

F.12.

K2.4

Hydro One Networks Inc.

Transmission

2017 and 2018 Revenue Requirement and Rates

EB-2016-0160

Board Staff Compendium

for

Witness Panel 1 – Strategy

November 24, 2016

Ontario Energy Board
FILE No. <u>EB-2016-0160</u>
EXHIBIT No. <u>K2.4</u>
DATE <u>Nov 25, 2016</u>
08/99

Ontario Energy Board (Board Staff) INTERROGATORY #001

Reference:

Exhibit A, Tab5, Schl

Interrogatory:

In 2015, Hydro One underwent a change in corporate structure which included the issuance of ownership shares to outside investors.

- a) Please provide a summary of the impacts of this change with regard to this application with particular regard to financial impacts that would affect customers.
- b) Please advise what impact, if any, the change in corporate structure will have on Hydro One's governance.

Response:

- a) All transactional costs associated with Hydro One's initial public offering (IPO) have been borne solely by Hydro One's shareholder. These costs include, but are not limited to, the payment by Hydro One of the \$2.6 billion Departure Tax, advisory costs, legal costs, prospectus and securities costs, and underwriting commissions.

The ongoing costs associated with Hydro One becoming a publicly traded entity are related solely to company's new governance structure, as described in part (b) of this response and as set out in IR I-13-018. The changes in cost associated with Hydro One's senior leadership team are not a function of the IPO.

They are directly attributable to Hydro One Limited's new governance structure.

As described in part (b) herein, the government of Ontario decided, in conjunction with the planned sale of shares of the company to the public, that it was appropriate for it to step back from the day-to-day management of the company. Accordingly, it appointed an Independent Board of Directors and executed the Governance Agreement that is described in part (b) of this response.

The Independent Board of Directors determined that in order to improve the performance of the company, it was necessary to increase the commercial orientation of the organization;

1 that is, increase the company’s focus on customers, create greater corporate accountability
2 for performance outcomes, and drive company-wide increases in efficiency and productivity.

3
4 The statutory obligation of the Board of Directors is to manage the company. To fulfill this
5 obligation, the Board of Directors delegates this responsibility to management. In order to
6 achieve its commercial objectives, the Independent Board of Directors determined that senior
7 managers with proven track-records of delivering the targeted commercial objectives were
8 needed. The individuals with these skills have been added to Hydro One’s senior leadership
9 team and have been empowered by the Independent Board of Directors to achieve these
10 commercial objectives.

11
12 The successful achievement of these commercial objectives (increased focus on customers,
13 greater corporate accountability for performance outcomes, and increased company-wide
14 efficiency and productivity) will be evident in all facets of Hydro One’s businesses, which as
15 of the date of this application are 99% rate regulated (by revenue).

16
17 b) The Province decided to broaden the ownership of Hydro One pursuant to an initial public
18 offering (IPO) of Hydro One’s common shares in order to strengthen the long-term
19 performance of Hydro One and generate value for Ontarians. Following the IPO and the
20 Province’s additional sale of the common shares in Hydro One Limited (“Hydro One”)
21 completed to date, the Province continues to directly own 416,803,660 common shares,
22 representing approximately 70.05% of Hydro One's total issued and outstanding common
23 shares and the public owns the remaining common shares. As a result of the issuance of
24 ownership shares, the Province is no longer Hydro One’s sole shareholder. Hydro One is
25 now a publicly listed company, and the impact on governance is described below.

26
27 Hydro One and the Province signed a Governance Agreement on November 5, 2015 in
28 connection with the closing of the IPO. The Governance Agreement describes certain
29 principles that govern how Hydro One will be managed and operated, including that the
30 Province, in its capacity as a largest holder of common shares, will engage in the business
31 and affairs of Hydro One as an investor and not as a manager. It is described in Exhibit A,
32 Tab 5, Schedule 1 and provided in Exhibit I, Tab 2, Schedule 6.

33
34 The Governance Agreement: (i) requires that except for the CEO, all board members be
35 independent of Hydro One and independent of the Province; (ii) addresses the director
36 nomination process, including the requirement to maintain a board of between 10 and 15
37 members and prescribing the maximum number of directors that may be nominated by the

1 Province; (iii) requires Hydro One to maintain a majority voting policy for director elections
2 and restricts the Province's ability to withhold from voting for directors except where the
3 Province replaces the entire board other than the CEO and, at the Province's discretion, the
4 board chair; (iv) requires approval by special resolution of the directors of the appointment
5 and annual confirmation of the CEO, the board chair and changes to key governance
6 practices of the company; (v) restricts the right of the Province to exercise certain
7 shareholder rights, such as to requisition a shareholder meeting to consider a fundamental
8 change, or to solicit others to exercise rights which the Province is restricted from exercising;
9 and (vi) restricts the acquisition of voting securities by the Province but grants the Province
10 pre-emptive rights with respect to future issuances of voting securities.

Witness: Michael Vels

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Consumers Council of Canada (CCC) INTERROGATORY #018

Reference:

Ex. C1/T3/S3/p. 3

Interrogatory:

For each year 2012-2018 please provide the actual and forecast Corporate Management Costs specifically related to the Board of Directors.

Response:

The table below summarizes the total compensation (in \$ millions) for the Board of Directors, including the Chair of the Board.

	2012		2013		2014		2015		2016	2017	2018
	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Plan	Plan	Plan
Board of Directors	1.7	1.5	1.7	1.5	1.6	1.9	3.7	1.9	4.2	3.4	3.4
Hydro One Chair	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.6	1.7	1.8

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1 **London Property Management Association (LPMA) INTERROGATORY #012**

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3 **Reference:**

4 Exhibit C1, Tab 6, Schedule 1 & EB-2013-0416 Exhibit C1, Tab 5, Schedule 1

5
6 **Interrogatory:**

7 Please explain the significant increase in total CCF&S costs shown in the current evidence of
8 \$201.8 for 2017 and \$202.7 for 2018 in Tables 1 and 2 with the figures in Tables 3 and 4 in
9 Exhibit C1, Tab 5, Schedule 1 in EB-2013-0416 of \$175.3 (Table 3) for 2017 and \$179.2 (Table
10 4) for 2018.

11
12 **Response:**

13 The most significant increase from the costs reflected in EB-2013-0416 is in the Corporate
14 Management costs. A large part of this increase is due to the inclusion of \$6.3 million of costs
15 that are not recoverable from transmission or distribution customers. These costs were not
16 included in the summaries in previous years. These are costs associated with: (a) "value growth"
17 team engaged in acquisitions; (b) corporate donations; and (c) investor relations. The balance of
18 the increase is largely due to increased salaries in this group. As Hydro One has been evolving,
19 the company has hired several new senior executives at market rates. See Exhibit I, Tab 11,
20 Schedule 23 for details.

21
22 A revised view of Table 1: CCF&S Costs (\$ Millions) is provided below, isolating these costs
23 and showing the Corporate Management costs exclusive of value growth, corporate donations,
24 and investor relations.

