

**Ontario Energy  
Board**

**Commission de l'énergie  
de l'Ontario**



**EB-2009-0096**

**IN THE MATTER OF AN APPLICATION BY**

**HYDRO ONE NETWORKS INC.**

**2010 and 2011 DISTRIBUTION RATES**

**DECISION WITH REASONS**

April 9, 2010



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**EB-2009-0096**

**IN THE MATTER OF** the *Ontario Energy Board Act 1998*,  
S.O.1998, c.15, (Schedule B);

**AND IN THE MATTER OF** an application by Hydro One  
Networks Inc. for an order or orders approving or fixing just  
and reasonable distribution rates and other charges for 2010  
and 2011.

**BEFORE:** Pamela Nowina  
Presiding Member

Cynthia Chaplin  
Vice Chair

Paul Sommerville  
Member

**DECISION WITH REASONS**

**April 9, 2010**

## **1. BACKGROUND**

On July 13, 2009 Hydro One Networks Inc. (“Hydro One”) filed an application for 2010 and 2011 distribution rates, including its Green Energy Plan. The Board assigned file number EB-2009-0096 to the application and issued an approved issues list on September 22, 2009.

Further procedural details are found in Appendix 1.

### **1.1 SETTLEMENT CONFERENCE**

The Board convened a settlement conference on November 18, 2009. While no settlement was achieved, a document filed by the parties identified those issues that would not be subject to cross examination in the hearing and would be dealt with only in final argument. The document filed as a result of the settlement discussion is attached as Appendix 2.

### **1.2 ORAL DECISION ON COST OF CAPITAL SUBMISSIONS**

On December 15, 2009, the Board issued an oral decision on submissions from parties regarding the Report of the Board on Cost of Capital for Ontario’s Regulated Utilities, EB-2009-0084, issued on December 11, 2009. A copy of this decision is attached as Appendix 3.

### **1.3 DECISION ON MOTION**

On January 12<sup>th</sup>, 2010 the Board heard a motion by the Consumers Council of Canada, seeking an order from the Board requiring Hydro One to publish an amended notice of application in the proceeding. The motion alleged that there were certain defects in the original Notice, which was published in various newspapers across the province in August 2009. The motion was denied on January 14, 2010. A copy of this decision is attached as Appendix 4.

### **1.4 PARTIAL DECISION**

On February 18, 2010 the Board issued a partial decision on Issue 9.3, which dealt with whether Hydro One’s methodology for allocating Green Energy Plan O&M and capital

costs between the Ontario Power Authority (OPA) (Global Adjustment Mechanism) and Hydro One was appropriate.

In a separate but related matter, on September 25, 2009, the Board initiated a consultation process (EB-2009-0349) to address how the Board should, in accordance with the requirements of Ontario Regulation 330/09, determine the direct benefits that accrue to the consumers of a distributor when that distributor has incurred costs to make an eligible investment in its distribution system to accommodate a renewable energy generation facility. These are costs that would generally be included in a Green Energy Plan. As a consequence of the determination of the direct benefits, the cost allocation between provincial ratepayers and the ratepayers of the individual distributor making the investment will be determined.

The Board issued its February 18, 2010 partial decision on this issue to provide Hydro One and other parties the information they need to participate fully in the Board's EB-2009-0349 policy initiative.

In that decision, the Board approved the methodology proposed by Hydro One in this rates proceeding for the allocation of Green Energy Plan costs for rate setting purposes on a provisional basis. More information on this is contained in the section on the Green Energy Plan.

The partial decision is attached as Appendix 5.

## **1.5 THE HEARING, SUBMISSIONS AND EVIDENCE**

The oral hearing for this proceeding took place in December 2009 and January 2010, concluding with Hydro One's oral Argument-in-Chief on January 14, 2010. Board staff and intervenor written submissions were submitted on February 1, 2010 and February 8, 2010 respectively. The Board received submissions from School Energy Coalition (SEC), Pollution Probe, Consumers Council of Canada ("CCC"), Canadian Manufacturers and Exporters ("CME"), Association of Major Power Consumers of Ontario ("AMPCO"), Energy Probe Research Foundation ("Energy Probe"), Society of Energy Professionals ("Society"), Rogers Cable Communications ("Rogers"), Electrical Contractors Association of Ontario ("ECAO"), Green Energy Coalition ("GEC"), Vulnerable Energy Consumers' Coalition ("VECC"), Power Workers Union ("PWU"), Hopper Foundry ("Hopper") and Board staff.

Hydro One submitted its reply argument on February 12, 2010. Copies of the evidence, exhibits, arguments and transcripts of the proceeding are available for review at the Board's offices or at the Board website, [www.oeb.gov.on.ca](http://www.oeb.gov.on.ca).

During the proceeding, confidential treatment was provided for a number of documents. These documents are filed at the Board's offices, but not on the public record.

The Board considered the full record of the proceeding but has summarized the record only to the extent necessary to provide context to its findings.



## 2. LOAD FORECAST

Hydro One's load forecast for 2010, including the impact of Conservation and Demand Management ("CDM"), is 38,306 GWh of electricity delivered to 1,196,000 distribution customers. CDM and the economic downturn are the major influences on the 2010 forecast resulting in a 4.3 percent decrease in electricity consumption from 2008 with a slight increase of 1.3 percent over 2008 customer count.

For 2011 the forecast features a continuing decrease in electricity load to 38,049 GWh but customer numbers growing to 1,204,000 (a .07 percent increase). Hydro One has demonstrated that its load forecast has tracked actual results in a consistent manner (within one standard deviation) over the past several years.

Hydro One indicated that while some macroeconomic inputs had changed since the last forecast was produced, these changes were of a minor nature and that the forecast would not be updated.

In the last distribution rates proceeding, the Board directed Hydro One to come forward in its next rates case with a detailed proposal to incorporate the impacts of CDM into its load forecast, both those attributable to its own actions and those not attributable to the Company's actions.<sup>1</sup> In the current proceeding Hydro One was unable to provide a new proposal for incorporating CDM into the load forecast. Hydro One did inform the Board and intervenors that a consulting study had been commissioned but that the results were not available until early 2010. Hydro One did file a "Net Load Impact of Conservation and Demand Management" report<sup>2</sup>.

## BOARD FINDINGS

The Board approves the load forecast as filed. Hydro One has a very sophisticated and capable load forecasting methodology. It has been approved in at least two previous Board decisions, and no intervener specifically challenged the company's forecast per se.

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<sup>1</sup> EB-2007-0681 Decision with Reasons, December 18, 2008, p. 8

<sup>2</sup> Exhibit H/Tab12/Sch2/Attachment 1

One area of concern which is shared by a number of parties and which also concerns the Board, is the absence of a proven rationale for the recognition of CDM outcomes into the load forecast.

As noted above, the Board's previous decision directed the applicant to produce a study, the purpose of which was to provide such a rationale. That study has not been produced for the purposes of this proceeding, and the deficiency in methodology with respect to CDM continues.

The Net Load Impact Analysis of Conservation and Demand Management report referenced above was produced by Hydro One staff and was intended to inform the preparation of its load forecast. While this report is of some assistance in assessing the influence of CDM in developing the load forecast, it expressly does not replace the anticipated contribution of the study Hydro One was directed by the Board to produce in EB-2007-0681.

The Board's concern is rooted in the fact that very substantial sums of money have been and are to be expended on CDM programs by this applicant, and indeed by virtually every other local distribution company in the province. The development of a methodology to appropriately incorporate the effects of these programs is an important regulatory milestone. While there is a belief that these programs are having the desired effect of reducing the use of electricity in general or at peak times, there is currently no reliable methodology which allows the Board to make a reliable or objective assessment of the efficiency or effectiveness of these programs.

The Board's direction to Hydro One to develop such a methodology was intended to be one step in developing a more satisfactory approach to the reflection of CDM programs into load forecast, and the efficacy of those programs.

The Board now restates its direction to the company to produce the study originally called for, for distribution to the Board, and the interveners of record in this proceeding, in connection with its next cost of service application.

Several intervenors urged the Board to adopt a mechanism which would track the differences between Hydro One's forecast of CDM effects and the actual CDM volumes realized.

This proposal is fuelled in part by the significant growth in the company's forecast for CDM in each of 2010 and 2011. For 2010 the impact of CDM, as forecast by the company, will increase very substantially over previous periods to 5.8% of total load. In 2011 the impact grows to 7%. If these forecasts are inaccurate there is a risk that ratepayers will have been overburdened.

Hydro One's forecast of CDM effects is derived primitively compared to the sophistication of its methodology for all other elements of its load forecast. In effect, it takes estimates from the OPA, which are themselves subject to considerable uncertainty, and applies them proportionately to its service area. This methodology is not one which inspires confidence in its outcome. Hydro One itself recognizes that this is a deficiency in its overall load forecasting methodology.

In light of the circumstances, the Board considers it appropriate to require the company to track the differences between its CDM forecast volumes and those which can be reasonably demonstrated to have been effected, using the best verification methods available at the time, akin to a Lost Revenue Adjustment Mechanism ("LRAM"). The Board notes that LRAM is a voluntary mechanism, and that Hydro One is not the only distributor to have not applied to the Board for LRAM recovery. However, the Board is concerned that Hydro One's method of forecasting CDM effects may result in an inappropriate level of over-recovery from ratepayers, and believes that a retrospective adjustment may be necessary and appropriate. When used properly, an LRAM decreases the incentive for distributors to over-forecast CDM effects in their load forecast, since there is a retrospective mechanism to compensate for any unforecasted lost revenues. This helps to stabilize the impact on ratepayers.

This approach was proposed by several intervenors, most notably GEC, but resisted by Hydro One. The company's resistance is based on its concern that the necessary utility-specific CDM program results are not currently available. There is an element of circularity in this line of argument. The Board considers it important for Hydro One to develop the requisite tools to establish the effects of CDM programs within its franchise area, as many other distributors have done. The requirement to track these effects is an important step in that process. The completion of the study is another.

### 3. OPERATIONS, MAINTENANCE AND ADMINISTRATION COSTS

The table below summarizes the Operations, Maintenance and Administration (“OM&A”) costs proposed by Hydro One for the two test years and includes the percentage change from the prior year. The OM&A level approved in the last cost of service rate application for 2008 rates was \$466 million. The 2010 test year amount requested by Hydro One is 20.2% higher than the approved 2008 level. Hydro One identified three key drivers for the increased spending: vegetation management, PCB regulations, and work related to the Green Energy Plan. The direct costs of the Green Energy Plan are not included in the table and are addressed separately in this decision. The table does include the indirect costs related to the Green Energy Plan, which Hydro One estimated to be \$10 to \$15 million.

**OM&A Expenditures, 2008 – 2011**  
(\$ million, including % variance from prior year)

Category	2008 Actual	2009 Bridge	2010 Test	2011 Test
<b>Sustaining</b>	<b>284.5</b> 4.4%	<b>296.4</b> 4.2%	<b>318.5</b> 7.5%	<b>340.5</b> 6.9%
<b>Development</b>	<b>8.0</b> 90.4%	<b>14.5</b> 81.2%	<b>21.7</b> 49.6%	<b>21.9</b> 0.9%
<b>Operations</b>	<b>12.4</b> -0.2%	<b>12.5</b> 0.8%	<b>16.7</b> 33.6%	<b>17.6</b> 5.4%
<b>Customer Care</b>	<b>99.3</b> 2.3%	<b>106.7</b> 7.4%	<b>106.3</b> -0.4%	<b>102.4</b> -3.7%
<b>Shared Services &amp; Other</b>	<b>62.9</b> -31.5%	<b>92.4</b> 46.9%	<b>92.1</b> -0.3%	<b>88.1</b> -4.3%
<b>Tax other than Income Tax</b>	<b>4.3</b>	<b>4.6</b>	<b>4.7</b>	<b>4.8</b>
<b>Total</b>	<b>471.3</b> -3.1%	<b>527.1</b> 11.8%	<b>560.0</b> 6.2%	<b>575.2</b> 2.7%

Hydro One maintained that year-over-year comparisons of OM&A costs should include the 2009 bridge year, because that was an Incentive Rate Mechanism (“IRM”) rate adjustment year and any cost increases above the adjustment level were borne by the

company. Hydro One submitted that many OM&A cost increases took place in 2009 and that this is evidence of the company's commitment to, and the necessity for, these programs.

Hydro One stressed the importance of the vegetation management program and explained the need to move to a shorter cycle to reduce unit costs and outages. It highlighted increased spending from \$118 million in 2008 to \$136 million in 2009, as an example of a bridge year increase that showed Hydro One's commitment to that program. Hydro One also highlighted lines and maintenance programs which are not discretionary and are a response to higher regulatory standards, principally for PCB regulations.

The following areas were addressed in the submissions:

- Overall OM&A Spending
- Compensation
- Vegetation Management

### **3.1 OVERALL OM&A SPENDING**

PWU supported the proposed level of expenditures and cited the twin requirements of new government-mandated initiatives and the need to maintain an aging system. In PWU's view, reducing costs now would lead inevitably to even higher costs in the future.

Board staff and intervenors identified a number of factors which in their view showed that the OM&A cost increases are excessive: lower inflation and cost escalation factors; trend analysis; benchmark results; and specific spending items.

Board staff and most intervenors noted that updated evidence indicated lower overall inflation and lower distribution cost escalation than in the original application. VECC submitted that based on these updates OM&A is overstated by at least \$9.4 million in 2010 and \$7.0 million in 2011.

