly disclosed], and it should not be untruthful or misleading ...”. It is for this precise reason that Hydro One Networks Inc. (“Hydro One Networks”) is seeking confidential disclosure of the documents in question, namely the documents referred to by SEC as the Quarterly Management Reports. These reports are on Hydro One Inc. (on a consolidated basis) and for the attention of the President & CEO of Hydro One Inc., the parent company of Hydro One Networks.

Specifically, the Securities Act requires full, true and plain disclosure of all material facts relating to an issuer, and prohibits selective disclosure of material facts, other than in the necessary course of business. It is for this reason that the Securities Act requires disclosure on the System for Electronic Document Analysis and Retrieval (“SEDAR”) of key pieces of information that investors need to know to make informed decisions. SEDAR is a publicly available internet site, and the Canadian Securities Regulators deem publication on SEDAR to constitute public disclosure for securities law purposes. Regulated public company filings (all of which are on SEDAR) include annual and quarterly financial statements, notes to those statements, auditors’ reports, management’s discussion and analysis, prospectuses and other offering documents, such as annual information forms. Hydro One Inc. is a public debt issuer and complies with all of its requirements as a public issuer of debt securities, and makes public all material information required by securities legislation.

Hydro One Inc. also complies with securities legislation by not selectively disclosing material information before that information has been generally disclosed. The Quarterly Management Reports are, in essence, internal working documents, the contents of which have not been approved by the Board of Directors, nor audited by an independent third party, such as the corporation’s auditor, KPMG LLP. As such, disclosure of these documents in a non-confidential manner could jeopardize the securities regime and could subject Hydro One Inc. to significant secondary market liability to investors who

purchase Hydro One Inc. securities following the disclosure of such information, if such information proves to be inaccurate, or the projections implied in such information do not materialize. Counsel for the SEC asserts in paragraph 0.3.12 that “in both these cases [past disclosure and disclosure in these management reports], the disclosure is public ...”; however this statement is wholly inaccurate. These Quarterly Management Reports have never been generally disclosed, have not been filed on SEDAR, and are not public documents. The contents of these documents have not been sufficiently vetted to be disclosed generally via SEDAR, and thus disclosure in a non-confidential manner to select parties (ie. not on SEDAR) could constitute selective disclosure of material facts, and reliance upon their contents could be detrimental. Hydro One Inc. is not required, nor is it prepared to generally disclose these Quarterly Management Reports on SEDAR for the reasons stated above; thus any selective disclosure is prohibited. However, Hydro One Networks is of the view that disclosure on a confidential basis would constitute disclosure “in the necessary course of business”, and would therefore be permissible due to an exemption in the Securities Act.

The SEC further argues in paragraph 0.3.12 that since there has been past disclosure of past actual data and future forecasts, it must follow that these reports, which contain some similar information, be made public. Hydro One Networks submits that by virtue of previous disclosures, as it has been submitted by the SEC to have taken place historically, there has been no waiver of its rights, obligations, and duties under securities legislation. Provision of these documents on a confidential basis to the participants in this distribution rate application would allow Hydro One Inc. to adhere to the requirements of both its regulators, by allowing for review of these documents by interested parties and interveners in this process, while also ensuring that the public is protected from the harm of selective disclosure.

The SEC’s suggestion in paragraphs 0.3.13 and 0.3.14 that the filing of these documents on a confidential basis would somehow render them not useful is flawed. The act of filing these on a confidential basis will allow for their review and use for all interested

parties in these proceedings. Hydro One Networks submits that the SEC itself has recognized through its assertion in paragraph 0.3.12 that the group of individuals that require access to the type of detailed information found in the Quarterly Management Reports is much narrower than the broad investing public: “In both cases, the disclosure is public, but in fact only a small handful of people will know about it and use the information.” All that is being sought by a request for confidentiality is an acknowledgement that Hydro One Inc. must simultaneously comply with securities legislation, which is intended to protect the public by requiring full, true and plain disclosure of all material information and prohibiting selective disclosure of material information. The public, rather than confidential, disclosure of these documents, would breach securities legislation. Surely one Ontario regulator’s regime is not paramount to another’s, and both can be complied with in a satisfactory fashion.

Hydro One would like to repeat its position that, in addition to the reasons above, production of these reports in this case should not be a precedent in future cases. Although the Applicant voluntarily filed these reports in response to a request from the Vice Chairman, it considers such documents to be confidential management tools which should be protected.

Other Issues:

Update on HOPPER

Hydro One continues to explore with HOPPER possible alternative solutions to deal with its unique situation as a result of Hydro One's proposal to end the interim time-of-use rate pilot. A number of face to face meetings have taken place between Hydro One staff and Mr. Vickers.

HOPPER obtained an estimate of the costs that would be required to upgrade its own power system to be able to receive electricity at a voltage that would be consistent with the voltage for the new proposed Sub-Transmission (ST) customer class. In its final argument, Mr. Vickers on behalf of HOPPER, provided the estimate of \$151,594. HOPPER requested that all costs be covered by Hydro One including lost production costs while its power system is upgraded.