1

Table 1: CCF&S Costs (\$ Millions)

Description	Historic Years				Bridge Year	Test Years		TX Allocation	
	2012	2013	2014	2015	2016	2017	2018	2017	2018
Corporate Management	5.0	4.9	5.5	12.5	23.4	22.3	22.1	7.2	7.1
Value Growth					5.9	4.2	4.2	0.0	0.0
Corporate Donations					1.1	1.1	1.1	0.0	0.0
Investor Relations					1.8	1.0	1.0	0.0	0.0
Corporate Management (excluding 3 groups above)					14.5	16.0	15.7	7.2	7.1
Finance	35.2	41.9	40.0	39.1	42.1	41.0	38.6	21.9	19.4
Human Resources	9.9	11.1	12.8	13.6	16.2	14.8	14.2	7.6	7.3
Corporate Communications & Services	11.3	15.0	19.5	17.3	17.5	17.3	19.4	8.7	9.9
General Counsel and Secretariat	8.8	9.6	8.7	8.6	10.3	10.4	10.5	5.5	5.6
Regulatory Affairs	20.6	20.6	23.0	24.1	26.4	25.4	26.0	9.6	9.8
Security Management	3.1	3.4	3.5	4.2	5.1	4.7	4.8	2.2	2.3
Internal Audit	3.5	3.4	3.6	4.2	6.2	6.3	6.4	3.3	3.4
Real Estate & Facilities	54.6	54.1	53.6	60.0	60.1	59.6	60.7	32.2	32.7
Total CCF&S Costs	152.0	164.0	170.3	183.6	207.3	201.8	202.6	98.3	97.5

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Human resources costs have also increased by approximately \$2 million. The period 2013 to 2015 saw an increase in training costs for: (a) a larger new graduate population; and (b) existing employees, specifically on the topic of the “craft of management”, with a focus on managers and supervisors. Some of the costs can also be attributed to on-campus recruitment and marketing.

Between 2016 and 2018, with Hydro One’s move to a more commercially-oriented culture, the People and Culture organization now requires resources and skills to meet new requirements. Examples include: (a) building and sustaining new compensation structures, such as the long-term incentive plan, the short-term incentive plan, and the employee stock option plan; (b) a renewed focus on performance management, which required building and sustaining a new talent management tool; and (c) a renewed focus on change management intended to maximize the value of corporate change initiatives.

Witness: Glenn Scott

1 Regulatory Affairs' costs have also increased by approximately \$3.9 million in 2017 and \$2.7
2 million in 2018 for the reasons explained in Exhibit C1, Tab 3, Schedule 3. There is a planned
3 staffing reduction based on a computer system upgrade that will enable automatic reporting,
4 which is currently performed manually, but this has been delayed beyond the rate period.

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6 Internal Audit costs have also increased by \$2.7 million for the reasons explained in Exhibit C1,
7 Tab 3, Schedule 3.

Witness: Glenn Scott

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Filed: 2016-05-31
EB-2016-0160
Exhibit C1
Tab 4
Schedule 1
Attachment 1
Page 1 of 6

PAYROLL TABLE 2013 TO 2018

2013

REPRESENTATION	TOTAL NO. EMPLOYEES	TOTAL WAGES	Base Pay	Overtime (Incl. Premium)	Incentive	Other Allowances	Average Base Pay
PWU Reg	3,321	360,796,279	281,875,202	63,863,013	5,000	15,053,064	84,877
SOCIETY Reg	1,260	137,310,153	127,597,867	6,218,672	18,650	3,474,964	101,268
MCP Reg	600	82,939,240	70,290,362	176,885	8,229,068	4,242,924	117,151
Total Reg	5,181	581,045,672	479,763,431	70,258,571	8,252,718	22,770,952	92,601
PWU Temp	205	6,751,607	6,520,851	189,533	0	41,224	31,809
Society Temp	46	3,144,574	2,911,798	115,174	0	117,602	63,300
MCP Temp	25	1,221,374	1,175,065	1,172	0	45,138	47,003
Total Temp	276	11,117,556	10,607,714	305,878	0	203,963	38,434
CASUAL	1,781	127,813,187	98,482,627	14,650,054	11,000	14,669,505	55,296
TOTAL	7,238	719,976,414	588,853,773	85,214,503	8,263,718	37,644,421	81,356

2014

REPRESENTATION	TOTAL NO. EMPLOYEES	TOTAL WAGES	Base Pay	Overtime (Incl. Premium)	Incentive	Other Allowances	Average Base Pay
PWU Reg	3,271	370,778,651	289,722,800	65,829,127	21,363	15,205,361	88,573
SOCIETY Reg	1,290	148,807,143	137,143,088	7,665,451	40,600	3,958,004	106,312
MCP Reg	584	81,578,789	67,757,213	185,789	7,192,909	6,442,879	116,023
Total Reg	5,145	601,164,583	494,623,100	73,680,367	7,254,872	25,606,244	96,137
PWU Temp	160	4,641,750	4,545,582	71,729	0	24,439	28,410
Society Temp	53	2,999,247	2,850,420	49,519	0	99,308	53,782
MCP Temp	27	1,597,893	1,527,837	0	0	70,056	56,587
Total Temp	240	9,238,889	8,923,838	121,248		193,803	37,183
CASUAL	1,951	146,895,649	111,501,232	18,773,141	0	16,621,276	57,151
Total	7,336	757,299,121	615,048,171	92,574,755	7,254,872	42,421,323	83,840

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Filed: 2016-05-31
EB-2016-0160
Exhibit C1
Tab 4
Schedule 1
Attachment 1
Page 3 of 6

2015

REPRESENTATION	TOTAL NO. EMPLOYEES	TOTAL WAGES	Base Pay	Overtime (Incl. Premium)	Incentive	Other Allowances	Average Base Pay
PWU Reg	3,350	368,449,119	293,565,741	57,001,053	14,000	17,868,324	87,632
SOCIETY Reg	1,285	148,539,224	137,568,561	6,732,360	2,000	4,236,303	107,057
MCP Reg	585	84,289,003	71,950,517	66,188	8,326,449	3,945,849	122,992
Total Reg	5,220	601,277,346	503,084,819	63,799,601	8,342,449	26,050,477	96,376
PWU Temp	154	4,604,443	4,379,175	142,105	0	83,162	28,436
Society Temp	56	3,370,167	3,185,769	30,148	0	154,250	56,889
MCP Temp	34	1,858,713	1,780,187	28,392	0	50,134	52,358
Total Temp	244	9,833,322	9,345,132	200,645	0	287,546	38,300
CASUAL	1,819	140,242,277	109,059,885	15,359,842	0	15,822,550	59,956
TOTAL	7,283	751,352,945	621,489,835	79,360,089	8,342,449	42,160,572	85,334



Filed: 2016-05-31
EB-2016-0160
Exhibit C1
Tab 4
Schedule 1
Attachment 1
Page 4 of 6

2016

REPRESENTATION	TOTAL NO. EMPLOYEES	TOTAL WAGES	Base Pay	Overtime (Incl. Premium)	Incentive	Other Allowances	Average Base Pay
PWU Reg	3,411	384,766,692	307,771,694	58,619,373	0	18,375,625	90,229
SOCIETY Reg	1,241	145,544,065	134,898,018	6,534,345	0	4,111,703	108,701
MCP Reg	596	88,255,656	75,502,535		8,652,675	4,100,445	126,682
Total Reg	5,248	618,566,413	518,172,247	65,153,717	8,652,675	26,587,773	98,737
PWU Temp	230	6,945,533	6,605,730	214,357	0	125,446	28,721
Society Temp	51	3,084,606	2,915,832	27,593	0	141,180	57,173
MCP Temp	26	1,427,650	1,388,546		0	39,104	53,406
Total Temp	307	11,457,788	10,910,108	241,951	0	305,730	35,538
CASUAL	1,971	153,480,870	119,354,922	16,809,781	0	17,316,167	60,556
TOTAL	7,526	783,505,072	648,437,277	82,205,449	8,652,675	44,209,670	86,160

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Filed: 2016-05-31
EB-2016-0160
Exhibit C1
Tab 4
Schedule 1
Attachment 1
Page 5 of 6