CME submitted that Hydro One's budget should be assessed through three trends or "indicators of reasonableness": total OM&A spending; OM&A cost per customer; and OM&A costs per circuit km. CME noted that OM&A costs have increased by 18.8% between 2008 and 2010 and by 44% between from 2006 and 2011. CME pointed to the

Board's decision in Hydro One's prior distribution rates case which specifically mentioned that past spending is a useful guide in assessing spending proposals. CME noted that OM&A cost per customer has grown by 16% between 2008 and 2010 and by 37% between 2006 and 2011, and that OM&A cost per circuit km has grown by 16% between 2008 and 2010 and by 35% between 2006 and 2011.

Hydro One agreed that historical spending levels are useful information for the Board but submitted that basing future expenditures only on historical norms ignores the reasons and evidence behind the changes. Hydro One argued that it had filed extensive evidence justifying the proposed spending increases and that arbitrary reductions without reference to the evidence should be rejected. With respect to the cost per customer and cost per circuit km trends, Hydro One responded that these measures were not meaningful because the cost increases are due to increased workload, not customer or wire additions. Hydro One cited the PCB regulations and increasing vegetation management spending as independent of either the customer numbers or circuit kilometres.

Board staff and intervenors also pointed to various benchmark results. Board staff submitted that the benchmarking results show that Hydro One has the highest distribution substation O&M expense per installed MVA, and was ranked in the middle-of-the-pack for substation O&M expense per asset. SEC also pointed to benchmarking results which show that Hydro One's OM&A cost per customer in 2010 is \$459.50, which is more than double that of many large and complex Ontario utilities. In CCC's view, Hydro One has demonstrated very little in terms of productivity gains because work programs are increasing by 33% and total head is increasing by 37%.

Intervenors were also concerned that Hydro One was not exercising sufficient control over spending increases. SEC acknowledged some key cost drivers, such as PCB regulations, vegetation management needs and the Green Energy Plan spending, but submitted that when customers are being asked to absorb significant cost increases as a result of such key cost drivers, keeping cost increases in other areas to approximately the rate of inflation is a reasonable cost containment measure. SEC submitted that "...companies in a competitive environment facing key cost drivers in certain areas would work to ensure that other areas of spending are either held constant or held to minimal year over increases. Hydro One has done none of that."<sup>3</sup>

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<sup>3</sup> SEC Final Argument, p. 17

CCC argued that in light of the pressure related to the Green Energy Plan and related projects, more discretionary projects should have been deferred or scaled back. CCC argued, for example, that the \$3 million in 2010 and \$4 million in 2011 associated with the head office and GTA space requirements should be viewed as discretionary and should be deferred.

CCC and CME both submitted that Hydro One should be held to a 3% inflationary increase relative to the 2008 Board approved level. CCC estimated this would result in a reduction of about \$66 million in each of the test years. SEC recommended an overall OM&A reduction of \$18.1 million in 2010.

Board staff recommended a reduction of \$33 million in the overall OM&A budget for 2010. The reduction was defined as the half-way point between a 3% inflation scenario and the original OM&A budget. Board staff submitted it was inappropriate to micro-manage Hydro One's activities and recommended that Hydro One should reduce OM&A costs in areas it determines most appropriate. CME agreed with this approach.

Hydro One disagreed with the proposals by Board staff and intervenors to cut OM&A costs based on envelope or index-linked reductions. Hydro One maintained that there was no meaningful criticism or analysis of the underlying causes of the proposed increases and reiterated that the shareholder has borne significant cost increases during the IRM period as a result of the increased work programs, thereby demonstrating that the increased work is necessary. Hydro One maintained that if OM&A is reduced, less work will be accomplished and the performance of the distribution system will be affected.

## **BOARD FINDINGS**

The Board finds that Hydro One's OM&A budget is excessive. Inflation and cost escalation factors are now lower than originally forecast and therefore the budgets are now over-stated on that measure. Second, and more importantly, the various trend measures demonstrate that Hydro One has had limited success in controlling expenditure increases. The Board agrees with Hydro One that these various trends are imperfect measures of reasonableness, but the measures are indicators. Hydro One emphasized that the expenditure increases are not driven by customer numbers or expansion in the circuit kilometres, but by increased workload particularly in the areas of vegetation management, PCB management, and Green Energy Plan related work.

However, if significant incremental work is required in particular areas, then it is the responsibility of the company to manage that in a way that ensures that growth in cost per customer is kept within reasonable levels to ensure ongoing customer affordability. The Board concludes that Hydro One has not been sufficiently successful in controlling the overall growth in spending. The benchmarking results also support the conclusion that Hydro One could and should do better in managing its growth in spending.

In the past, the Board has used different techniques to determine the allowed OM&A. In some cases a detailed line by line examination has resulted in an equally detailed funding prescription from the Board. In other cases the Board has provided the applicant with an overall envelope of funding. In such cases the Board does not stipulate an approved amount of spending for any particular category of spending, but rather leaves to the applicant the freedom to apply that spending according to its own prioritization.

In the Board's view, given Hydro One's capabilities and its complexity, it would not be appropriate to micromanage the utility's operations through a line by line authorization of spending; rather the Board should set an overall envelope and leave the specific allocation of the available funds to Hydro One's judgment and prioritization. In the following two sections of this decision, the Board will provide its observations and findings with respect to compensation and vegetation management. The company should take the Board's guidance on these subjects into account in arriving at its prioritization.

In arriving at the quantum of the envelope approved for OM&A the Board has taken a number of factors into account:

First is the totality of the evidence developed throughout the case. Through the detailed examination which takes place the Board achieves an understanding of the key drivers of utility operations and cost structures. This process also gives the Board the opportunity to assess the overall implications of the company's rate proposals for its customers and includes the opportunity for a variety of interests to express their particular concerns respecting the applicant's rate proposal and operational plans. This is a key element in arriving at a balanced and fair rate decision. The Board's consideration of the specific elements of the application as developed in the evidentiary portion is reflected in our observations and findings under compensation and vegetation management.



Second, the Board has considered the recent rate history of the distribution business. Over the last number of years Hydro One has applied for and received significant increases in the delivery portion of its electricity rates. Since 2004, Hydro One's delivery rates have increased significantly. Between 2004 and 2009 rates for the R1 Class have increased about 28%, whereas inflation has run at about 9%. The increase between 2007 and 2009 has also significantly outpaced inflation. As a result, Hydro One's revenues have exceeded inflation materially. That is not to say that the previous rate decisions have been inordinately generous. Over this period the company has been able to demonstrate a need to improve its customer information systems, maintain its physical plant, and generally manage its operations according to the revenue requirements approved. But the fact remains that customers have experienced increases in the delivery portion of their rates over this period that have significantly outstripped the general inflationary pressure within the economy.

Third, some of these rate increases combined with a recognized need to rationalize and harmonize the rate classes associated with acquired utilities have led to very significant increases in delivery charges for some customers. These increases have been of such a nature that they have been subject to rate mitigation measures, which are continuing.

Fourth, the Board must take into account the overall increase and prospect of further increases in the commodity portion of the bill. While these charges are outside of the control of the applicant, they are no less real for customers. In giving effect to the Board's objective to protect the interests of consumers the Board cannot ignore the overall impacts on customers.

The evidence also reveals another factor that has implications in determining the appropriate quantum of the conventional operations funding envelope. The Province, as part of a global phenomenon, has experienced a significant contraction in economic activity. The resulting demand reductions have two important implications. First, to the extent businesses have curtailed electricity demand or ceased operations, the per unit cost to be covered in delivery charges by the remaining customers will increase. This has an inherently inflationary effect on delivery charges. Second, both companies and individuals are experiencing material challenges in carrying added costs for the delivery of electricity.

Hydro One has maintained that the increases in 2009 borne by the shareholder demonstrate that the expenditures are necessary. In the Board's view, if a company spends more than the amount embedded in rates (whether for a test year or an IRM

year), it is not determinative of whether the amounts are reasonable and prudent; nor does it establish the appropriate base for future levels. Management and shareholders make expenditure decisions for a variety of reasons, and the Board must still determine whether the test year forecasts are appropriate in light of all the evidence. Considering all the factors identified above, and in particular the conclusion that Hydro One has not sufficiently controlled its growth in spending, the Board finds that the appropriate quantum of the envelope to accommodate conventional operations should be derived from the year which was most recently examined and approved by the Board. In 2008, the approved level of expenditure was \$466 million and the actual level of expenditure was \$471 million. These figures are sufficiently close that the Board will derive the allowed level for 2010 and 2011 using the 2008 actual level.

To this initial 2008 level, the Board will apply an annual increase of 5% to derive an allowed OM&A for 2010 of \$520 million. For 2011 the Board will apply an increase factor of 3% for an allowed OM&A of \$535 million. The escalation factor for 2010 is higher than the rate of inflation. The Board adopts this approach in recognition that the company has statutory obligations, other than those associated with the *Green Energy and Green Economy Act, 2009* (GEA), which it must meet, and the fact that it is preparing itself for an operating environment that is turbulent and to some extent unknown. The escalation factor for 2011 is lower, although still higher than forecast inflation, to reflect that Hydro One itself proposed an even lower level of increase between 2010 and 2011. The Board notes that the approved spending levels are well in excess of the Minimum Level of spending (as explained in the capital expenditure section of this decision) of \$476 million for 2010 and \$483 million for 2011.

The Board recognizes that accommodating these levels of spending, which are significantly less than that applied for, will require the company to engage in a thoughtful reconsideration of its spending priorities. The Board concludes, however, that given the overall pressures operating within this environment, which are highlighted above, this is the right time for such a recalibration.

### **3.2 COMPENSATION**

Hydro One's total compensation (for the distribution and transmission businesses) is forecast to grow from \$566 million in 2008 to \$849 million in 2010 and to \$934 million by 2011. Headcount is forecast to increase from 6,547 in 2008 to 9,552 in 2010 and to 10,245 in 2011. Hydro One referred to the Mercer/Oliver Wyman Compensation Cost

Benchmarking study (“the Mercer study”) filed in the last transmission case (EB-2008-0272). The Mercer study concluded that on a weighted average basis for the positions reviewed, Hydro One’s compensation was approximately 17% above the market median. In the transmission proceeding, the Board disallowed \$4 million in compensation costs. Hydro One estimated that the comparable reduction for the distribution business would be \$9 million.

Hydro One noted that the Mercer study results were largely driven by the PWU represented employees. Hydro One submitted that because it is currently under a labour contract with the PWU it was not practical to expect it to negotiate a reduction in absolute wage levels and benefits through the collective bargaining process, at least not without a work stoppage. Hydro One maintained that it has demonstrated it is attempting to control labour costs while at the same time making a concerted effort to improve efficiency in the utilization of its labour resources.

Hydro One filed evidence comparing wages in 1999 and 2009 for the Ontario Hydro successor companies: Hydro One, Bruce Power and OPG. Hydro One also included the IESO in the comparisons showing the Society positions. Hydro One claimed that this comparative information demonstrated that it did have success in reducing compensation costs between 1999 and 2009 compared to the other companies.

Intervenors representing Hydro One’s unionized staff supported the company’s position. The Society cited the competitive pressures in attracting and retaining skilled staff, the efficiency benefits of a healthy collective bargaining relationship, and Hydro One’s prudent use of internal staff and contractors. PWU submitted that the conclusions of the Board in the transmission case should not be applied in this case because the decision was flawed. PWU also highlighted the demographic challenges faced by Hydro One, the challenges faced by others in the industry, the increased volume of work, and the shortage of skilled labour. PWU maintained that the evidence showed that Hydro One has achieved smaller increases than other comparable companies and that Hydro One is maintaining wage escalation at competitive levels.

Board staff and intervenors representing ratepayers all argued that the compensation levels were excessive. Board staff, CCC, SEC and VECC each argued that the transmission decision remained applicable and that the compensation costs should be reduced by \$9 million as a result. CCC and VECC took the position that Hydro One had not provided any significant new evidence which would justify a departure from the Board’s decision in the transmission application. CME submitted that the Board should

reduce compensation costs by at least \$9 million but also indicated that the Board would be justified in reducing compensation by up to \$29 million, CME's estimate of the impact of bringing costs to the market median determined in the Mercer study.

Board staff submitted that the tables that compare Hydro One to its related Ontario Hydro successor companies appeared to show that it has made some progress in controlling wages, but do not refute the conclusions made by the Board in the transmission case. Board staff maintained that the argument that high wages are required for attracting highly skilled staff does not explain why non-skilled wages were shown to be substantially higher as well. Board staff argued that more progress was required in those areas.

Energy Probe made similar submissions but rather than adopting the \$9 million impact identified by Hydro One, Energy Probe estimated that the appropriate comparable reduction would be \$16.5 million. Energy Probe also argued there should be two additional adjustments: a further 10% reduction for overtime on the basis that overtime represents about 10% of the total budget; and a reduction of \$12 million in capitalized labour costs.

Energy Probe noted that the Management Compensation Plan (MCP) wage increases are in excess of inflation for 2006 to 2009 and submitted that the Board should set a zero percentage increase for MCP staff in 2010 and 2011. In Energy Probe's view, increases for MCP staff are not warranted in an economic slowdown and the evidence showed that turnover rates were not unusually high. Energy Probe estimated these reductions would reduce the compensation budget by \$1.35 million in 2010 and \$1.39 million in 2011.

A number of intervenors also took issue with the overall staffing level and the rate of increase. Board staff pointed out that staffing has continued to grow every year since 2006, that attrition is not a problem (besides retirements, very few employees leave of their own accord) and that witnesses acknowledged that hiring qualified workers is generally not an issue except for a few specific areas.

VECC submitted that the staff increase of 37% relative to the work program increase of 33% did not show any increases in productivity. SEC also noted the 47% increase in Head Office/GTA headcount between 2008 and 2011, and compared that with the increase in customer numbers of only 4%. SEC recommended that the Board deny

increases in headcount that exceed the increases in customer count. Energy Probe questioned whether the staff increases were even achievable.