Hydro One requests that any solution proposed by the Board to deal with HOPPER's situation take into consideration that Hydro One should be able to recover its approved revenue requirement.

HOPPER Argument

Mr. Vickers on behalf of HOPPER is asking the OEB to grandfather the continuation on the interim time-of-use and continue to charge HOPPER the same rates.

Hydro One must charge Board approved rates and conform to system code requirements. It does not have discretion to make special arrangements with individual customers such as HOPPER.

Hydro One understands that the Board is evaluating distribution Rate Design issues and one of the issues being explored is whether the time-of-use concept should be part of any future distribution rate design. In the interim period, Hydro One proposes that HOPPER would qualify for the additional mitigation that limits the total bill impact for Acquired general service demand billed customers to a maximum of \$100 and 15%.

Hydro One is financially neutral so long as other customers pay for the shortfall in revenues.

In paragraph 7.7.100 and 7.7.101 SEC claims that the facts are that the reason for the increase in Hopper is not due mainly to the elimination of the TOU as Hydro One's evidence states but is due equally as a result of harmonization. The basic math is as follows:

- Current distribution bill: $45 \text{ kW} * \$4.44 = \199.80
- Proposed distribution bill: $719 \text{ kW} * 8.48 = \$6,097.12$
- Increase due to elimination of TOU billing: $(719 \text{ kW}/45 \text{ kW}) = 15.978 \text{ times}$
- Increase due to Harmonization $(\$8.48/\$4.44) = 1.90991 \text{ times}$
- Therefore, current bill $\$199.80 * 15.978 * 1.90991 = \text{Proposed bill } \$6,097.21$

Clearly, the increase as a result of the elimination of TOU billing (15.978 times) is much higher than the increase due to Harmonization (1.90991 times).

Milton Hydro

Milton's argument urges the OEB to create a new category of line for the purpose of the LV rate design, a "Dedicated Line". Milton's criteria would be that the line was constructed to serve a single LDC customer and will continue to serve only one LDC, that it crosses a Network transformer station property ("from the station itself to the municipal boundary" added in Final Argument) and the line does not cross the service territory of another LDC.

Based on Milton's own criteria for "dedicated line" prior to Final Argument, the two feeders out of Palermo TS do not meet the criteria of crossing the Network station property to the municipal boundary, and also not traversing the service area of any other LDC. As shown in Exhibit H, Tab 9, Schedule 1, the location of the fence at Palermo TS is not at the municipal boundary. There is a portion of land outside the fence and before the road allowance where the municipal boundary is, that is Oakville Hydro's territory, and also is outside the transformer station property. If a new customer would be located between the station and the municipal boundary, it would have to be served by Oakville Hydro and could not be served by Hydro One Transmission. By definition Hydro One Transmission can not serve a customer at a voltage of 27.6 kV, which is the voltage of the two feeders in question.

Milton Hydro's Final Argument says "at the time these various LV lines were built it was a matter of Hydro local policy and happenstance whether the local LDC served by the Palermo transmission station, or any other TS, was permitted to build the feeder right to the TS itself, or just to the edge of the Networks property on which the TS sat (Vol. 6, p. 102, Thorne)." This statement is inconsistent with the OEB's Distribution System Code.

The Distribution System Code disallows a distributor building distribution system outside its territory if the line is not dedicated to the distributor, or if there is opportunity for both distributors to share the line, or if sole ownership impinges on the operations of the distributor in whose territory the line is.

From the OEB's Distribution System Code:

6.3.4 A distributor shall not build any part of its distribution system in another distributor's licensed service area except under the following conditions:

- The part of the distribution system that is to be located inside another licensed service area is dedicated to the delivery of electricity to the distributor who owns the distribution facilities; and

- There is no apparent opportunity for both distributors to share the distribution facilities; and
- The distributor in whose service area the distribution facilities are to be located determines that the presence of the distribution facilities in that location does not impinge on its distribution operations.

Milton Hydro claims that Hydro One's line charges for their supply from Palermo TS are "outrageous". However, the charges are based on a well-reasoned, appropriate, OEB-approved basis, methodology and definition. Milton Hydro is confusing "injustice" with "pool winners and losers" inherent in accepted and approved cost pooling practices.

Hydro One made another offer after the conclusion of the Oral Hearing to Milton Hydro for the sale of the two feeders from Palermo TS. The offer was rejected by Milton Hydro and Milton Hydro made a counter offer that is not consistent with the market value of the assets based on current applicable rates for these assets. It seems that the two parties are now at an impasse and await the Board's decision.

All of which is respectfully submitted.

ORIGINAL SIGNED BY D.H. ROGERS

D. H. Rogers

Counsel to the Applicant Hydro One Networks Inc.

August 28, 2008