2017

REPRESENTATION	TOTAL NO. EMPLOYEES	TOTAL WAGES	Base Pay	Overtime (Incl. Premium)	Incentive	Other Allowances	Average Base Pay
PWU Reg	3,319	386,516,917	310,849,411	57,608,700	0	18,058,806	93,658
SOCIETY Reg	1,212	145,551,630	135,102,376	6,413,557	0	4,035,698	111,471
MCP Reg	593	89,567,644	76,624,939		8,781,304	4,161,402	129,216
Total Reg	5,124	621,636,191	522,576,726	64,022,257	8,781,304	26,255,905	101,986
PWU Temp	221	6,740,488	6,410,717	208,029	0	121,742	29,008
Society Temp	49	2,978,459	2,815,493	26,644	0	136,322	57,459
MCP Temp	25	1,400,195	1,361,843		0	38,352	54,474
Total Temp	295	11,119,143	10,588,054	234,673	0	296,416	35,892
CASUAL	2,106	165,633,191	128,805,216	18,140,747	0	18,687,228	61,161
TOTAL	7,525	798,388,525	661,969,995	82,397,677	8,781,304	45,239,549	87,969

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Filed: 2016-05-31
EB-2016-0160
Exhibit C1
Tab 4
Schedule 1
Attachment 1
Page 6 of 6

2018

REPRESENTATION	TOTAL NO. EMPLOYEES	TOTAL WAGES	Base Pay	Overtime (Incl. Premium)	Incentive	Other Allowances	Average Base Pay
PWU Reg	3,278	385,559,650	310,079,546	57,466,023	0	18,014,080	94,594
SOCIETY Reg	1,177	142,055,149	131,856,909	6,259,488	0	3,938,751	112,028
MCP Reg	587	90,434,623	77,366,637	0	8,866,303	4,201,682	131,800
Total Reg	5,042	618,049,421	519,303,092	63,725,512	8,866,303	26,154,514	102,995
PWU Temp	215	6,623,064	6,299,037	204,405	0	119,621	29,298
Society Temp	49	2,993,351	2,829,571	26,777	0	137,003	57,746
MCP Temp	25	1,428,199	1,389,080		0	39,119	55,563
Total Temp	289	11,044,614	10,517,688	231,182	0	295,744	36,393
CASUAL	2,158	171,420,129	133,305,447	18,774,553	0	19,340,128	61,773
TOTAL	7,489	800,514,164	663,126,228	82,731,247	8,866,303	45,790,385	88,547

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Table 1: Proposed Transmission Scorecard

RRFE Principle	Category	Metric	Definition
Customer Focus	Service Quality	Satisfaction with Outage Planning Procedures	<i>% satisfied in OGCC survey</i>
		Customer Delivery Point Performance Standards Outliers (as % of total delivery points)	<i>% of total delivery points designated as outliers</i>
	Customer Satisfaction	Overall % satisfied in corporate survey	<i>Transmission customers (Industrial, Generators, LDC) only</i>
Operational Effectiveness	Safety	# of recordable incidents per 200,000 hours	<i>Average # of incidents per 200K hours</i>
	System Reliability	Average # of sustained interruptions per delivery point	<i>T-SAIFI-S</i>
		Average # of momentary interruptions per delivery point	<i>T-SAIFI-M</i>
		Average minutes that power to a delivery point is interrupted	<i>T-SAIDI</i>
		System unavailability (%)	<i>% of system not available for use</i>
		Unsupplied energy (minutes.)	<i>Unsupplied MW-minutes/Peak MW</i>
	Asset Management	In-service additions as % of OEB-approved plan	<i>\$ ISA as percentage of Planned \$ Amounts</i>
		Capital Expenditures as % of Budget	<i>\$ Capital Expenditures as % of Budgeted \$ Capital Expenditures</i>
	Cost Control	OM&A and Capital Expenditures/Gross fixed asset value	<i>OM&A and Capital Expenditures/ Gross fixed assets</i>
		Sustainment capital /Gross fixed asset value	<i>Sustainment Capital Expenditures/ Gross fixed assets</i>
OM&A/Gross fixed asset value		<i>OM&A/ Gross fixed assets</i>	
Policy Response	Renewables	% of new connection impact assessments completed on time	<i>Total assessments completed within expected time/Total connections requested</i>
	Regulatory Compliance	NERC & NPCC Standards Compliance – High impact issues	<i># of high impact compliance violations as defined by NERC/NPCC</i>

Witness: Michael Vels

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Ontario Energy Board (Board Staff) INTERROGATORY #091

Reference:

Exhibit B2/Tab 1/Sch1 – Section 4: Process to Develop Scorecard Metrics, Table 1 – Proposed Transmission Scorecard, pg. 5-6

Interrogatory:

As one of the paramount concerns of customers is the cost of receiving electricity service, please explain why the proposed scorecard doesn't include a cost per unit, either in \$/MWh of energy delivered or \$/MW-year of capacity billed to customers or a measure of total costs to be borne by rate payers over the years.

Response:

Normalizing Cost (either OMA or Capital) by energy delivered (MWh) or MW of capacity billed has been considered in the past. Costs based on unit volume do not account for differences in the geography, topography and customer density of a utility's service territory and its overall system size. The measures proposed: (Total OMA + Capital) per GFA (in %); Sustainment Capital per GFA (in %) and OMA per GFA (in %), account for system size.

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Table 2: Tier 2 and Tier 3 Metrics

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Performance Categories	Scorecard Metric	Preliminary Tier 2 Metrics	Preliminary Tier 3 Metrics
Service Quality	% Satisfaction with Outage Planning Procedures	% of outages cancelled Planned outages per Delivery Point	
Customer Satisfaction	Overall % satisfied in customer survey		Customer satisfaction with Price (%) Customer Satisfaction with Relationship (%) Product Quality / Reliability Satisfaction (%) Customer Service
		OGCC Transmission Customer Satisfaction (%)	
Safety	Recordable Incidents per 200,000 hours	Recordable Motor Vehicle Accidents (#/1,000,000 km driven)	
System Reliability	T-SAIFI	Interruption frequency for multi-circuit delivery points	Frequency of Momentary Delivery Point Interruptions (MC only) Frequency of Sustained Delivery Point Interruptions (MC only)
		Interruption frequency for single-circuit delivery points	Frequency of Momentary Delivery Point Interruptions (SC only) Frequency of Sustained Delivery Point Interruptions (SC only)
	T-SAIDI	Interruption minutes for multi-circuit delivery points Interruption minutes per single circuit delivery point	
	System Unavailability	Lines Unavailability Stations Unavailability	% of Forced outages caused by equipment type

Witness: Michael Vels

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2016-05-31
 EB-2016-0160
 Exhibit B2
 Tab 1
 Schedule 1
 Page 10 of 25

Asset Management	In-service Additions as % of OEB-approved plan	% of budgeted work completed on or ahead of schedule	Km of line refurbished versus plan Number of transformers replaced versus plan Number of breakers replaced versus plan
	Capital Expenditures as % of budget	ECS Capital Expenditures/Project Management FTE Engineering Costs/ECS Capital \$ ECS CapEx/Construction FTE	
	Performance Categories	Scorecard Metric	Preliminary Tier 2 Metrics
Cost Control	Total Capital and OM&A/Gross Fixed Assets	Supply Chain Value Realization % (Ratio of supply chain savings to procurement operations cost)	Preliminary Tier 3 Metrics Sum of discounts and savings from strategic sourcing (\$) Sum of Costs of procurement operations (\$)
		Facilities & Real Estate value realization (Ratio of facility savings and revenues to real estate operations cost)	Sum of revenues and savings from real estate initiatives (\$) Sum of costs of real estate operations (\$)
		Overhead as % of net Capital Expenditures	
	Sustainment Capital/Gross Fixed Assets	Administrative Costs as % of OM&A & Capital Expenditures	Fleet utilization (%)
	OM&A/Gross Fixed Asset Values	Actual costs versus estimated costs for completed capital projects (%)	Transmission Wood Structure Condition Assessment (\$/pole) Transmission Wood Structure Replacement (\$/structure) Transmission Brush Control Cost per Hectares (\$/hectare) Transmission Line Clearing Cost per Km (\$/Km) Cost per 115kV Tower Coated (\$/tower) Cost per 230kV Tower Coated (\$/tower) Cost per Transmission Cable Locate (\$/locate, network operating only)
	Lines RCE Stations RCE	Ratio of unplanned work to planned work	