Hydro One maintained that in this proceeding it had attempted to provide additional and more meaningful evidence to demonstrate its bargaining achievements. Hydro One noted that in response to the Mercer study it had provided additional evidence comparing Hydro One to a more appropriate and relevant peer group: its successor companies, Bruce Power and OPG. Hydro One maintained that these are Hydro One's main competitors for labour resources and that Hydro One has achieved more success in controlling wage increases across virtually all wage classifications. In Hydro One's view, these achievements should be considered rather than simply focusing on current wage and benefit levels.

Hydro One acknowledged that it fully understands the Board's message in the earlier transmission decision but maintained that little can be done to address the issue in the short term because collective bargaining agreements are in place until 2011 for PWU and 2013 for the Society. Hydro One assured the Board that it would continue with its best efforts to address the Board's concerns through the means available to it.

## **BOARD FINDINGS**

In the last transmission decision the Board stated:

"The Board concludes that it is appropriate to disallow some compensation costs because these costs are substantially above those of other comparable companies and the company has failed to demonstrate that productivity levels offset this situation."<sup>4</sup>

The Board also stated:

"Hydro One's evidence is that the revenue requirement would be \$13 million less if it were based on the median compensation level from the Mercer Study...The Board has already indicated that while the full level of compensation has not been justified, Hydro One has made strides in controlling these costs. The Board will disallow \$4 million in each of the test years; this level of adjustment goes some

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<sup>4</sup> EB-2008-0272 Decision with Reasons, May 28, 2008, p. 30

way toward aligning Hydro One's costs with other comparable companies."<sup>5</sup>

The Board concludes that a comparable reduction is warranted for the distribution business. Hydro One has shown (for the categories presented) that it has controlled wage escalation better than some of the other Ontario Hydro successor companies. However, compensation costs remain excessive in comparison to market indicators. The evidence indicates that Hydro One's main competition for labour comes from within Ontario and the Board regulates most of those other entities. It would be unacceptable for the Board to, in effect, fuel that wage competition by incorporating ever rising wage levels (over and above market related levels) into rates. Hydro One has indicated that a reduction of \$9 million would be comparable to the Board's finding in the transmission decision. The Board has already established an overall OM&A envelope and will not order this as a specific reduction. However, the Board would observe that compensation costs, including growth in headcount, are one of the areas in which Hydro One must take further action to control expenditure increases.

### **3.3 VEGETATION MANAGEMENT**

Hydro One's vegetation management program manages clearances to energized equipment to maintain reliability, manage safety hazards posed by trees, manage plant species to permit maintenance and restoration of power, and minimize environmental, ecological and social impacts. Vegetation management accounts for about 40% of the Sustaining budget in 2010. In 2008, actual spending was \$118 million, increasing to \$136 million in 2009, dropping slightly to \$133 million in 2010 and growing to \$145 million in 2011.

Hydro One's evidence indicated that the 2010 and 2011 spending requirements are based on continuing to reduce the vegetation management cycle so that a 7-year cycle can begin in 2011. Line clearing accomplishments in 2007 and 2008 were performed at about an 8-year cycle. Hydro One's evidence was that a reduction to a 7-year cycle would require a 14% increase in expenditures in 2010 and a 24% increase in 2011 in comparison to the 2007 and 2008 period.

PWU supported the proposal and submitted that the increased spending is required, will improve Hydro One's performance, and will control costs in the long-term.

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<sup>5</sup> EB-2008-0272 Decision with Reasons, May 28, 2008, p. 31

AMPCO, VECC, CME, and SEC all argued that the vegetation management costs should be reduced by maintaining an 8-year cycle rather than moving to a 7-year cycle. Two primary reasons were cited: the need to control spending at this time and a lack of strong evidence supporting the benefits of moving to a 7-year cycle. Intervenors were also of the view that the activity was not being conducted as efficiently as possible.

AMPCO submitted that the evidence does not show improved reliability even though there have been increases in vegetation management spending since 2006. AMPCO accepted that there may be some benefits from moving to a 7-year cycle, but submitted that Hydro One had not provided sufficient evidence to support a decision to move beyond an 8-year cycle at this time. AMPCO urged the Board to direct Hydro One to continue on the 8-year cycle and provide evidence in its next application as to whether its projections of improved service quality are being realized. SEC also recommended staying with the 8-year cycle until evidence is provided that a shorter cycle is warranted and the benefits to ratepayers are determined.

VECC submitted that Hydro One is focusing too much on labour hours and not enough on overall cost efficiency and that an overall cost efficiency focus could lead to achieving more than an 8-year cycle for the same level of expenditure. In AMPCO's view, the Vegetation Management Study shows that the actual per unit cost for Hydro One to treat a tree was more than double that of other utilities. AMPCO submitted that the Board should direct Hydro One to undertake a study to determine whether it is prudent and cost effective to continue to execute their vegetation management program in-house.

Hydro One responded that its evidence, including the Vegetation Management Study, supported the move to a 7-year cycle. Hydro One maintained that the benefits of a shorter cycle do not seem to be in doubt and that reducing these costs in the short term would lead to increased costs in the longer term.

## **BOARD FINDINGS**

The Board concludes that this is an area where spending deferrals or reductions may well be warranted. The analysis suggests that there are net benefits from moving to a 7-year cycle. However, the actual benefits of moving to an 8-year cycle have yet to be demonstrated on Hydro One's system. The Board understands the lag involved between increased spending levels for vegetation management and reduced future

expenditures on trouble calls, but it would be appropriate to perform some analysis of actual results at the 8-year cycle before embarking on the significant expense associated with moving to the 7-year cycle.

The evidence also suggests that Hydro One's efficiency level for this activity could be enhanced whatever the cycle length. The significant expenditures associated with moving to the 7-year cycle should be supported by a thorough demonstration that Hydro One has investigated all potential efficiency improvements for this work, for example, greater outsourcing.

The evidence indicates that if Hydro One were to maintain spending at the 8-year cycle level, OM&A could be reduced by about \$17 million in 2010 and \$28 million in 2011. The Board has already established an overall OM&A envelope and will not order a specific incremental reduction for this item. However, vegetation management is one of the areas where expenditure reductions should be achievable.



#### 4. RATE BASE AND CAPITAL EXPENDITURES

Hydro One's forecast distribution rate base for 2010 and 2011 is \$4,836 million and \$5,146 million, respectively. For 2010, the proposed rate base is 13.9% higher than the approved rate base for 2008 of \$4,247 million.

Historical and forecast capital expenditure levels are summarized by major cost category in the table below. The table includes the percentage change from the previous year. Hydro One also proposed significant additional capital expenditures for its Green Energy Plan. The direct costs for the Green Energy Plan are not included in the table, but indirect costs, in the form of capitalized overheads estimated at \$10 million to \$15 million, are included. The Green Energy Plan is addressed separately in this decision; the rest of the capital expenditure program is addressed in this section.

**Capital Expenditures, 2006 – 2011**  
(\$ million, including % variance from prior year)

Category	2006 Actual	2007 Actual	2008 Actual	2009 Bridge	2010 Test	2011 Test
Sustaining	172.2	146.9 -14.7%	170.7 16.2%	176.5 3.4%	185.8 5.3%	202.5 9.0%
Development <sup>6</sup>	146.8	154.2 5.0%	153.2 -0.6%	167.9 9.6%	189.2 12.7%	219.0 15.8%
Operations	2.1	2.0 -4.8%	0.9 -55.0%	2.4 166.7%	8.1 237.5%	11.2 38.3%
Shared Services and Other	57.4	96.8 68.6%	110.6 14.3%	103.5 -6.4%	164.8 59.2%	110.8 -32.8%
<b>Total</b>	<b>378.5</b>	<b>399.9</b> 5.6%	<b>435.3</b> 8.8%	<b>450.5</b> 3.5%	<b>547.9</b> 21.6%	<b>543.5</b> -0.8%

Hydro One provided evidence on its planning process which can be broadly divided into four steps:

<sup>6</sup> Hydro One Reply Submission, page 34 (excludes GE Plan Expenditures in the test years)

1. Asset planners determine a list of investments for the various investment categories based on the assumption that no constraints exist. After a series of challenges the list of investments is finalized.
2. This list undergoes a prioritization process resulting in a portfolio of individual investments that together make up a preliminary Investment Plan.
3. The preliminary Investment Plan is reviewed by senior management who may further modify it based on various considerations.
4. The end result is a prioritized Investment Plan proposal, which is recommended to the Hydro One Board of Directors for approval as part of the Corporation's business plan.

Hydro One's prioritization process considers risk mitigation against the dimensions of a set of business values to select the proposed levels of investment. The process incorporates a probability/severity-of-outcome risk matrix to determine the impact ratings for each business value. The Probability scale ranges from Remote to Very Likely and the Severity of Outcome scale ranges from Minor to Worst Case. The accomplishment levels are established and evaluated for a period of five years. The lowest level of investment is referred to as Minimum Level. Minimum Levels of investment are those required to avoid unacceptable risk within the five-year planning period.

The following issues are addressed in this chapter:

- Overall Capital Expenditures
- Distribution System Code Interpretation
- Allowance for Funds Used During Construction
- Working Capital Allowance

#### **4.1 OVERALL CAPITAL EXPENDITURES**

Capital expenditures, excluding the direct Green Energy Plan expenditures, are forecast to increase by 22% between 2009 and 2010. The level in 2011 is projected to be slightly lower than in 2010, but still 21% higher than 2009. The arguments generally focused on the overall level of the proposed capital expenditures.

Hydro One argued that aside from the Green Energy Plan investments the capital budget has not increased considerably and that the increases are primarily driven by Green Energy Plan related activity. PWU supported the capital expenditure budget and noted that if Hydro One does not undertake increased sustaining work now and into the future, the system will be left with a population of assets that is too old and in very poor condition. PWU submitted that replacing assets under those circumstances could be prohibitively costly.

Board staff noted that Minimum Level funding by definition is intended to mitigate unacceptable risk and questioned whether certain capital programs could be deferred in light of the significant increases proposed in the application. Board staff also noted the significant decline in the cost escalators as updated since the initial application.

CME submitted that the Board should reduce Hydro One's budget to the Minimum Level. VECC submitted that the Board should reduce the work plan by limiting capital expenditures to near the Minimum Level. VECC proposed a 10% reduction to the 2010 capital budget and 5% reduction to the 2011 budget. VECC argued that as Minimum Level spending culminates in unacceptable risk after 5 years, it is appropriate for Hydro One to be restricted to Minimum Level spending for the two test years as a rate impact mitigation measure.

VECC also submitted that before the capital budget is reduced to near Minimum Level, it should first be adjusted for the reduction in the cost escalator for construction. VECC noted that the cost escalator had been significantly reduced from applied-for levels and estimated the impact would be a reduction of 2% to the budget.

SEC argued that Hydro One should prioritize its capital expenditures within an overall envelope, including the Green Energy Plan. SEC submitted that the distribution capital budget should be \$460 million in 2010.

CCC submitted that spending should be capped at \$415.5 million in 2010. This level is the average for the period 2006 through 2009. CCC proposed that the level for 2011 be set at \$423.8 million which is a 2% increase over the level proposed for 2010. CCC also submitted that there should be an asymmetric variance account to capture any underspending.

Hydro One responded that the proposed work plan is based on asset condition information and no party challenged that information. In Hydro One's view, arguments

that call for a reduction to the work plan are inconsistent given the uncontested asset condition information. Hydro One also noted that while there was an overall decrease in system demand, the evidence demonstrated that there are pockets of the Province where demand is increasing and Hydro One is obligated to respond to new customer connections.

## **BOARD FINDINGS**

The Board concludes that in light of the significant increased expenditures associated with the Green Energy Plan, there should be significant efforts to contain spending in other areas of the distribution business. The Board acknowledges that spending at the Minimum Level may not be appropriate over the longer term, but it is appropriate to consider limiting spending to this level during this period of accelerated Green Energy Plan expenditures. The Minimum Level for 2010 is \$487 million and for 2011 it is \$505 million. However, this analysis was driven off a base level of spending which included the portion of the Green Energy Plan spending which is proposed to be recovered directly from Hydro One's ratepayers. As a result, since Green Energy Plan spending is considered separately in this decision, the Minimum Level for the rest of the distribution business is likely somewhat lower than these levels. In addition, it is also clear that inflation and cost escalation factors are lower than the levels incorporated into the Minimum Level budget.

In the OM&A section of this decision the Board has laid out in detail the basis for its envelope approach. The Board will adopt the same approach for capital expenditures for the same reasons. The Board acknowledges that there are areas of work driven by asset condition (for example, wood pole replacement) and regulatory obligations (for example, customer connections). However, given the very significant expenditure plans associated with connecting renewable generation and implementing smart grid technologies, it is incumbent upon Hydro One to manage and prioritize the balance of its expenditures in order to moderate the overall impact on customers. This may involve reducing the level of work. For example, the budget for Transport and Work Equipment, though driven by the Green Energy Plan, is likely over-stated given more realistic estimates of the magnitude and timing of that program. Prioritizing may also lead to the deferment of certain projects. The large increases in expenditures in the area of Facilities and Real Estate suggest this may be an area where project deferrals are in order. However, as with OM&A, the Board will not make project-specific reductions or

disallowances; in the Board's view it is appropriate for Hydro One to make those decisions.

The Board finds that capital expenditures for 2010 and 2011 will be reduced to \$500 million in each year. This level remains above the Minimum Level and represents a significant increase over historical levels. Given the significant reduction from the proposed level, the Board concludes that a variance account is not required. As indicated above, the Green Energy Plan is addressed separately in this decision.