Witness: Michael Vels

1 **6. COMMITMENT TO PRODUCTIVITY IMPROVEMENT**

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3 Hydro One has made efforts to improve the efficiency of the organization and the
4 productivity of its work programs in recent years, and has begun to see the results of
5 these efforts in its work programs and budgets. The company has been able to maintain
6 transmission OM&A at steady levels over recent years, despite factors putting upward
7 pressure on OM&A. See Exhibit C1, Tab 2, Schedule 1 for further details on the OM&A
8 expenditure levels. Forces contributing to these upward pressures include:

9

- 10 • Inflation of approximately 2% per year;
- 11 • Increased operating and maintenance requirements of a growing asset base; and
- 12 • Costs of compliance with new regulatory standards including NERC Cyber Security,
13 PCB regulation, and new vegetation management standards.

14

15 Hydro One will continue to face many of these same upward pressures on OM&A in the
16 coming years. However, through efforts to increase efficiency throughout its work
17 programs, OM&A levels in both 2017 and 2018 are forecast to decline.

18

19 Hydro One is committed to pursuing initiatives to increase efficiency across both its
20 administrative and operating groups. These include:

21

- 22 • **Improved maintenance planning** facilitated by greater collaboration between the
23 asset management team and the program management team to ensure an efficient
24 work release process;
- 25 • **Revised timelines to release work earlier and in multi-year segments** to enable
26 greater flexibility in planning for outages and staff time;

Witness: Michael Vels

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Ontario Energy Board (Board Staff) INTERROGATORY #116

Reference:

Exhibit C1/Tab2/Sch6/pp. 5 - 17

Interrogatory:

Hydro One lists a number of productivity improvements and business practices that are intended to increase efficiency. Has Hydro One quantified these improvements in terms of OM&A savings over the 2016 to 2018 period? Please provide a forecast of the savings that may be expected through each of these process improvements.

Response:

<u>2016 Productivity Savings</u>			
<u>OMA only</u>			
Cost Efficiency Initiative	2016 YE Forecast	2017 YE Forecast	2018 YE Forecast
Cable Vault Inspection with cameras	\$35,000	\$35,000	\$35,000
Inhouse retorques on light vehicles	\$40,000	\$40,000	\$40,000
Regular used materials in inventory rather than shopping	\$250,000	\$250,000	\$250,000
TWHQ Stations	\$375,000	\$375,000	\$375,000
Stradle Hoist Usage - Instead of crane contractor	\$95,000	\$95,000	\$95,000
Recondition oil - Instead of purchasing new	\$400,000	\$400,000	\$400,000
Outsourcing G&S BGIS	\$300,000	\$300,000	\$300,000
Wrench Time Studies	\$0	\$400,000	\$1,000,000
OT Reductions on Correctives/Prev 1% reduction on 11% 2015	\$1,000,000	\$1,000,000	\$1,000,000
	\$2,505,000	\$2,905,000	\$3,505,000

Witness: Andy Stenning

Ontario Energy Board (Board Staff) INTERROGATORY #114

Reference:

Exhibit C1/Tab2/Sch2/p.41 and Exhibit B2/Tab1/Sch1 p.18

Table 11 shows Vegetation Management costs over the test year period. Brush Control costs grow from \$17.8 million in 2015 to \$21.5 million in 2018, an increase of 21% over 3 years. At page 44, Hydro One indicates that the increase is due to the requirement to perform additional necessary brush control.

Interrogatory:

- a) What are the specific reasons for the increase in brush control costs over this period?
- b) At the second reference in Table 3, Hydro One provides unit cost metrics for forestry and lines work, covering 2012 to 2015. Please provide Hydro One's forecast or targets for the metrics on this table for 2016, 2017 and 2018.
- c) What are the clearing cycles employed by Hydro One that it considers are appropriate for its system and how it has determined that these cycles provide a cost-effective and sustainable level of reliability? Please provide examples to illustrate the varying cycle times.

Response:

- a) The proposed expenditure for brush control maintenance in 2017 and 2018 is consistent with historical spending levels.
- b)

Line of business	Unit Metric	2016	2017	2018
Forestry	\$ /brush control cost per hectare	12,500	11,500	11,800
	\$ /line km cleared	3,100	2,800	2,800
Provincial Lines	\$ /wood pole condition assessment	363	381	389
	\$ /wood pole replacement	47,000	47,000	47,000
	\$ /115 kv tower coated (average)	25,500	25,500	25,500
	\$ /230 kv tower coated (average)	40,500	40,500	40,500
Network operating (only)	\$ /cable locate	16	16	16

Witness: Chong Kiat Ng

Filed: 2016-08-31
EB-2016-0160
Exhibit I
Tab 1
Schedule 114
Page 2 of 2

- 1 c) Please refer to Exhibit C1, Tab 2, Schedule 2, section “Line Clearing” on page 42 for
- 2 clearing cycles employed. Hydro One vegetation management cycles have been established
- 3 based on historical experience to maintain vegetation related outages at the current level.

Witness: Chong Kiat Ng

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Ontario Energy Board (Board Staff) INTERROGATORY #120

Reference:

Exhibit C1, Tab 3, Schedule 2, p. 5

Interrogatory:

Regarding the BGIS services agreement which was effective February 19, 2015:

Please provide Hydro One’s rationale for entering into such an agreement with an emphasis on the expected cost savings over the 10 year period. In addition, please provide a report of client satisfaction and the regular reviews as indicated on page 7 of the schedule.

Response:

Hydro One entered into the BGIS services agreement to achieve a significant reduction in total costs in respect of the scoped facilities management, accommodation activities and related maintenance and repair work at its operations centres, stations, administrative facilities and rights of ways which are considered non-core to Hydro One’s business. In addition to lower operational costs, the agreement provides for stable, defined market level services over its 10 year term by leveraging industry best practices and offers significant potential to increase work accomplishments and internal customer satisfaction as a result of this work being BGIS’s core business. Through the agreement, Hydro One expects to realize costs savings in excess of \$80 million over the 10-year term of the agreement, as compared against Hydro One’s historical OM&A spend.

Internal client satisfaction is identified as one of the key performance measures in the agreement. Client satisfaction is measured by way of formal survey completed by internal clients who have requested services. The survey seeks feedback on the quality, timeliness and professionalism of the work performed to determine overall satisfaction. Surveys commenced in May of 2015. The customer satisfaction results obtained to date are set out below.

Service Request Customer Satisfaction Survey Results	
Quarter	Results
Q2 2015 (May & June)	80%
Q3 2015 (July – Sep)	85%
Q4 2015 (October – Dec)	79%
Q1 2016 (Jan – Mar)	75%
Q2 2016 (Apr – June)	83%

Witness: Gary Schneider

Filed: 2016-08-31
EB-2016-0160
Exhibit I
Tab 1
Schedule 120
Page 2 of 2

1 In accordance with the agreement, Hydro One's relationship is managed by means of a robust
2 governance structure which includes rigorous performance monitoring and oversight through
3 meetings at regular intervals at the executive (bi-annual), governance (quarterly), and operational
4 levels (monthly). Areas of focus at these meetings include a review of performance against the
5 key performance indicators and critical service levels, benchmarking, budgeting and goal setting,
6 risk identification and management, and the development of continuous improvement initiatives.