## **4.2 DISTRIBUTION SYSTEM CODE**

During the proceeding VECC's counsel raised two issues with respect to Hydro One's interpretation of certain sections of the Distribution System Code ("DSC"). The first dealt with the types of activities that were considered "enhancements" versus "expansions" for the purpose of applying the cost recovery provisions of the DSC to load and non-renewable generation customers. The second issue dealt with Hydro One's interpretation of section 3.3.4 of the DSC which addressed the implementation period for changes to the DSC.

Hydro One provided a list of the types of investment activities it considers to be "enhancements" as opposed to "expansions" for the purpose of applying the cost recovery provisions of the DSC. At the hearing, Counsel for VECC noted that three activities on the list of enhancement activities (increasing the size of distribution station transformers, re-conductoring lines and modifications to voltage regulating equipment) are categorized as expansion activities in section 3.2.30 of the DSC. Hydro One clarified its position and indicated that its categorization of what is enhancement and what is expansion varies depending upon whether the activity arises as a result of the connection of a particular customer or group of customers or whether the activity is part of its overall distribution system plan. Hydro One noted that if the Board finds that the activities it has interpreted to be enhancements are in fact expansions, the impact would be a reduction of \$2 million per year to the connections budget.

VECC submitted that the DSC clearly lays out the definition of enhancement and expansion activities and that Hydro One should align its approach with the DSC. VECC however acknowledged that under the DSC the cost recovery treatment for certain activities changes depending on whether they are in or out of a distributor's system plan and this may have the same effect as Hydro One's approach.

The second issue deals with the effective date for the DSC changes in cost recovery as they are applied to new non-renewable generators and load connections. Sections 3.3.3 and 3.3.4 of the DSC state:

3.3.3 Subject to section 3.3.4, the distributor shall bear the cost of constructing an enhancement or making a renewable enabling improvement, and therefore shall not charge:

(a) a customer a capital contribution to construct an enhancement; or

(b) a customer that is connecting a renewable energy generation facility a capital contribution to make a renewable enabling improvement.

3.3.4 Section 3.3.3(a) shall not apply to a distributor until the distributor's rates are set based on a cost of service application for the first time following the 2010 rate year.

VECC submitted that the wording of the DSC is clear and the changes should not be applied in the current application.

Hydro One did not address this issue in reply.

## **BOARD FINDINGS**

The Board is satisfied with Hydro One's explanation of how it operationalizes the provisions in the DSC related to enhancements and expansions as they relate to load customers and non-renewable generation. The Board has previously recognized that there may be some overlap between enhancements and expansions, but the Board is satisfied on Hydro One's evidence that it addresses the issue on a consistent basis.

With respect to the timing of implementation, the Board will accept Hydro One's interpretation because the application addresses the impacts of the new provisions adequately. It may well be that other distributors have interpreted the provision differently and have not adjusted their 2010 applications to incorporate that change. That too may be acceptable in the circumstances of that distributor.

### **4.3 ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION**

The Allowance for Funds Used During Construction (“AFUDC”, also referred to Construction Work in Progress or CWIP) is \$22.3 million in 2010 and \$27.1 million in 2011. The AFUDC rate is 6.4% in 2010 and 7.7% in 2011.

No party was opposed to Hydro One’s overall approach to establishing the AFUDC rates. Energy Probe however submitted that consistent with the approach used to update the cost of capital components, Hydro One should update its test year AFUDC rates based on September 2009 information. The AFUDC rates based on September 2009 forecasts are considerably lower than the rates included in the application. The updated AFUDC rate for 2010 would be 5.23% and for 2011 would be 5.73%.

Hydro One maintained that the original amounts were appropriate and noted that it did not intend to or support revising the AFUDC rates.

### **BOARD FINDINGS**

The Board finds that it would not be appropriate to update the AFUDC rate for more current information. All test year forecasts are underpinned by assumptions for economic factors which may vary as time passes as the test year approaches or as the test year begins. The Board has traditionally resisted selective updates because in order to be consistent the entire application would need to be updated. When the Board updates the return on equity and the deemed debt rates, it does so for purposes of the overall cost of capital in accordance with the deemed capital structure, and for only that purpose. No adjustment will be made to the AFUDC.

### **4.4 WORKING CAPITAL ALLOWANCE**

The working capital allowance for 2010 is \$300.7 million (or 11.7% of 2010 OM&A and cost of power expenses) and \$305.4 million in 2011 (or 11.9% of 2011 OM&A and cost of power expenses).

The determination of working capital relies on a lead-lag study and is based on the forecast of OM&A expenses, cost of power, capital and income taxes, the net lead-lag days and materials and inventory. Hydro One proposed to continue the methodology originally approved by the Board in 2005 and reviewed in subsequent proceedings. In

2009, Hydro One retained Navigant Consulting Inc. to conduct a lead-lag study. The results of that update were used to estimate the test year working capital requirements.

No party objected to the results of the lead-lag study or the methodology used to determine the working capital requirements. VECC and Energy Probe however raised concerns with certain assumptions used to determine the cost of power and the impact on the revenue lag of the planned migration of 140,000 customers from bi-monthly billing to monthly billing.

To determine the cost of power Hydro One has used a weighted average commodity price of \$61.70 per MWh, based on prices in the Board's April 2009 Regulated Price Plan (RPP) Report. Hydro One also calculated the cost of power based on prices in the Board's October RPP Report which is a weighted average price of \$61.12 per MWh. This change would reduce the cost of power by \$15 million and the cash working capital by \$1.5 million per year. Hydro One has relied on the historical RPP/non-RPP customer split of 69%/31% to estimate the weighted average commodity price. However, Hydro One recalculated the commodity price based on a forecast split of 65%/35% and the Board's October 2009 RPP Report, and this would further reduce the weighted average commodity price to \$60.99 per MWh.

Energy Probe and VECC argued that the allowance should be based on the cost of power in the Board's October 2009 RPP Report. They argued the Board's standard practice was to require the working capital allowance to be updated for the most recent RPP Report (typically October or April depending on the timing of the Decision) and that there is no reason why Hydro One should be treated differently. Energy Probe further argued that Hydro One should use the forecast split between RPP and non-RPP customers to calculate the weighted average price and noted that this further reduces the working capital requirement by approximately \$400,000 in 2010 and \$1.9 million in 2011.

Starting in 2010 Hydro One will begin the migration of 140,000 customers from bi-monthly billing to monthly billing. This migration is expected to be completed by mid 2011 and will reduce the revenue lag by 1.96 days from 69.99 days for those customers. Hydro One estimated this change will reduce the working capital requirement by approximately \$13 million per year when the full year impact of the migration occurs in 2012.



Energy Probe and VECC argued that a portion of the full year reduction in working capital should be reflected in the test year estimates given that the migration begins in 2010. VECC submitted that based on the timing of the migration approximately 85%-90% of the full year impact will be realized by 2011 and therefore the 2011 working capital should be reduced by \$11 million. Energy Probe submitted that the working capital should be reduced by \$4.3 million in 2010 and by \$11.9 million in 2011.

Hydro One submitted that the working capital inputs are appropriate and argued that the impact of the updates is relatively small and is offset by other impacts. With respect to the movement of customers, Hydro One submitted that it will be considered after 2011.

## **BOARD FINDINGS**

The Board has consistently incorporated the most current available Board approved commodity price for purposes of determining the working capital allowance in cost of service decisions. The Board concludes that a similar approach is appropriate here and therefore directs Hydro One to use the cost of power in the October 2009 RPP report and to use its forecast split between RPP and non-RPP customers (65%/35%). The Board will also make an adjustment to recognize the impact of the shift from bi-monthly to monthly billing. As this will largely be completed within 2011, the Board will reduce the allowance for that year by \$11 million, as estimated by VECC, but no reduction will be made for 2010.

## 5. GREEN ENERGY PLAN

Hydro One filed its Green Energy Plan in response to certain provisions of the *GEA*. The plan covers the five year period from 2010 to 2014 and includes the incorporation of renewable energy generation, development of a Smart Grid and promotion of energy conservation.

Using the Board's *Guidelines: Deemed Condition of Licence: Distribution System Planning – G-2009-0087*, issued on June 16, 2009 (the "Guidelines"), Hydro One presented the O&M and capital expenditures related to renewable generation under the categories of Connection, Expansion and Renewable Enabling Improvements ("REI"). Hydro One's Green Energy Plan is summarized in the table below.

**Green Energy Plan Summary, 2010 – 2014**  
(\$ million)

	2010		2011		2012 – 2014	
Category	O&M	Capital	O&M	Capital	O&M	Capital
Renewable Generation	3	168	3	296	10	930
Smart Grid	10	30	10	62	45	250
Energy Conservation	>20	-	>20	-	>60	-
Total Plan Costs	>33	198	>33	358	>115	1,180
Less Generator Funded Costs	-	13	-	27	-	40
Less External Funding	>20	139	>20	236	>60	780
Net Costs to Hydro One	13	46	13	95	55	360

With respect to cost recovery, Hydro One has assumed that the revenue requirement associated with a significant portion of the capital investments contained in the plan will be recovered through an external funding mechanism that recovers the required revenue from all electricity consumers in Ontario. The cost responsibility proposals for the Connections, Expansion and REI investments were developed in accordance with the proposed Distribution System Code ("DSC") amendments issued by the Board on June 5, 2009 and subsequently updated on September 11, 2009. The DSC amendments were finalized on October 21, 2009, after the filing and update of Hydro One's Green Energy Plan.

Hydro One sought two specific approvals with respect to its Green Energy Plan:

- That the Board accept the five year plan as fulfilling Hydro One's obligation to put forward a Green Energy Plan pursuant to the GEA, and
- That the Board specifically approve the levels of spending set out in the plan for the years 2010 and 2011 for rate-making purposes.

The total capital costs for 2010 and 2011 are \$556 million, over 84% of which are related to renewable generation connection. The balance is related to the Smart Grid program. Hydro One intends to reapply in 2011 with an updated plan for approval of expenditures in future years.

The Board will address the following issues:

- Overall Assessment of the Green Energy Plan
- Express Feeders
- Remaining Renewable Generation Expenditures
- Smart Grid Expenditures
- Conservation and Demand Management (CDM)

## 5.1 OVERALL ASSESSMENT OF THE GREEN ENERGY PLAN

Hydro One outlined its view of how the Board should review and approve the Green Energy Plan as follows:

"The review of Hydro One's Plan should be consistent with the review normally done in a Cost of Service application in terms of testing the evidence. In addition, the Board must satisfy itself with respect to the plan's support of the Board's objectives under the *Green Energy and Green Economy Act, 2009* to promote electricity conservation and demand management and renewable energy generation, and facilitate the implementation of a smart grid. Hydro One submits its Green Energy Plan has met these objectives by bringing forward a set of investments that will allow Hydro One to proceed with expanding and enabling the distribution system to accommodate increased renewable generation and to further develop the smart grid to support this objective as well as promote and expand energy conservation in the province. As stated in the Green Energy Plan, Hydro One is currently not submitting an updated set of CDM programs until the issues noted in the plan are resolved. Once the processes to address these issues are

completed, Hydro One Distribution will be in a position to assemble a portfolio of CDM programs for the Board's review and approval."<sup>7</sup>

Intervenors generally agreed with this view of how the Board should assess the plan, although they disagreed as to the conclusion the Board should reach.

Board staff submitted that the Green Energy Plan meets the objectives in the GEA, to the extent that those objectives can be identified in section 70(2.1) of the OEB Act. Board staff also noted that as yet there is no "obligation" for Hydro One to put forward a Green Energy Plan. The obligation to prepare and file plans arises when the Board mandates such filing, and as yet the Board has not done so.

Board staff submitted that Hydro One's Plan may not meet the Board's filing guidelines in two ways: the absence of a section providing a current assessment of the capacity of the system to accommodate the connection of renewable generation, and a failure to provide sufficient detail to enable the Board to carry out its mandate to evaluate the plan. Most intervenors made similar submissions.

Intervenors generally were of the view that expenditures proposed in the plan should not be approved, but that a funding adder/deferral account approach could be used, albeit at a reduced level, with prudence being considered later. Intervenors noted the uncertainty of the renewable generation forecast and the lack of specificity in the plans. CME submitted that the requested expenditure levels were excessive in light of overall rate impacts and affordability considerations and proposed that funding be allowed at the 67% level.

Hydro One was not opposed to a rate rider/variance account approach (i.e. assuming the prudence of the expenditures had been approved), but emphasized the need to approximate the cash flow that would result if the expenditures were included directly in the revenue requirement.

## **BOARD FINDINGS**

In assessing Hydro One's Green Energy Plan, the Board must reconcile the Board's objectives to protect the interest of consumers with respect to prices and reliability, to promote economic efficiency, to promote conservation and demand management, to facilitate the implementation of a smart grid, and to promote generation from renewable

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<sup>7</sup> Exhibit H-9-52

energy sources consistent with the policy of the Government of Ontario. The policy articulated in the Board's guidelines on distribution planning provides guidance to this consideration. The Guidelines include the expectation that an applicant will bring forward a plan to support a request for material funds to develop and implement green energy initiatives. Hydro One has made such a request and therefore it is appropriate for the company to have filed a plan. However, the timing was not ideal for Hydro One. The specific requirements for additional capacity to connect renewable generation were in the early stage of development when Hydro One submitted its application, and continue to develop at the time of this decision. While Hydro One cannot be faulted for not bringing forward a more detailed plan, the lack of specifics in the test years does provide significant difficulty for the Board.

While the Board accepts that Hydro One's plan has addressed the objectives of the *GEA*, in level of detail it falls short of the expectations of the Board's filing guidelines. This detail is important because if the Board approves the Green Energy Plan, there are three significant impacts.