Witness: Gary Schneider

Consumers Council of Canada (CCC) INTERROGATORY #009

Reference:

Ex. B2/T1/S1

Interrogatory:

Please indicate whether HON has explicitly built in productivity into its 2017 and 2018 budgets. If not, please explain why not. Please explain why HON is not proposing a price cap approach to determining rates for 2018.

Response:

Hydro One Networks has explicitly built productivity into the 2017 and 2018 budgets. For example, Supply Chain will launch a series of sourcing initiatives using a competitive bid process over the next two years that is intended to drive increased competition between suppliers and result in reduced costs in specific purchase categories.

Below illustrates the budgeted saving estimates for four purchase categories, in millions of dollars:

Category	2017	2018
Equipment Rentals	\$1.31	\$3.31
General Hardware	\$1.80	\$1.80
Construction Services	\$1.68	\$1.68
Construction Materials	\$1.22	\$2.35
Total	\$6.01	\$9.14

These budgeted savings translate into the following impacts to transmission work programs.

	2017	2018
Capital	\$5.28	\$8.25
OM&A	\$0.73	\$0.89
Total	\$6.01	\$9.14

The OEB provided in its Filing Requirements for Electricity Transmission Applications dated February 11, 2016, that it will not immediately require all existing electricity transmitters to apply under Custom IR or a Revenue Cap index methodology for their first application after the issuance of the Filing Requirements, on the basis that applicants may need to make significant adjustments to business processes and planning activities prior to embarking on a new five year rate plan. As such Hydro One has applied for a two-year cost of service application that fulfills

Witness: Michael Vels/Oded Hubert

Filed: 2016-08-31
EB-2016-0160
Exhibit I
Tab 13
Schedule 9
Page 2 of 2

32

1 the February 11, 2016 Filing Requirements. As indicated on page 3 of Exhibit A-3-1 and
2 discussed in the response to CCC #1 (Exhibit I, Tab 13, Schedule 1), Hydro One is in the process
3 of devising new approaches relating to serving its customers, forming its investment plans, and
4 operating and maintaining its assets, while maintaining a strong commitment to safety and the
5 environment, all in anticipation of the requirement to file a 5-year rate plan that is fully
6 compliant with the OEB's RRFE for rates commencing January 1, 2019.

Witness: Michael Vels/Oded Hubert

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UNDERTAKING – TCJ2.2

Undertaking

To clarify the response to Board Staff Interrogatory 116 in terms of the potential for double counting in the forecast period.

Response

The savings found in Board Staff interrogatory 116 and Consumers Council of Canada interrogatory 9 are unrelated. The savings in Board Staff interrogatory 116 are calculated/estimated on a per year average against the historical cost prior to the implementation of the initiative.

24

UNDERTAKING – TCJ1.17

Undertaking

To clarify whether or not the amounts shown at Exhibit B, Tab T-1 – B2, T1, S1 are amounts that are just examples, or if they’re amounts in aggregate; to provide a list of additional examples of productivity initiatives.

Response

The amounts provided in response to Exhibit I, Tab 13, Schedule 9 were only a few examples of procurement related savings.

Currently embedded in the investment plan are the following savings.

In \$M	2017	2018
Procurement		
OM&A	2.1	2.8
Capital	11.2	21.4
Information Solutions Division (ISD)		
OM&A	3.4	4.5
Stations		
OM&A	2.9	3.5
Total		
OM&A	8.4	10.8
Capital	11.2	21.4

The forecasted savings are in the areas of procurement, information technology and stations. The procurement and information technology savings are explained below. For a breakdown of the stations savings, refer to Exhibit I, Tab 1, Schedule 116.

Procurement Savings

Following the initial public offering (IPO), Hydro One identified opportunities for cost savings and productivity improvements.

As described in Exhibit C1, Tab 5, Schedule 1, Hydro One’s Supply Chain division is refining its current approaches and introducing new approaches to increase both savings potential and productivity efficiencies for Hydro One.

Witness: Michael Vels

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Specifically, there are seven planned enhancements to sourcing approaches.

1. Bundling/Volume Discounts – Renew view of sourcing categorization, grouping materials/services supplied by like-suppliers to maximize savings and volume discount opportunities, and addressing multiple sub-categories at once. Bundle multiple contracts with a single supplier, and negotiate volume discounts across multiple categories and contracts.
2. Feedback Rounds – Maximize competitive pressure through multiple feedback rounds on rates, with an opportunity for vendors to improve their proposals.
3. ‘Lean’ RFPs – Emphasize leaner, “bidder-friendly” scope and value in RFP formats with fewer onerous requirements and redundancies.
4. Standardization of Spend and Specifications – Standardize requirements to allow direct, like-for-like comparisons across bidders. Move towards industry-standard specifications where reasonable, rather than Hydro One specifications, to reduce unnecessary costs.
5. Streamlined Evaluation – Compress timelines and streamline evaluation process to meet business needs and accelerate the realization of negotiated savings.
6. Cost Transparency – Increase knowledge of bidders’ prices and composition to improve Hydro One’s ability to challenge and negotiate less competitive pricing.
7. Transition Pricing – Where contracts are being renegotiated with incumbent vendors, implement new negotiated rates before the renegotiated contract execution.

The table below lists spending categories and their associated potential savings (expressed as percentages) over the test years. The savings assumptions for procurement are against the 2015 spend.

37

Procurement Productivity – Category Overview

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2

Category	Potential Savings (%)	Potential Approach/Levers
Electrical Hardware	5 – 15	<ul style="list-style-type: none"> • Conduct broad RFP with multiple feedback rounds • Consolidate spend across common suppliers thus increasing volume discount potential
EPC Services	10 – 15	<ul style="list-style-type: none"> • Establish competitive rate cards for project work through RFP with rate decomposition and quartile feedback
Engineering Services	10 – 15	<ul style="list-style-type: none"> • Establish competitive rate cards through RFP with cost transparency • Review distribution of work strategy to maximize use of best rates
Fleet	5 – 7	<ul style="list-style-type: none"> • Conduct broad RFP with multiple feedback rounds • Renegotiate Fleet Management contract
Staff Aug	5 – 15	<ul style="list-style-type: none"> • Conduct RFP with consolidated roles and conduct multiple feedback rounds on cost transparency
Professional Services	10 – 20	<ul style="list-style-type: none"> • Renegotiate rate cards and greater cost transparency
Equipment Rentals	5 – 10	<ul style="list-style-type: none"> • Conduct RFP to lock-in rates and consolidate spend for rentals with preferred suppliers(s) with provincial capacity • Bundling other services as part of the same RFP process
IT Software	5 – 15	<ul style="list-style-type: none"> • Renegotiate IT software contract (s)
Transformers	5 – 10	<ul style="list-style-type: none"> • Conduct broad RFP with multiple feedback rounds leveraging an expanded supplier base
Construction Services	2 – 5	<ul style="list-style-type: none"> • Conduct RFP to establish competitive rate cards preferred suppliers(s) through multiple feedback rounds
General Hardware	10 – 15	<ul style="list-style-type: none"> • Conduct broad RFP with multiple feedback rounds • Consolidate suppliers thus increasing volume discount potential
Construction Materials	5 – 10	<ul style="list-style-type: none"> • Conduct broad RFP with multiple feedback rounds • Consolidate suppliers thus increasing volume discount potential

Witness: Michael Vels

Telecom	0 – 5	<ul style="list-style-type: none"> • Conduct broad RFP with telecoms and networks carrier services spend to leverage scale • Consolidate bulk of spend with fewer preferred suppliers
IT Hardware	5 – 15	<ul style="list-style-type: none"> • Conduct broad RFP with telecoms and networks carrier services spend to leverage scale
Enviro. Services	5 – 10	<ul style="list-style-type: none"> • Conduct RFP to lock-in prices with preferred suppliers through multiple feedback rounds • Bundling other services as part of the same RFP process
Engineered Hardware	5 – 10	<ul style="list-style-type: none"> • Re-establish prices with insulator suppliers and conduct broad RFP to rebase prices for top repeat items • Negotiate volume discount agreements to maximize savings
Travel & Ent.	10 – 20	<ul style="list-style-type: none"> • Rationalize and lock-in preferred supplier rates for hotels and accommodations and negotiate volume discounts
Office Supplies	5 – 15	<ul style="list-style-type: none"> • Conduct broad RFP with multiple feedback rounds • Evaluate market alternatives and renegotiate printing supplies

1

2 The majority of the savings are embedded in OM&A forecasts for Real Estate and
3 Facilities, IT, Power Equipment, and NERC Cyber Security Compliance. In aggregate,
4 the savings for 2017 and 2018 are \$1.5 million and \$1.9 million.