The most immediate and obvious impact of approval of part or all of the Plan is that the spending for approved projects will be recovered from ratepayers (both Hydro One ratepayers and provincial ratepayers). According to the Board's guidelines, once approved in a plan, the need, selection, and budget of a project will not be revisited in subsequent proceedings except in regard to material deviations. Second, approval of all or part of a plan would also result in changes in cost responsibility in accordance with the DSC and regulations. Specifically, costs would be shifted from generators to ratepayers (both local and provincial) pursuant to sections 3.2.5A and 3.2.5.B of the DSC, section 79.1(4)(c) of the Act and section 1(2) of O. Reg. 330/09. Third, under the Act, a distributor can be required to expand or reinforce its system, or make Smart Grid investments, in accordance with an approved plan (section 70(2.1)3 of the Act). This was of particular concern to VECC.

The Board concludes that it cannot approve all the 2010 and 2011 expenditures in the Green Energy Plan. The Board will approve the expenditures for Smart Grid, and subject to material conditions, the expenditures associated with the six express feeders as described at Exhibit D2/Tab 2/Schedule 3/Reference D29. No other aspect of the Green Energy Plan is approved. The Board will, however, provide a funding mechanism for a portion of the projected Renewable Generation expenditures that are not being approved at this time. Funds are to be recovered from both local and provincial ratepayers. The Board will establish a process whereby the prudence of these

funded expenditures can be tested at the appropriate time. In the interim the Board will facilitate the operation of the rate protection provisions of the legislation and the regulations.

Hydro One has indicated that costs indirectly related to the Green Energy Plan are embedded in Hydro One's Capital and O&M forecasts. These costs are in addition to the amounts filed as Green Energy Plan and explicitly dealt with in this section of the decision. In future proceedings, the Board directs Hydro One to identify in its evidence the total cost of its Green Energy Plan – direct and indirect. It is important that the full impact of the plan is known both for the Board's consideration and for transparency of communication.

## **5.2 EXPRESS FEEDERS**

Hydro One provided evidence regarding the planned construction of six express feeders that are expected to be approximately 25 km long and connect to a new, as yet unsited transmission station in southwest Ontario. These feeders are expected to be constructed in 2011, with a route that will be finalized after connection applications related to the OPA's FIT program are received. The aggregate cost of these assets is estimated to be \$34.7 million, accommodating no less than 240 MW of generation capacity. However, Hydro One has indicated that these assets will not be constructed until Hydro One has sufficient assurance that the feeders are fully subscribed at least to the level identified in the plan.

## **BOARD FINDINGS**

The Board approves as prudent the proposed capital expenditures related to the express feeders, provided that construction does not commence until a time mandated by the Board. The revenue requirement amounts for each test year related to the feeders will be recovered by way of a rate rider and external funding. A variance account will be used for the purpose of tracking the difference between the forecast and actual expenditures for future disposition.

The Board is mindful that the deemed condition of licence set out in section 70(2.1)3(i) of the Act requires a distributor to expand or reinforce its system in accordance with an approved plan or as otherwise mandated by the Board.

Given the current uncertainty regarding the total demand for and location of the feeders, the Board does not wish its approval to result in a requirement that Hydro One expand or reinforce its system prematurely. The Board is therefore directing that the construction of the express feeders be deferred. Hydro One shall inform the Board when it has sufficient information regarding requests for connection underpinning the need for each feeder and the location of each feeder. The Board will then determine when and confirm how this expansion of Hydro One's distribution system should occur, which the Board may do with or without a hearing. However, the Board does authorize Hydro One to begin the necessary development and pre-construction work associated with the express feeders.

The revenue requirement amounts for each test year related to the express feeders will be split between Hydro One's ratepayers and provincial ratepayers. In its partial decision in this application, dated February 18, 2010, the Board provisionally approved, for rate setting purposes, the methodology proposed by Hydro One for the allocation of eligible investment costs in Hydro One's Green Energy Plan between Hydro One ratepayers and provincial ratepayers. The allocation methodology and the resulting responsibility for eligible investment costs for 2010 and 2011 will be subject to later revision to reflect the Board's final policy determination in EB-2009-0349. If the result of the Board's policy is to change the allocation that has been provisionally approved, Hydro One will be required to recalculate the assignment of costs, and implement a debit or credit to each ratepayer group.

### **5.3 REMAINING RENEWABLE GENERATION EXPENDITURES**

Hydro One proposes to connect 3,500 MW of renewable generation to its system by the end of 2011. The capital required to connect this level of generation is projected to be \$464 million over two years for connections, expansions and REI. The capital expenditures by cost responsibility category are summarized below:

**Renewable Generation Capital Expenditures, 2010 and 2011  
(\$ millions)**

	Connection		Expansion		REI		Total	
	2010	2011	2010	2011	2010	2011	2010	2011
<b>Generator Funded</b>	13	27	0	0	0	0	13	27
<b>Externally Funded</b>	0	0	60	118	79	118	139	236
<b>Hydro One Ratepayer Funded</b>	0	0	12	25	4	8	16	34
<b>Total Capital</b>	13	27	72	143	83	127	168	296

One of the key assumptions in the capital budget is the expected number of renewable generation connections. Hydro One has assumed that a majority of these new connections will be from the Feed-in Tariff (“FIT”) program. However, when Hydro One’s capital expenditure forecast was developed, the actual results of the FIT program were not definitively known.

Hydro One also proposed that the renewable generation capital assets developed under the Green Energy Plan be depreciated on a straight line basis over a 20 year period. Hydro One argued that a 20-year depreciation period is appropriate because it equals the length of the underlying electricity contracts between the OPA and the renewable generators. Hydro One claimed that there is no guarantee that the assets will be used and useful beyond the life of those contracts and that the service life should match the period of time for which there is a benefit for provincial ratepayers. Board staff argued that the assets will still be used and useful when the initial contracts expire and notes that Hydro One has not provided any rationale for why this is not the case.

The intervenors generally submitted that the amount of additional capacity needed and the timing of renewable generation connections are very uncertain. In addition, CCC questioned Hydro One’s capability to complete the work plan by 2011 in any event, given the significant level of expenditures for the overall capital program.

**BOARD FINDINGS**

With the exception of the proposal to construct the express feeders, the Board will not approve as prudent the expenditures for renewable generation at this time. In the Board’s view, the proposal is deficient due to the unsubstantiated magnitude of the



forecast connections, and therefore total expenditures, and the lack of specificity as to projects to be undertaken.

Hydro One has provided little conclusive evidence regarding the timing and extent of renewable generation connections. The OPA's FIT program is in its very early stages and the most recent public information from the OPA suggests capacity renewable generation connections at 50% to 75% of Hydro One's estimate. While the Board recognizes that this is very preliminary information, there is little else to indicate the overall capacity required in 2010 and 2011. The Board also shares the concern expressed by CCC that Hydro One may not have the capability to complete such an ambitious program in any event.

Hydro One agreed that the Board's review of the plan should be consistent with the review normally done in a cost of service application in terms of testing the evidence. The level of detail for renewable generation expenditures, however, did not allow such a review to be conducted. The actual projects, their location and the specific needs to be addressed by each project were not set out in the Green Energy Plan.

The Board notes that considerable uncertainty remains regarding all the proposed green energy projects, despite Hydro One's efforts to work with all available information. The Board concludes that it is necessary to have greater detail and specificity regarding the projects to be undertaken before a finding of prudence and approval of the remaining expenditures can be made. In the past, expansion costs to serve a generator would be paid for by the generator and ratepayers faced minimum risk if the forecast was inaccurate. In today's environment for renewable generation, if the Board approves the expenditures, ratepayers are at risk for the entire cost of the expansions. It is therefore particularly important to have confidence that the investments become used and useful. In addition, given the still uncertain take-up and location of FIT generation, the Board is reluctant to make a finding which under section 70(2.1)3 of the Act, might require Hydro One to build the facilities approved in the plan even if it became unnecessary to do so.

Although the Board will not approve these renewable generation expenditures on the basis of the record in this application, the Board understands that Hydro One will likely need to undertake work in this area during 2010 and 2011 and should therefore have funding to undertake that work. The Board concludes that funding adders and deferral accounts should be used to support Hydro One's work, while managing the risk to ratepayers and Hydro One.

The Board finds that funding will be provided for 67% of the remaining capital and OM&A expenditures for renewable generation connection for 2010 and 2011. In the Board's view, this represents a more probable level of activity for 2010 and 2011. Actual expenditures will be captured in deferral accounts which will be subject to a prudence review and cleared as part of Hydro One's next distribution rate case. This clearance will be symmetrical. That is, if Hydro One has spent less than the amount collected through the funding adder, the difference will be returned to ratepayers, in addition to any costs found to be imprudently incurred. If Hydro One has prudently spent more than the amount collected through the funding adder, Hydro One will collect the difference through future rates.

Rate protection as prescribed under section 79.1 of the Act will apply to allow collection of a portion of the costs from provincial ratepayers, consistent with the allocation proposed by Hydro One. As explained in the previous section, this allocation is provisional and will be revisited once the Board's policy is determined through the EB-2009-0397 process.

Section 79.1(2) of the Act reads as follows:

**Distributor entitled for compensation for lost revenue**

(2) A distributor is entitled to be compensated for lost revenue resulting from the rate reduction provided under subsection (1) that is associated with costs that have been approved by the Board and incurred by the distributor to make an eligible investment referred to in subsection (1).

In making an order permitting collection of amounts from provincial ratepayers in this case prior to a prudence review, the Board has taken a purposive approach to section 79.1 of the Act, using a regulatory approach that is consistent with the manner in which the Board sets rates in the normal course as well as one that will further the Board's objective of promoting the use and generation of electricity from renewable energy sources.

Under the Board's rate setting regime, rates are set based on a forecast of the revenue that will be required by the distributor in the test year. Rates are therefore largely set on the basis of costs that have not yet been incurred. In exercising its other powers under the Act, the Board should do so in a manner consistent with how the Board carries out its mandate to set just and reasonable rates under section 78 of the Act. In some instances in the past the Board has permitted the collection of funds from ratepayers,

subject to a subsequent prudence review. This enables the utility to have a source of funding, while protecting ratepayer interests.

The Board, for the reasons cited above, cannot make a finding of prudence with respect to the remaining proposed expenditures for renewable generation connection in Hydro One's plan. However, when viewed in light of the way in which the Board sets rates, the Board is of the view that in the circumstances of this application, costs can be specifically approved for collection under section 79.1 even if not yet approved as prudent.

The Board is of the view that, ultimately, the liability of provincial ratepayers for the rate protection referred to in section 79.1 of the Act is limited to costs that have been determined by the Board to have been prudently incurred (net of any direct benefits). As such, where collection from provincial ratepayers is provided for by the Board on a provisional basis, it will be important to ensure that an appropriate mechanism is in place to allow for any necessary reconciliation. In this case, the Board has provided for a reconciliation between costs actually spent and costs prudently incurred, as well as between amounts provisionally collected from provincial ratepayers and costs that are determined to be their responsibility once the Board's policy on the calculation of direct benefits is finalized.

The Board's Guidelines created two deferral accounts for the recording of renewable connection expenditures: account 1531 for capital costs and account 1532 for OM&A costs. Hydro One should use these accounts to record actual expenditures related to renewable energy generation connections. In addition, in its *Filing Requirements for Distribution System Plans*, released March 25, 2010, the Board approved two deferral accounts for the recording of amounts collected through Green Energy Act related funding adders. Account 1533 should be used to record amounts collected through the funding adder. It will be necessary to use sub-accounts to separate collection from Hydro One ratepayers and provincial ratepayers (i.e. payments from the IESO).

Under the provisions of the DSC, if expansion and REI costs have not been previously approved by the Board, then any amounts over \$90,000 per MW are the responsibility of the generator. If a plan or the specific expenditures are approved (found prudent) the cost responsibility for those expenditures shifts from the renewable generator to ratepayers. The Board understands, therefore, that its approval of a plan, or expenditures within a plan, has significant ramifications for renewable generators as well as ratepayers. The DSC does contemplate approval of expansion and REI work

outside the context of a five year Green Energy Plan. When sufficient detail becomes available to allow Hydro One to demonstrate the prudence of the remaining renewable connection expenditures for the test period, Hydro One may apply for a determination of prudence and collection of those expenditures through a rate rider.

#### Depreciation for Renewable Generation Investments

The Board does not accept Hydro One's proposal to use a 20-year depreciation period at this time. The Board agrees with Board staff that Hydro One did not provide sufficient evidence to support a deviation from the standard treatment for depreciation. However, it would be appropriate for Hydro One to bring further evidence supporting its request for a shortened depreciation period when the Board considers the prudence of the expenditures. Until such a case is made and decided upon, Hydro One will use the normal depreciation periods for the assets in the plan, including the Express Feeders.

#### **5.4 SMART GRID**

Hydro One plans to spend \$30 million in 2010 and \$62 million in 2011 on Smart Grid capital investments. Hydro One proposes that the investments be included in rate base for the test years, arguing that the investments are necessary, used and useful, and sufficiently well defined to be included as part of its rate base. Smart Grid O&M costs of \$10 million for each of 2010 and 2011 are also included in the Green Energy Plan.

The Smart Grid expenditure projection was developed following a three step process. The first step was to focus on integrating renewable energy generation, CDM, and system automation. Second, Hydro One formulated plans to utilize pilots to investigate new innovative technologies. The final step is the implementation of pilot projects. The capital expenditures on the smart grid program are summarized below:

**Smart Grid Capital Expenditures, 2010 and 2011  
(\$ million)**

	2010	2011
Energy Storage	2	2
Smart Zone Pilot	13	42
PHEV Trials	1	1
Distribution System Innovation	5	5
Facilities/System Upgrades	7	10
Technology Work (GIS)	3	3
<b>Total Smart Grid Capital</b>	<b>30</b>	<b>62</b>

As shown above, a significant portion of the investments is related to the Smart Zone pilot project. The main objective of this project is to innovate, test and prove new and emerging technologies. Hydro One issued an RFP in 2009 related to research and development and other development work that will be undertaken in the Smart Zone pilot. The results are yet to be finalized.