5

6 Embedded capital savings are reflected in the areas of transmission High Voltage Yard
7 Investments, Overhead Lines, IT, Fleet and Load Customer Connections. They total \$9.4
8 million in 2017 and \$16.5 million in 2018.

9

10 **Information Technology Savings**

11

12 The following list of initiatives is driving the majority of the OM&A savings in IT.

13

14 1. Backup and Storage Optimization

15 Based on an assessment of industry best practices as well as project and application
16 support requirements, Hydro One has determined opportunities to change its practices
17 regarding frequency of full backups on non-production environments with resultant
18 savings of disc space and staff time.

Witness: Michael Vels

1 Procedures have been changed regarding the backup and archiving policies related to full
2 backups and daily incremental backups of its SAP production environment, with some
3 routines changed to weekly rather than daily. For no material change in risk profile, this
4 change resulted in a SAP storage savings of over 75%. Specifically, Hydro One's
5 monthly storage requirement has decreased by fifty percent.

6
7 2. Project Environment Optimization

8 Hydro One has consolidated IT environments where there were redundancies and, in
9 some cases, decommissioned them outright. This has resulted in a reduction in its
10 monthly invoices from its service provider.

11
12 3. Infrastructure and Database Decommissioning

13 After an assessment of all IT infrastructure components and databases, Hydro One began
14 decommissioning servers and databases that had very little or no utilization. To date, 138
15 servers and 38 databases have been decommissioned, and Hydro One plans to
16 decommission an additional 76 servers and seven databases by January 1, 2017. An
17 ongoing monthly review of all servers and database has been implemented to ensure
18 unused infrastructure is decommissioned in a timely manner. This has reduced Hydro
19 One's monthly server and database fees.

20
21 4. Software Contract Renegotiation

22 A review of all 3rd party contracts was performed to determine opportunities for
23 renegotiation based on overall cost and current contract renewal timelines. Hydro One
24 renegotiated its contract with a significant provider with savings to take effect in 2017.
25 Hydro One is continuing its analysis of other 3rd party contracts and opportunities for
26 renegotiation.

27
28 5. 3rd Party Contractor Rate Reduction

29 Hydro One has engaged its primary vendor in negotiations to reduce its rates by 20 to
30 30% effective as of 2017.

31
32 6. Mobility Contract Reduction

33 Hydro One has negotiated a significant per user rate reduction with its mobility providers
34 Bell and Rogers for a period of five years.

35
36 7. Implementation of Cloud Infrastructure

37 Hydro One plans on implementing secure cloud platform technology for certain
38 applications. This will result in a reduction in infrastructure resource effort, ongoing
39 management and support and reduced costs.

Witness: Michael Vels

41

POWERING UP

ANNUAL REPORT 2015

ONE OF NORTH AMERICA'S LARGEST
ELECTRICAL UTILITIES (TSX: H)

hydroOne

HYDRO ONE INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
For the years ended December 31, 2015 and 2014

43

Risks Relating to Capital Expenditures

In order to be recoverable, capital expenditures require the approval of the OEB, either through the approval of capital expenditure plans, rate base or revenue requirements for the purposes of setting transmission and distribution rates, which include the impact of capital expenditures on rate base or cost of service. There can be no assurance that all capital expenditures incurred by Hydro One will be approved by the OEB. Capital cost overruns may not be recoverable in transmission or distribution rates. The Company could incur unexpected capital expenditures in maintaining or improving its assets, particularly given that new technology is required to support renewable generation and unforeseen technical issues may be identified through implementation of projects. There is risk that the OEB may not allow full recovery of such expenditures in the future. To the extent possible, Hydro One aims to mitigate this risk by ensuring prudent expenditures, seeking from the regulator clear policy direction on cost responsibility, and pre-approval of the need for capital expenditures.

While the Company expects all of its expenditures and regulatory assets to be fully recoverable after OEB review, any future regulatory decision to disallow or limit the recovery of such costs would lead to a lower than expected approved revenue requirement or rate base, potential asset impairment or charges to the Company's results of operations, any of which could have a material adverse effect on the Company.

Risks Relating to Deferred Tax Asset

As a result of leaving the PILs Regime and entering the Federal Tax Regime, Hydro One recorded a deferred tax asset due to the revaluation of the tax basis of Hydro One's fixed assets at their fair market value and recognition of eligible capital expenditures. Management believes this will result in annual net cash savings over the next five years due to the reduction of cash taxes payable by Hydro One associated primarily with a higher capital cost allowance. There is a risk that, in future rate applications, the OEB will reduce the Company's revenue requirement by all or a portion of those net cash savings. If the OEB were to reduce the Company's revenue requirement in this manner, it could have a material adverse effect on the Company.

Risks Relating to Other Applications to the OEB

The Company is also subject to the risk that it will not obtain required regulatory approvals for other matters, such as leave to construct applications, applications for mergers, acquisitions, amalgamations and divestitures, and environmental approvals. Decisions to acquire or divest other regulated businesses licensed by the OEB are subject to OEB approval. Accordingly, there is the risk that such matters may not be approved or that unfavourable conditions will be imposed by the OEB.

First Nations and Métis Claims Risk

Some of the Company's current and proposed transmission and distribution assets are or may be located on Reserve (as defined in the *Indian Act* (Canada)) lands, and lands over which First Nations and Métis have Aboriginal, treaty or other legal claims. Although the Company has a recent history of successful negotiations and engagement with First Nations and Métis communities in Ontario, some First Nations and Métis leaders, communities and their members have made assertions related to sovereignty and jurisdiction over Reserve lands and traditional territories and are increasingly willing to assert their claims through the courts, tribunals, or by direct action. These claims could have a material adverse effect on the Company or otherwise materially adversely impact the Company's operations, including the development of current and future projects.

The Company's operations and activities may, on occasion, give rise to the Crown's duty to consult and potentially accommodate First Nations and Métis communities. Procedural aspects of the duty to consult may be delegated to the Company by the Province or the federal government. A perceived failure by the Crown to sufficiently consult a First Nations or Métis community, or a perceived failure by the Company in relation to delegated consultation obligations, could result in legal challenges against the Crown or the Company, including judicial review or injunction proceedings, or could potentially result in direct action against the Company by a community or its members. If this occurs, it could disrupt or delay the Company's operations and activities, including current and future projects, and have a material adverse effect on the Company.

Risk from Transfer of Assets Located on Reserves

The transfer orders by which the Company acquired certain of Ontario Hydro's businesses as of April 1, 1999 did not transfer title to assets located on Reserves. The transfer of title to these assets did not occur because authorizations originally granted by the federal government for the construction and operation of these assets on Reserves could not be transferred without required consent. In several cases, the authorizations had either expired or had never been issued.