In cross examination, the witnesses confirmed that until the RFP process is completed, the final costs may vary. However, Hydro One acknowledged that the final costs may vary, but argued that the estimates have been developed in a prudent manner and that the final costs will reflect the forecast.

Board staff argued that Smart Grid costs were of higher risk because of developing requirements for distribution grids and quickly evolving technology. Staff suggested the use of a rate adder and deferral account with a subsequent review for prudence.

CCC and CME both objected to the Smart Grid costs. CME argued that the total plan costs should be reduced by 67%, including the Smart Grid costs. CCC submitted that Hydro One's costs were uncertain since its RFP process was not finalized. CCC also argued that Hydro One had not met the Smart Grid guidelines because the company had not entered into joint participation agreements and that part of the RFP was for research and development. Hydro One responded that the forecast is reliable and maintained that the work does not include research and development but rather technical studies.

## **BOARD FINDINGS**

Hydro One's Smart Grid plan includes many of the activities identified in the Board's filing guidelines regarding smart grid. Generally, the Board finds that the activities identified in Hydro One's Smart Grid plan are consistent with the filing guidelines. Other than the submissions of CCC that Hydro One had not entered in a joint participation agreement and that the activities included research and development (which is prohibited under the guidelines), no party argued that the activities were inconsistent with the Board's guidelines. Parties were most concerned with the uncertainty of the costs.

Although the Board encourages utilities to jointly participate in Smart Grid studies, the Board accepts that Hydro One is uniquely positioned to move forward at this time with Smart Grid activities. The Board encourages Hydro One to share the results of its programs with other utilities where applicable.

The Board accepts Hydro One's evidence that the activities do not include research and development as contemplated in the Board's guidelines. The Board agrees with Hydro One that the RFP in question is very detailed and that Hydro One has the expertise to accurately forecast the cost.

Regarding Board staff's concern that Smart Grid functions are quickly evolving, the Board notes that it is the need to understand these changes which drives the requirement for Smart Grid studies. The development of renewable generation is dependent to a significant degree on technical enhancements to the system - smart grid capabilities. Given the unique role of Hydro One in the province, and the need to develop these capabilities, the Board considers it prudent to approve the Smart Grid aspects of the Green Energy Plan.

Therefore, the Board concludes that the costs as budgeted are prudent, and should be recovered in rates.

While the Board accepts that the cost forecast for the Smart Zone pilot is reasonable, the Board is concerned that the funds may well not be spent in the 2010 and 2011, because the RFP has not yet been finalized. Given this uncertainty regarding the timing of this significant portion of the Smart Grid budget, the Board directs that Smart Grid costs will be recovered through a rate rider, and will be subject to further review, not for prudence, but to determine if the amounts were actually spent in the period. Therefore,

the difference between amounts collected and actual expenditures are to be recorded in a variance account which can be cleared at Hydro One's next distribution rate proceeding.

## **5.5 CONSERVATION AND DEMAND MANAGEMENT (CDM)**

Hydro One included CDM in its Green Energy Plan but indicated that it was seeking only minimal rate funding as it awaits the setting of CDM targets for each distributor and OPA funding for CDM initiatives. Hydro One indicated that it has engaged a consultant to propose a portfolio of programs suitable for Hydro One's service territory and the customer end uses within it, when the CDM targets are established. Hydro One budgeted \$1 million for CDM in the application and indicated that \$20 million is the current level of OPA-funded CDM activity.

Pollution Probe and GEC focused on CDM and the related LRAM issue in this proceeding. The LRAM issue is dealt with in the Load Forecast section of this decision. Pollution Probe recommended that specific CDM programs be expanded, including the Hydro One Peaksaver, Electricity Retrofit Incentive and the Double Return Programs.

GEC expressed disappointment that Hydro One had not focused enough effort on load reduction in its Green Energy Plan. GEC noted that the legislative and policy framework anticipates a continued coordinating and planning role for the OPA and target-setting by the Board in response to Ministerial direction, but submitted that the delays in that process should not slow progress by individual distributors with their existing programs given that the Board has explicitly authorized distributors to apply for rate funding to address gaps in provincial programs. GEC noted that Hydro One had agreed to a Green Energy Plan variance account and that CDM spending variances could be captured in such an account. GEC concluded that the Board should direct Hydro One to accelerate its existing programs in the 2010 and 2011 and track its costs in the Green Energy Plan variance account.

## **BOARD FINDINGS**

The Board recognizes the important role that CDM has in meeting the government's policy objectives and providing customers with a means to reduce their bills. However, the Board will not direct Hydro One to expand its CDM programs as suggested by GEC and Pollution Probe. Hydro One is appropriately waiting for further direction from the

government (through regulation or directive), the Board and the OPA on the appropriate targets for CDM. The OPA is developing programs that are widely applicable which will be available to Hydro One.

The Board approves the CDM spending as proposed by Hydro One.

## **5.6 SUMMARY OF BOARD FINDINGS IN THIS SECTION**

### **Renewable Generation Expenditures - Express Feeders:**

- Capital expenditures approved.
- Development and pre-construction work can proceed.
- Construction deferred awaiting further information from Hydro One and direction from the Board.
- Costs to be recovered through a rate rider, with a variance account to track the difference between actual expenditures and amounts collected through the rate rider.
- Rate protection as prescribed under section 79.1 of the Act will apply to allow collection of a portion of the costs from provincial ratepayers consistent with the allocation proposed by Hydro One. If application of the Board's policy regarding the determination of direct benefits would alter this allocation, Hydro One will be required to recalculate the assignment of costs, and implement a debit or credit to each ratepayer group.

### **Renewable Generation Expenditures – Remainder:**

- Expenditures not approved as prudent at this time.
- 67% of applied-for expenditures to be collected through a funding adder.
- Amounts collected through the funding adder are to be recorded in Account 1533, using sub-accounts to separate amounts collected from Hydro One ratepayers and from provincial ratepayers.
- Actual expenditures are to be recorded in account 1531 for capital costs and account 1532 for OM&A costs.
- Rate protection as prescribed under section 79.1 of the Act will apply to allow collection of a portion of the costs from provincial ratepayers consistent with the allocation proposed by Hydro One. If application of the Board's policy regarding the determination of direct benefits would alter this allocation, Hydro One will be



required to recalculate the assignment of costs, and implement a debit or credit to each ratepayer group.

**Smart Grid:**

- Proposed expenditures approved.
- Costs to be recovered through a rate rider, with a variance account to track the difference between actual expenditures and amounts collected through the rate rider.

**CDM:**

- Spending as proposed by Hydro One approved.
- Costs to be recovered through the OPA and in rates.

## 6. COST OF CAPITAL

The table below summarizes the proposed capital structure and cost of capital for the two test years as reflected in Hydro One’s original filing:

**Capital Structure & Cost of Capital  
2010 and 2011**

Deemed	2010				2011			
	\$M	%	Cost Rate (%)	Return (\$M)	\$M	%	Cost Rate (%)	Return (\$M)
Long-term Debt	2,707.9	56.0%	5.72%	154.8	2,881.6	56.0%	5.72%	164.7
Short term Debt	193.4	4.0%	1.19%	2.3	205.8	4.0%	2.76%	5.7
Common Equity	1,934.2	40%	8.11%	156.9	2,058.3	40.0%	9.09%	187.1
<b>Total</b>	<b>4,835.6</b>	<b>100.0%</b>	<b>6.49%</b>	<b>314.0</b>	<b>5,145.7</b>	<b>100.0%</b>	<b>6.95%</b>	<b>357.4</b>

Hydro One’s deemed amount of short-term debt is fixed at 4% of rate base, as part of its deemed capital structure, and is based on the three-month bankers’ acceptance rate plus a fixed spread of 25 basis points based on the then prevailing Cost of Capital policy. Short term variable rate debt, which pays interest based on the bankers’ acceptance rate, has been included as part of the deemed short term debt amount of 4%.

Hydro One’s long term debt rate (56% of rate base) is calculated as the weighted average rate on embedded debt, new debt and forecast debt planned to be issued in 2010 and 2011. As Hydro One Distribution has a market determined cost of debt, the weighted average long term debt rate is also applied to any notional debt that is required to match the actual amount of long term debt to the deemed amount of long term debt. This approach is consistent with the Board’s EB-2008-0272 Decision.

With respect to Return on Equity (“ROE”), in its original evidentiary filing, Hydro One proposed an ROE of 8.11% for the 2010 test year and 9.09% for the 2011 test year per

the Board's formulaic approach in Appendix B of the then prevailing Cost of Capital methodology developed in EB-2006-0088/EB-2006-0089, issued December 20, 2006.

## **BOARD FINDINGS**

This aspect of the application was not controversial until the Board issued its cost of capital report in EB-2009-0084<sup>8</sup> (the "Report"). The Report had the effect of amending the Guideline the Board uses to establish the applicable cost of capital parameter which is applied to rate base, and which provides the stipulated return on equity to the utility.

In its initial filing, and throughout the proceeding, the applicant had indicated that it would rely upon and apply the prevailing Board approved Guideline for the derivation of the return on equity, which with the issuance of the Board Report on December 11, 2009 became the Revised Guideline.

Early in 2009 the Board embarked on what evolved into a comprehensive review of its cost of capital methodology. All of the parties in the instant case participated in one degree or another in this consultation on cost of capital.

The Board's review culminated in its report of December 11, 2009. That report changed the method used by the Board in developing the cost of capital parameter component of rates. It is unnecessary for the purposes of this decision to discuss in any detail how that methodology was amended as a result of the Board's consultation, but the end result is a material increase in return for the utility.

As documented in the Board's letter of February 24, 2010, the revised methodology increases the 2010 ROE from 8.11% to 9.85%, and the short-term debt rates were established at 2.07%.

The Report was issued in the middle of the oral portion of this proceeding, and immediately caused concern among a number of the intervenors representing ratepayer interests. For its part, the applicant indicated that it would hold to its abiding position that the Board-approved methodology, as amended by the Revised Guideline, should be applied to its application without deviation.

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<sup>8</sup> Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, EB-2009-0084, December 11, 2009

Prior to the release of the Report the cost of capital issue did not attract significant interest from any party through the interrogatory process or otherwise.

The first attack on the company's position by the ratepayer-oriented intervenors took the form of submissions which sought to require the production by Hydro One of additional evidence to justify the application of the amended approach to its case.

On December 15, 2009, after hearing argument from all parties, the Board issued its oral decision. In denying the relief sought by parties, the Board recognized that its report of December 11, 2009 specifically addressed the question of challenges to the applicability of the Guideline, or any part of the Guideline in any given rate case.

Put simply, the Board found that its Report contemplated circumstances where intervenors may want to challenge the application of the Revised Guidelines to a particular applicant in a particular case. In such cases the Report made it incumbent upon intervenors to lead evidence supporting that point of view. In its oral decision, the Board cautioned intervenors that the Board would not entertain, in the context of this case, a re-consideration of the Revised Guideline per se. The Board did indicate that it would entertain a challenge to the applicability of the Guideline or any portion of it to Hydro One in this case, provided that challenge was supported by evidence. The Board invited the intervenors challenging the application of the Guideline in this case to file evidence on the point. A few days later, the intervenors informed the Board that they did not wish to file evidence in this case on this issue.<sup>9</sup>

CCC filed a motion on January 12, 2010, which sought a re-publication of the notice of application in this case so as to include as part of the notice, the rate implications associated with the application of the Revised Guideline. Their contention was that the change brought about by the amendment of the Revised Guideline was of such materiality that the original notice failed to adequately inform the public of the implications of the application and therefore had to be replaced by a revised notice which did.

After considering the submissions of all parties, Board denied that motion. A copy of the Board's decision on that motion is appended to this Decision.

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<sup>9</sup> Tr. Vol. 8, p. 2&3

The challenge to the application of the Board's Revised Guideline on cost of capital appears in the arguments filed by the ratepayer-oriented intervenors in this case.

CME, in an argument that was adopted by a number of other intervenors, challenged the application of any cost of capital parameter for this applicant. In its view, which as noted was adopted by a number of other intervenors, this applicant, because of its ownership structure ought not to be subject to any return on equity. CME argued that Hydro One, as an entity that is owned and directed by the province itself does not raise capital conventionally, and is not subject to the business risks associated with independent, privately owned and operated entities. In effect, CME contends, the utility is supported through taxation, and to reward it with any return on equity would be a form of double recovery.

For its part, CCC argued that because of the ownership of the utility by the province and its role within the infrastructure of the province, it operates essentially in a risk-free environment, and any return on equity should be no greater than the cost of debt actually experienced in the market.

Other intervenors suggested that, because Hydro One does not raise equity based capital in equity markets, that portion of the Guideline that provides for 50 basis points in "transaction costs" as part of the return on equity should be excluded. The argument is that these are costs that are not experienced by Hydro One and therefore should not form part of its cost of capital.

A further argument was made respecting the application of the short-term debt rate to the working capital allowance portion of rate base. Essentially this argument contends that the assets to which the working capital allowance typically relate ought to be subject to the prevailing short-term interest rate. This approach is not consistent with the Board's Revised Guideline, or the previous December 20, 2006 Report of the Board. The Board established in the December 20, 2006 Report of the Board that there would be a 4% short term debt capitalization in the deemed capital structure, and this was continued in the Revised Guideline. Under the Board's policy to the extent the working capital allowance exceeds 4% of rate base, it will attract the long-term debt cost.