Currently, the Ontario Electricity Financial Corporation holds legal title to these assets and it is expected that the Company will manage them until it has obtained permits to complete the title transfer. To occupy Reserves, the Company must have

Ontario Energy Board (Board Staff) INTERROGATORY #134

Reference:

Exhibit C1/Tab 8/Sch1 – Departure from PILs Regime

Interrogatory:

Hydro One Limited realized a deferred tax recovery of \$2,619 million that was triggered by the deemed disposition of its assets upon exiting the PILs regime in 2015 (see page 28 of the Hydro One Limited 2015 Annual Report). The impact of this deferred tax recovery has been excluded from the test year PILs calculations filed with this application.

- a) In RP-2004-0188, Report of the Board on the 2006 Electricity Distribution Rate Handbook, the OEB reviewed a similar matter related to a deferred tax recovery that utilities realized upon first entering the PILs regime in 2001 (RP-2004-0188, pp. 55-57). Given the similar circumstances, has this conclusion been considered in determining the regulatory treatment of the \$2,619 million deferred tax recovery in the current application?
- b) What portion, if any, of the \$2,619 million deferred tax recovery would be allocated to the Transmission business?
- c) How would the test period PILs calculations in Exhibit C2/Tab 4/Sch 1, Attachment 1 be impacted if the deferred tax recovery was applied to the estimate?

Response:

- a) Consideration of the Board's RP-2004-0188 Report, including the sections on pp.55-57, was given in the preparation of this application. The present circumstances however differ significantly from the Fair Market Value Bump scenario discussed in the Board's Report. Specifically:
 - The IPO process resulted in a change in Hydro One's relevant taxation regime and triggered a deemed disposition of assets for taxation purposes. The loss of Hydro One's exemption from tax under the existing legislative scheme and its departure from the PILs regime cannot be reasonably described as a change in tax rules that would fall into the category of a taxation change subject to true-up in rates;
 - In the RP-2004-0188 Report, the OEB disregarded the regulatory principle that "benefits follow costs" and determined that ratepayers should benefit from the deferred tax

1 recovery on the basis that shareholders would not be disadvantaged as they had not
2 incurred a cost as a result of the Fair Market Value Bump. However, that is not the case
3 here. The IPO process triggered the above-mentioned change in taxation regime, the Fair
4 Market Value Bump, the associated requirement for Hydro One Limited to pay the
5 departure tax of \$2.6 billion and the requirement for Hydro One Limited to recognize the
6 deferred tax recovery. The amount of the departure tax was driven substantially by the
7 Fair Market Value of the assets. As a result, Hydro One Limited incurred a real \$2.6
8 billion cost associated with the Fair Market Value Bump and would be disadvantaged if it
9 is not allocated 100% of the benefit of the deferred tax recovery;

- 10
11 • The incurrence of the departure tax and the recognition of the deferred tax recovery arise
12 from facts and circumstances that do not relate to Hydro One's rate regulated activities.
13 These amounts arise from the IPO process. This process is not a rate regulated activity
14 and the resulting Fair Market Value Bump does not affect the accounts and balances upon
15 which rates are set. The OEB acknowledged in the 2006 DRH that under the "stand-
16 alone" principle, the Fair Market Value Bump should be disregarded, such that in the
17 current circumstances, Hydro One Limited and its shareholders would be solely
18 responsible for the costs and benefits from changes arising from the Fair Market Value
19 Bump; and
- 20
21 • Hydro One incurred a real cost. The payment of the departure tax by Hydro One Limited
22 and how it was funded by Hydro One Limited's shareholder is set out in the financial
23 statements filed as part of the evidentiary basis for this application. Payment by Hydro
24 One Limited of the departure tax reduced its retained earnings by approximately \$2.6
25 billion. In order to mitigate the potentially negative financial consequences arising from
26 the payment of the departure tax, Hydro One Limited's shareholder funded the payment
27 by purchasing a corresponding number of common shares of the company. The purchase
28 of common shares restored the common equity component of Hydro One Limited's
29 capitalization and maintained the strong financial profile of the company.

30
31 b) \$1,475 million of the \$2,619 million deferred tax recovery pertains to the transmission
32 business.

- 1 c) The requested analysis has not been performed as it would be inconsistent with the “stand-
2 alone” and “benefits follow costs” principles used in the Board’s RP-2004-0188 Report, and
3 the Board’s Handbook to Electricity Distributor and Transmitter Consolidations dated
4 January 19, 2016, and the OEB’s related predecessor policies¹.

¹ EB-2014-0138 Report of the Board regarding Rate-Making Associated with Distributor Consolidation dated March 26, 2015, Report of the Board regarding Rate-making Associated with Distributor Consolidation dated July 23, 2007 and the determinations of the Board in the Combined Proceeding Decision – OEB File No. RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257

Witness: Giovanna Baragetti

**Ontario Energy
Board**

**Commission de l'Énergie
de l'Ontario**



RP-2004-0188

**2006 ELECTRICITY DISTRIBUTION RATE
HANDBOOK**

REPORT OF THE BOARD

2005 MAY 11

tax information disclosure, addressed later in this section, will allow for adequate monitoring of these issues.

With respect to the third point, the Board accepts the evidence of Dr. Mintz that in a competitive market tax reductions will tend to lead to lower prices, but does not agree with his conclusion that the tax savings of disallowed expenses should be passed on to ratepayers. Such an approach takes no account of the increased expenditures from which the tax savings arise. Presumably in a competitive market, if an entity incurs a cost from which a tax reduction is gained, the increased cost works its way into prices as well. A unilateral allocation of the tax savings to the ratepayers would seem to be an inappropriately simplistic application of the competitive market principle.

With respect to the fourth point, the Board does not agree that the link between PILs and the stranded debt is relevant. All tax revenues are used for some purpose, whether to fund programs or repay debt. To the extent tax deductions are allowed, there will necessarily be a reduction in funds available for those other purposes. The relationship between PILs and the stranded debt is no different. This conclusion is supported by the fact that the express purpose of PILs was to put municipal distributors on an equivalent basis with tax paying distributors. The fact that PILs payments are allocated to the stranded debt is a function of provincial policy and is not necessarily a permanent feature. Finally, the Board notes that PILs from distributors are not the only, or largest, source of funds currently paying down the stranded debt.

For all of these reasons, the Board rejects the proposal by Schools, and concludes that tax savings arising from disallowed expenses, including purchased goodwill and charitable donations, will not be allocated to ratepayers. Ratepayers have not paid for the expense through rates, and therefore are not entitled to the tax benefit.

Fair market value “bump”

The Ministry of Finance required the re-valuation of distributor assets to market value, effective October 1, 2001. This Fair Market Value Bump, or FMV Bump, adjusted the

value of distributors' Cumulative Eligible Capital or Undepreciated Capital Cost. No adjustments to rate base were made for regulatory purposes. There is a potential impact on the Cumulative Eligible Capital (or Eligible Capital Expenditures) deduction or the Capital Cost Allowance. With respect to the Cumulative Eligible Capital or Undepreciated Capital Cost, the issue is whether the tax savings arising from the FMV Bump should be shared between ratepayers and shareholders, allocated 100% to the ratepayers, or allocated 100% to the shareholder.

The positions and reasoning taken by each of the parties were largely the same for this issue as for the previous issue of tax savings arising from disallowed expenses.