The fact is that none of these arguments seeking to displace all of, or portions of, the Revised Guideline on cost of capital is supported by any evidence whatsoever. Whatever the relative merit of any of these arguments may be, in order to prevail they must be underpinned with persuasive evidence, which has been subjected to the usual

testing processes. This is a basic tenet of law; in order to succeed an argument must be founded on evidence properly before the decision maker.

The Revised Guideline is clear on its face: parties wishing to challenge the application of the Guideline in whole or in part to any given utility have an obligation to file evidence supporting their point of view. That burden properly rests with the party seeking to displace the operation of the Guideline. Argument, unsupported by evidence, is not the appropriate vehicle for advancing these positions.

In this proceeding the intervenors seeking to challenge the application of the Guideline explicitly chose not to file evidence on these issues. They also did not reference any aspects of the evidence already on the record.

It should also be noted that an attack on the application of the Revised Guideline in the context of a particular rate proceeding, such as this one, does not involve a re-consideration of the Revised Guideline per se. As has been determined in this case in our ruling of December 15, 2009, the Board will not entertain such a re-consideration of the Guideline. What the Board can consider is whether the Guideline or some portion of it ought not to apply to a given utility in the context of a specific cost of service proceeding. In order to succeed, that challenge must be supported by properly introduced evidence. It is for the challenging party to decide what evidence it believes is appropriate to bring, but it may well go beyond a simple assertion respecting transaction costs or the nature of the assets typically funded through the working capital allowance.

For these reasons, the Board finds that the Revised Guideline will be applied to the applicant. This includes implementation of the updated cost of capital parameters, which were issued on February 24, 2010. It also means that the company's cost of long term debt must be updated to reflect the actual debt costs associated with the actual debt instruments used by the company in 2009. In its oral evidence, the company had suggested that such an update would not be undertaken. The Board considers that approach to be inconsistent with the Revised Guideline, which expresses the Board's intention to rely on the actual costs for long term debt, when they are known.

The Cost of Capital parameters will be updated for the purpose of establishing 2011 rates. The Board will rely on September, 2010 data for purposes of deriving the ROE and short-term debt rate. The Board will issue a letter containing the necessary values to allow Hydro One to develop a Draft Rate Order, to be effective January 1, 2011.

Hydro One will be required to provide an updated cost of long-term debt, based on actual debt issued. The Board expects this process to be mechanistic in nature; no further evidence will be heard at that point.

## 7. DEFERRAL AND VARIANCE ACCOUNTS

Hydro One is requesting disposition of certain deferral/variance account balances as at December 31, 2009. The principal balances and interest in these accounts are forecast beyond December 31, 2008 audited balances. The accounts for which disposition is requested including the balances, are summarized in the table below:

**Deferral & Variance Account Balances  
2008 and 2009<sup>10</sup>**

Account Number	Description	Balance at December 31, 2008 (\$ millions)	Balance at December 31, 2009 (\$ millions)
1518/1548	RCVA	(1.7)	(1.9)
1555 and 1556	Smart Meter Minimum Functionality Under-recovery Jan. 1 to Dec. 31, 2008	.9	.9
1555 and 1556	Smart Meter Exceeding Minimum Functionality Under-Recovery between Jan. 1 to Dec. 31, 2008	1.1	1.1
1580	RSVA Wholesale Market Services	(11.4)	(18.7)
1584	RSVA Tx Network & Tx Network Aggregation	(14.0)	(7.2)
1586	RSVA Tx Connection & Tx Connection Aggregation	(2.9)	.8
1588 Sub-account Global Adjustment	RSVA Provincial Benefit	5.5	19.6
1550	RSVA Low Voltage	1.9	2.6
1590	Regulatory Asset Recovery Phase 1	(18.7)	(23.0)
	<b>Total Requested for Disposition</b>	<b>(39.3)</b>	<b>(25.8)</b>

Hydro One is proposing to refund the total regulatory asset balance of \$(25.8) million, or \$(12.9) million per year, starting January 1, 2010 over a two year period, with the assumption that new distribution rates would be effective on January 1, 2010.

Submissions on the clearance of existing accounts focused on whether audited or unaudited account balances should be used, whether the disposition period should be 1 or 2 years, whether the variance in the distribution system losses should be specifically

<sup>10</sup> Exhibit F1/Tab1/Sch1 and Exhibit H/Tab1/Sch110



reflected in account 1588, and whether a separate rate rider should be established for non-RPP customers when disposing of the 1588 Global Adjustment account.

## **7.1 AUDITED VS UNAUDITED BALANCES**

Board staff pointed out that it was not common practice in the electricity sector to dispose of forecast principal balances for deferral and variance accounts but also acknowledged that the Board had disposed of forecast balances in the past. Intervenors had varying views on this issue. VECC and Energy Probe agreed only audited balances with forecast interest should be considered for disposal. CCC and CME submitted that the Hydro One proposal was appropriate as long as the balances are ultimately trued up when the audit process is complete.

In reply argument, Hydro One noted that the 2009 audited results will be available when the final rate order is implemented.

## **BOARD FINDINGS**

While acknowledging that past Board decisions have at times varied on the disposition of audited or non-audited balances for deferral and variance accounts, in this case, the Board will order that only audited amounts will be cleared. Hydro One has indicated that audited values will be available for 2009 in time for the issuance of the rate order for this proceeding. Board approves the clearance of 2009 audited balances and directs Hydro One to prepare the draft rate order for Board's approval on that basis.

## **7.2 ONE OR TWO YEAR DISPOSITION**

Board staff advocated disposition of the accounts over one year rather than the proposed two year period, to mitigate the rate impacts of the application. CCC and CME agreed with this approach. Energy Probe advocated that the amount for recovery should be equally split between 2010 and 2011, which would mean a higher rebate in 2010 if the rates were implemented later in the year. AMPCO advocated for disposition from May 1, 2010 to December 31, 2011.

In reply argument, Hydro One submitted that a principled approach should be followed that is consistent with past practice, and that disposition over the two test years has an

overall rate smoothing effect for both test years. If disposed of in only the first year, the 2010 rate impact would be lower but 2011 would be higher.

## **BOARD FINDINGS**

As new distribution rates will not be in place until May, the Board orders the balances to be recovered over the time period remaining from implementation to December 31, 2011. If the entire balance were returned in 2010, the rate increase for 2011 would in effect be even higher. The Board finds that the proposed approach of disposing the balances over both test years is preferred.

### **7.3 ACCOUNT 1588 DISTRIBUTION SYSTEM LOSSES**

Board staff submitted that Hydro One is excluding the variance relating to distribution system losses from account 1588 RSVA – Power and submitted that there is a difference between the cost of actual line losses and what is collected in rates. Board staff took the position that Hydro One should reflect this difference in account 1588. Board staff submitted that this is a calculated number that does not require special meters and noted that other LDCs are able to calculate line loss variances in account 1588. Board staff also submitted that Hydro One does identify the kWh line losses and reports the same to the Board under Reporting and Record Keeping Requirements (RRR) 2.1.5. An analysis of RRR 2.1.5 filings from 2005 to 2008 was presented by Board staff at the oral hearing. This chart showed that on average, Hydro One's losses from 2005 to 2008 have been approximately 6.8% of the wholesale kWh purchased. The Hydro One witness suggested that distribution system loss, expressed as a percent of retail kWh would be 7.3%<sup>11</sup>. However, this is still a significant difference from Hydro One's currently approved loss factors.

Board staff also submitted that the difference between the dollar value of the actual losses and the dollar value of losses recovered in billings should be booked in account 1588.

Hydro One responded that given its unique and complex distribution system, it has different loss factors for each rate class while other LDCs have one uniform approved loss factor. So the comparison of actual losses to the approved losses requires an allocation of actual losses to each rate class. Hydro One maintained that the accuracy

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<sup>11</sup> Exhibit K10.1 and Tr. Vol. 10, p. 81

of this allocation negates the benefit of any comparison. The only way to provide a meaningful comparison is to track actual losses which would require a significant investment to install meters to record actual sales compared with electricity purchases. Hydro One submitted that the cost of doing so would be greater than the gains that may be achieved. Hydro One also referred to the Board's EB-2005-0378 decision where the Board agreed with Hydro One's submissions on this issue.

## **BOARD FINDINGS**

It is important that Hydro One calculate and report to the Board the difference between the cost of actual line losses and the amounts recovered from ratepayers. These amounts could have a material impact on ratepayers. The Board understands that Hydro One's calculation of cost and revenue is more involved than any other distributor, and that with the several deemed loss factors in Hydro One's tariff, there is the likelihood of inaccuracies that are different in nature from other distributors. However, this differential is tracked by other distributors and the Board is of the view that Hydro One should attempt to do so as well, or should demonstrate more clearly to the Board why such an approach is impractical.

The Board directs Hydro One to track the dollar value of variances between the Board approved losses recovered in rates, and actual line losses, commencing January 1, 2010. The Board expects that the information related to wholesale purchases, as well as line losses recovered in rates, are currently available to Hydro One through its wholesale meters, and its billing systems. The Board further expects that Hydro One can obtain the dollar value of recoveries of losses in rates from its billing system; and can convert the kWh information of actual line losses (which are measured and reported to the Board under RRR 2.1.5) to dollar values, although other approaches, such as the allocation method identified by Hydro One, may be appropriate. Hydro One is directed to bring this analysis to its next cost of service proceeding so that this issue may be further examined.

#### **7.4 SEPARATE RATE RIDER FOR NON-RPP CUSTOMERS FOR RECOVERY OF 1588 SUB-ACCOUNT GLOBAL ADJUSTMENT**

With regard to the amounts in the Global Adjustment account, Board staff submitted that Hydro One should establish a separate rate rider for disposition of account 1588, sub-account Global Adjustment. The rate rider should apply prospectively to non-RPP customers, and would exclude the MUSH sector and other designated customers that were on RPP. Energy Probe supported Board staff's position. Hydro One did not address this issue in its reply submissions.

#### **BOARD FINDINGS**

Although Hydro One did not respond to the proposal for a separate rate rider, many other distributors are able to determine a separate rate rider and therefore the Board will direct Hydro One to develop a separate rate rider for these non-RPP amounts, for disposition of the Global Adjustment to non-RPP customers only, excluding the MUSH sector and other designated customers that were on RPP.

With regard to the disposition of Deferral and Variance account balances, for accounting purposes, the respective balance in each of the accounts shall be transferred to Account 1595 Disposition and Recovery of Regulatory Balances Control Account, as soon as possible, and certainly no later than June 30, 2010 so that the Reporting and Record Keeping Requirements (RRR) data reported in the second quarter of 2010 reflects these adjustments.

#### **7.5 NEW ACCOUNTS REQUESTED**

Hydro One is requesting Board approval for five new deferral accounts. These are the Pension Cost Differential Account, OEB Cost Differential Account, Impact of Changes in International Financial Reporting Standards (IFRS), Fixed Charge for Micro-Generators, and Bill Impact Mitigation Account. The specific accounts are described below:

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

In this account, Hydro One proposes to track the difference between the actual pension costs booked using the actuarial assessment provided by Mercer, and the estimated pension costs used in this filing. Hydro One would use Account 1508 Other Regulatory Assets; Sub Account Pension Contributions to record pension cost differentials.

Of those intervenors that commented on the Pension Cost Differential Account, VECC and Energy Probe supported approval. SEC and AMPCO argued against the approval of this account. SEC advocated that Hydro One provide more information to the Board after the pension evaluation is complete, detailing potential impacts and how this should be addressed.

In reply, Hydro One reiterated that this account was appropriate and would cover the impact of any changes in pension contributions on Hydro One's OM&A that cannot reasonably be predicted in advance of the completion of the updated valuation.

## **BOARD FINDINGS**

The Board finds that the proposal is reasonable and approves the Pension Cost Differential Account. The Board accepts that the impact of the actuarial assessment could be significant and notes that the issues identified by SEC and AMPCO can be addressed at the time of disposition.

### **OEB Cost Differential Account**

In this account, Hydro One is seeking to track the difference between approved and actual costs for 2010 and 2011 with respect to the Board's cost assessments, intervenor cost awards and costs associated with Board-initiated studies. Hydro One would use Account 1508 Other Regulatory Assets: Sub Account OEB Costs to record these amounts.

Board staff noted that Hydro One had previously requested this account in EB-2007-0681, but the request was denied and the Board did not allowed a similar request by Toronto Hydro. In the last Hydro One transmission proceeding (EB-2008-0272), a variance account was allowed but exclusively for variances in the Board's costs assessments. Staff submitted that the account should continue to be approved for Board cost assessments only.

VECC, CCC, SEC, CME, AMPCO and Energy Probe all agreed with this submission. CCC submitted that Hydro One should not be afforded what would effectively be a pass-through of intervenor cost awards and cost associated with Board-initiated studies. Hydro One did not address this account in its reply submission.

## **BOARD FINDINGS**

The Board concurs with Board staff and the intervenors. The extended coverage sought by Hydro One is not available to other distributors, and no compelling reason has been provided for why Hydro One should be treated differently.

The Board approves this account on the basis that it be used for the Board cost assessments only.

### **Impact for Changes in IFRS Account**

In this account, Hydro One proposes to track the difference between costs in the current revenue requirement and any difference in revenue requirement directly attributable to changes which may arise in IFRS standards between now and the conclusion of the test period. The application has been filed based on IFRS standards as they are reflected in the publications of the relevant accounting authorities. It is possible that IFRS standards may change during the test period, and this proposed account is designed to capture the revenue requirement consequences of any such changes.