CITD maintained that while no "cost" has been incurred, the tax savings would be subject to recapture if the assets are sold at fair market value, and therefore it is essentially a temporary benefit. Hydro One submitted that because the tax benefit is recaptured upon sale of the assets or change in tax status, ratepayers would have to compensate the distributor for that recapture if they are to benefit from the tax benefit. Schools essentially agreed that recapture of the benefit might occur and submitted that ratepayers should get the savings now, and that the Board should address the recapture at the time of the future transaction.

Conclusions

The Board finds that any tax savings resulting from the FMV Bump will be allocated to the ratepayers. It is true that the rates themselves are based on book value not market value, which suggests that under the stand-alone principle the FMV Bump should be disregarded. However, the shareholder has not incurred any cost related to the change in value for tax purposes (as CITD acknowledged), so the "benefits follow costs" principle is not applicable. In addition, the FMV Bump could be characterized as a change in the tax rules, and therefore would fall into the category of changes subject to true-up. Ms. McShane testified that the savings would be subject to recapture and Hydro One submitted that if the ratepayer benefits from the FMV Bump, it should also be liable for the recapture. The Board agrees that if the ratepayers benefit from this tax saving, then any subsequent recapture should be considered for recovery from

ratepayers as well. However, the Board has no evidence as to how frequently or to what extent this recapture will take place.

While the Board cannot address the recapture at this point, it can address the current tax savings. The Board has determined that the 2006 tax calculation will incorporate the impact of the FMV Bump. If at some point a related tax liability arises from a sale of assets or change in tax status, then the distributor will be able to apply to the Board for relief, at which point the issue will be determined. The Board notes that this approach will reduce the variance between actual taxes and the tax provision in rates, that it will not disadvantage the shareholder because the shareholder incurred no cost, and, if there is subsequent recapture, the distributor may apply to the Board for relief.

Loss carry-forwards

The Draft Handbook requires the distributor to take into account the potential reduction in actual taxes payable where a loss carry-forward is applicable.

Hydro One submitted that any loss carry-forward resulting from revenue or expense variations in prior years was irrelevant for the 2006 tax calculation. It argued that the ratepayer has not contributed to the prior loss and therefore is not entitled to the future tax savings. Hydro Ottawa made similar submissions.

Conclusions

The Board has no evidence before it to determine whether loss carry-forwards are the result of revenue or expense variations or whether the loss carry-forwards arise for other reasons that may be related to ratepayers. The Board notes that the consensus approach will reduce the variance between taxes collected in rates and actual taxes paid. The Board will adopt this approach in the Handbook. However, the Board has concluded that a projection of this factor to 2006 will not be required as this represents unnecessary complexity for purposes of 2006 rates.



**Ontario Energy Board
Commission de l'énergie de l'Ontario**

DECISION AND ORDER

EB-2014-0369

ONTARIO POWER GENERATION INC.

Motion to review and vary the Decision with Reasons on the 2014-2015 payment amounts (EB-2013-0321)

BEFORE: Ken Quesnelle
Presiding Member

Cathy Spoel
Member

January 28, 2016

56

6 TAX LOSS CARRY-FORWARD

OPG incurred a regulatory tax loss of \$211.6 million in 2013 that OPG attributes to a shortfall in nuclear production. In the 2014-2015 payment amounts proceeding, OPG submitted that the associated tax loss carry-forward should not be applied to regulatory taxable income in 2014 to reduce the tax provision included in the payment amounts. OPG argued that its shareholder incurred the costs associated with the loss in 2013 and should receive the benefit of the resulting tax loss carry-forward in 2014.

In the 2014-2015 payment amounts decision, the OEB found that the tax loss carry-forward should be applied against the 2014 tax provision. At page 101 of the decision, it states:

The Board directs OPG to reduce its 2014 income tax provision to recognize and carry forward its regulatory tax loss in 2013. This finding is consistent with Board policy as indicated in the Board's 2006 Electricity Distributor's Rate Handbook (the "Handbook") and in subsequent Filing Requirements.¹¹ The Board understands the policies contained in the Handbook and the Filing Requirements apply to electricity distributors, not directly to OPG as an electricity generator, yet finds that the underlying Board policy should be applicable to OPG in this application.

The rate regulation of the electricity distribution sector shows a history of tax loss carry-forwards being routinely used in the rate setting process for distributors. This approach is completely consistent with Board policy for tax losses to be applied to reduce income tax to be included in rates, and there is no reason for OPG to be treated any differently in this instance.

OPG referred to two decisions in which the Board did not apply the policy, namely OPG's EB-2007-0905 decision and Great Lakes Power's EB-2007-0744 decision. The Board finds that the circumstances in these two cases were unique and are not comparable to OPG's current circumstances.

At the motion hearing, OPG reviewed the EB-2007-0905 and EB-2007-0744 decisions in detail and explained how these decisions and the benefits follows costs principle is applicable to 2013 regulatory tax loss. OPG argued that the 2014-2015 payment

¹¹ A requirement to identify any loss carry-forwards and when they will be fully utilized has been included in the Board's Filing Requirements for electricity distributors' cost of service applications since 2012. With the issuance of the 2012 Filing Requirements (for 2013 rates), the Board included any remaining relevant sections of both the 2000 and 2006 Electricity Rate Handbooks.

amounts decision did not correctly consider the two cases and made several errors, including limiting the reference to the Great Lakes Power case to the matter of regulated and non-regulated businesses. There were tax matters related to the regulated business and the OEB considered the benefits follows costs principle as well as the guidance of the Distribution Rate Handbook. OPG submitted that Great Lakes Power case is the leading case with respect to tax loss and that the OEB took a principled approach.

Threshold Test

As with the Niagara Tunnel Project disallowance, OEB staff and most of the intervenors argued that OPG made the same argument before the panel hearing the 2014-2015 payment amounts proceeding. OEB staff argued that there is no error as the basis of the OEB decision in the 2014-2015 payment amounts proceeding was the application of guidance in the Distribution Rate Handbook, not the benefits follows costs principle. OEB staff noted that tax loss carry-forwards have been applied in eleven distribution rate applications from 2005 to 2011. SEC submitted that a cost of service application rebases all costs, including taxes.

OPG argued that the panel's determinations with respect to the comparability of the two cases cited are erroneous. OPG provided what it considered to be the applicable common elements that the OEB should have considered.

The decision states that the two cases were considered to be unique and found not to be comparable to OPG's current circumstances. The decision does not contain a description of the distinguishing characteristics of the two other cases that would make them unique.

The OEB does not consider the lack of analysis of the comparability of the two cases to the current OPG circumstance to be an error. The decision to apply the tax loss carry-forward to regulatory taxable income in 2014 to reduce the tax provision included in the payment amounts was not primarily based on a determination that the current circumstances differ from the circumstances in the two cases cited by OPG. The decision is clear as to why the OEB determined that the tax loss should be treated as directed. As noted above, the decision stated:

The rate regulation of the electricity distribution sector shows a history of tax loss carry-forwards being routinely used in the rate setting process for distributors. This approach is completely consistent with

Board policy for tax losses to be applied to reduce income tax to be included in rates, and there is no reason for OPG to be treated any differently in this instance.

The threshold test findings from the motions to review the Natural Gas Electricity Interface Review Decision covered in chapter 4 of this decision include the following.

The applicant must also be able to demonstrate that the alleged error is material and relevant to the outcome of the decision, and that if the error is corrected, the reviewing panel would change the outcome of the decision.

The OEB finds that even if the finding that the current circumstances differ from those in the cases cited by OPG, and was made in error, it would not affect the outcome of the decision as it would not change the primary basis on which the decision was made. As submitted by OEB staff, the basis of the OEB decision in the 2014-2015 payment amounts proceeding was the application of guidance in the Distribution Rate Handbook, not the benefits follows costs principle.

The OEB does not consider the grounds for this part of OPG's motion to warrant any further consideration.