Board staff pointed out that the creation of such an account has been specifically considered by the Board and rejected (EB-2008-0408, Report of the Board, Transition to International Financial Reporting Standards, July 28, 2009) and submitted that such an account should not be approved in this case. VECC, CCC, SEC, CME, AMPCO and Energy Probe all submitted that the proposal should be denied.

Energy Probe noted that Hydro One has included IFRS transition administration related costs in approved rates and submitted that the Board should require Hydro One to track any difference between the amount included in rates and the actual transition costs in the variance account set out in Section 8.2 of the EB-2008-0408 Report. Hydro One has not explicitly identified the amount included in revenue requirement in this proceeding.

Hydro One responded that the nature of the requested IFRS account was misunderstood by Board staff and intervenors. Hydro One maintained that the requested account would conform to Board policy and would not include revenue requirement impacts arising from changes in the timing of the recognition of expenses, as specifically excluded from the deferral account in the Board's EB-2009-0408 Report which is effective from January 1, 2011. Hydro One submitted that it requires the

account to address changes in IFRS or its interpretations that could not be predicted arising between the date of its application in this proceeding and January 1, 2011.

Hydro One stated that its application for 2011 rates, while based on Canadian Generally Accepted Accounting Principles (GAAP), contemplated eventual adoption of IFRS as it was known at the date of application, including the International Accounting Standards Board (IASB)'s exposure draft on accounting for rate regulated activities. Hydro One stated that adoption of IFRS, in its then expected form, would not have a material impact on its reported cash flows. Hydro One also stated that the impact of IASB approved changes or interpretations between the date of Hydro One's application in this proceeding and the date of adoption on January 1, 2011, should be provided for through the mechanism of the proposed account.

## **BOARD FINDINGS**

In its EB-2008-0408 Report, the Board stated that it will:

“...require(s) distributors to specifically identify financial differences and any revenue requirement impacts that result from adoption of modified IFRS requirements in the distributor's first cost of service application after adoption. Revenue requirement impacts of any change in capitalization policy must be specifically and separately quantified.”<sup>12</sup>

The Report also noted that:

“There was general agreement among participants that rate mitigation mechanisms currently used by the Board, such as deferral accounts and rate riders, could be used to reduce any impacts resulting from IFRS-related costs that the Board permits to be recovered through rates.”<sup>13</sup>

In addition, the Report stated in Appendix 2:

“Rate impacts (from adopting IFRS policies) should be considered in aggregate to determine the significance of the cumulative effect. Distributors must provide specific

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<sup>12</sup> EB-2008-0408, Report of the Board, p. 25

<sup>13</sup> EB-2008-0408, Report of the Board, p. 25

information regarding the individual cost drivers making up the aggregate impact.”<sup>14</sup>

The Board will approve the creation of the IFRS deferral account to capture the aggregate impact on the 2011 revenue requirement resulting from any changes to existing IFRS standards and changes in the interpretation of such standards. The granting of this account is, in part, in recognition of the fact that this application by Hydro One covers a two year period.

The account is to permit Hydro One to record, for future disposition of revenue requirement, impacts due to changes in IFRS that arise before the next Hydro One cost of service proceeding. It is to provide for mitigation, should it be appropriate, when considering the impact of transition to IFRS in aggregate, as contemplated in Section 7.0 of the EB-2008-0408 Report.

Approval of this account does not indicate approval of any particular regulatory accounting practice. When considering disposition of the account at the next cost of service application after adoption of IFRS, the Board will address the extent to which entries can be directly linked to changes to the IFRS standards which were used for purposes of the current application, as well as the usual parameters such as prudence, materiality, alternatives considered and other management actions taken by Hydro One to mitigate any material aggregate impact.

### **Fixed Charge for Micro-Generators**

This account is intended to record revenue collected from the new fixed meter charge that will be applied to micro-generators. This revenue will be tracked in a variance account to be refunded in the future to customers. Hydro One would be using Account 1508 Other Regulatory Assets: Sub Account Fixed Charge for Micro-Generators to record these amounts.

### **BOARD FINDINGS**

The Board notes that the Fixed Charge for Micro-Generators Account was supported by all parties. The Board approves the account.

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<sup>14</sup> EB-2008-0408, Report of the Board, Appendix 2



## **Bill Impact Mitigation Account**

This account will record any revenue forgone and any incremental costs associated with implementing any additional mitigation measures that might be required as a result of completing the rate harmonization process. Hydro One intends to use Account 1508 Other Regulatory Assets; Sub Account Bill Impact Mitigation to record these variances.

The Bill Impact Mitigation Account received detailed submissions from two parties: AMPCO and VECC. VECC pointed out that the purpose of this account is to record any revenue foregone or incremental costs required as a result of completing the harmonization process. VECC questioned the need for such an account as Hydro One has stated that it is not proposing to forego revenue as means of mitigating the impact of harmonization. Also, Hydro One had a similar account approved for 2008 rates but has not recorded any costs in the account. Furthermore, now that the harmonization is underway, VECC did not understand what additional costs could be incurred. VECC submitted that, unless Hydro One is being asked to forego revenues as a means of mitigating the impact of harmonization, this request should be denied.

AMPCO submitted that mitigation should be viewed in the context of the need to mitigate overall bill impacts for all customers first and for specific groups only afterwards. If this is done, AMPCO could support a specific bill impact mitigation account as proposed. AMPCO continued that, at the same time, if the total bill impact across all customer groups remains high, AMPCO could not support this approach, as it inevitably generates cross-class subsidies when the account is cleared across all customer groups.

Hydro One did not comment on this account in its reply argument.

## **BOARD FINDINGS**

The Board finds that it is appropriate for Hydro One to record rate mitigation amounts in a formally constituted Rate Mitigation Account to complete the rate harmonization process, especially as the increase in revenue requirement as a result of updates in this case has increased the potential need for rate mitigation. The Board therefore approves creation of this account.

### **Deferral Account for Harmonized Sales Tax (“HST”)**

The provincial sales tax (“PST”) and goods and services tax (“GST”) will be harmonized effective July 1, 2010 pursuant to Bill 218 which received Royal Assent on December 15, 2009. Unlike the GST, the PST is currently included as an OM&A expense and is also included in capital expenditures. When GST and PST are harmonized, Hydro One will realize a reduction in OM&A expense and capital expenditure that has not been reflected in the current application.

Hydro One did not include any forecast of the impact of HST but indicated that it would track the PST savings and that the estimated savings would be tracked in deferral account 1592.

### **BOARD FINDINGS**

The Board finds that Hydro One’s proposal is acceptable. This approach is consistent with the approach which has been adopted by the Board for other distributors.

### **Green Energy Plan Accounts**

Please refer to the Green Energy Plan section of this decision.

## **8. COST ALLOCATION AND RATE DESIGN**

The following issues are addressed in this section of the decision:

- Cost Allocation
- Density Criteria and Study
- Revenue to Cost Ratios
- Hopper Foundry
- Unmetered Scattered Load
- Milton LV Assets
- Harmonization and Impact Mitigation

### **8.1 COST ALLOCATION - GENERAL**

VECC submitted that the Hydro One cost allocation methodology raises concerns in a number of areas, including:

- direct allocation of certain costs
- allocation of administrative and general expenses
- allocation of revenue from miscellaneous charges
- assumptions underlying the Minimum System customer and demand costs.

It did not suggest that the Board should reject the cost allocation as filed in 2010, but submitted that Hydro One should modify its methodology or address the matter with its next cost of service application.

### **BOARD FINDINGS**

The Board finds that the cost allocation study is sufficient for 2010 and 2011 rates. No concerns were raised by the parties, and Hydro One's methodology has been reviewed and approved in a number of prior proceedings. VECC has identified several issues which it submits have yet to be addressed by Hydro One. The Board concludes that these matters should be reviewed in the course of Hydro One's work to consider

potential improvements to its cost allocation methodology as a normal part of its evolution and directs Hydro One to address these issues in the pre-filed evidence at its next cost of service application.

## 8.2 DENSITY CRITERIA AND STUDY

Hydro One provided a Study on Density Criteria in response to the Board direction in EB-2007-0681 to analyze the relationship between density and cost allocation; to review the customer class demarcation in order to assess if it reflects cost causation; and to develop alternative considerations regarding density weightings. The Board directed Hydro One to:

“.....provide a more detailed analysis on the relationship between density and cost allocation to the Board. This should consider whether the number of Residential and General Service customer classes in the new class structure is adequate, and whether the customer class demarcations approved in this Decision offer the best reflection of cost causation. The study should include consideration of alternative density weightings, with descriptions and criteria for comparing alternatives. Comparisons with the costs of distributors similar in size and location to Acquired Distributors would also be useful. The Board requires that Hydro One submit this information in its next cost of service application.”<sup>15</sup>

The report filed by Hydro One was prepared by John Todd of Elenchus Research Associates. Hydro One acknowledged that the report is not in full compliance with the Board’s direction. Hydro One submitted that the report is the first step of a staged approach, and was achieved over a relatively brief period of time. A focus of the report is the methodology (or methodologies) that could be employed in the subsequent stage(s) of the analysis.

SEC filed evidence on density based classes and rates by Dr. C.K. Woo, of Energy and Environmental Economics Inc.

Both experts agreed that where urban/rural distinctions are found, it is more usual to base them on municipal boundaries than on the density characteristics of the distribution system.

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<sup>15</sup> EB-2007-0681, Decision with Reasons, December 18, 2008, p. 31

SEC submitted that customers in the service areas acquired by Hydro One have been assigned to pre-existing classes without appropriate cost allocation. Many of these service areas are small clusters of relatively high density that may be less costly to serve than the legacy area with which they have been grouped. SEC made three recommendations:

- Hydro One should be directed to complete a proper study of the relationship between density and cost of service as soon as possible, and should do so on a cooperative basis.
- Until the study is reviewed any further harmonization should be halted.
- The cost of the study should be borne by Hydro One as it was already included in the 2008 cost of service.

AMPCO submitted that SEC's evidence, which suggests that Hydro One should develop a rate structure based on municipal boundaries, is illogical and unpersuasive. However, AMPCO was also of the view that Hydro One had not responded adequately to the Board's direction and should be required to provide a more detailed analysis on the relationship between density and cost allocation.

CME and Board staff argued that the Board should direct Hydro One to comply with the previous direction. Board staff suggested that Hydro One should take responsibility for determining the most appropriate methodology but that analysis of sample data or the engineering study method (or a combination) would be appropriate.

CCC submitted that further study was warranted, but should not be undertaken until completion of the harmonization process. VECC also submitted that Hydro One should be directed to comply with the previous direction. Specifically, VECC stated:

“Thus, VECC submits that the first step is to establish a methodology that reasonably captures the cost causation implications of density and then test whether there are urban/rural splits other than the one currently used by Hydro One Networks that better reflect the cost differences that arise due to density. Indeed, VECC submits that this is precisely what the Board directed Hydro One Networks to do in its EB-2007-0681 Decision, To this end, VECC also submits that the use of a couple of simple methodologies (including Hydro One Network's current approach based on

customers per kilometer of feeder) would be a good starting point.”<sup>16</sup>

Pending the completion of the analysis, VECC submitted that Hydro One should maintain the existing approach to reflecting density in its cost allocation methodology and not change the treatment of seasonal customers.

Hydro One responded by requesting further guidance from the Board. Hydro One maintained that a full study of the relationship between density and costs would be “extremely costly and is not certain to provide information which is better than the current density definitions used by Hydro One.” Hydro One also maintained that it should be permitted to continue with the harmonization and that it should be permitted to change the density weighting factors for its Seasonal customers.

## **BOARD FINDINGS**

The Board will direct Hydro One to comply with the Board’s prior direction regarding this issue. Hydro One has not requested to be released from the prior direction and the rationale for the work still exists. There has been no change, nor any evidence, to suggest that the study is no longer relevant or necessary.

The Board will not specify at this point the precise methodology or approach Hydro One is to use. A variety of approaches were discussed in the testimony of the experts and it is not clear at this point if there is one single best approach. The Board concludes that there is merit in pursuing a variety of approaches, at least to some extent, to assist in determining the preferred approach. The Board expects Hydro One to work cooperatively with the parties but leaves it to Hydro One’s discretion to determine how best to conduct the study taking into consideration timing, feasibility and cost. The Board recognizes there are concerns about the costs involved, particularly if there are full cost allocation studies done involving alternative customer classifications and density weighting factors. The Board expects Hydro One to manage the project efficiently and recognizes that it may be appropriate to compare scenarios that are not as completely developed as Hydro One’s main cost allocation study.

The Board will not stop the harmonization process. This program was already examined and approved in a prior proceeding, and although the work on density has not

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<sup>16</sup> VECC Final Argument, p. 41

been completed there is no evidence to suggest the harmonization is inappropriate. However, the Board finds that Hydro One will not be permitted to change the density weighting factor for Seasonal customers at this time. This represents a further change beyond what has already been approved, which may not be adequately supported. On balance, the Board finds that it is more appropriate to wait for further analysis in this area.

### 8.3 REVENUE TO COST RATIOS

Hydro One proposed downward changes to its rate design to achieve a ratio of 1.15 for the Seasonal customer class, a ratio of 1.20 for the UGSe class, a ratio of 1.00 for Distributed Generation, and a corresponding upward change to 0.89 for the GSd class. It also proposed small upward shifts to Streetlights and Sentinel Lights. Hydro One's existing and proposed revenue to cost ratios are presented in the table below.

**Revenue to Cost Ratios  
2010 and 2011**

<b>Class</b>	<b>Status Quo Ratios</b>	<b>Proposed Ratios</b>	<b>Target Range</b>
UR	1.09	1.09	0.85 – 1.15
R1	0.92	0.92	0.85 – 1.15
R2	1.02	1.02	0.85 – 1.15
Seasonal	1.16	1.15	
UGSe	1.21	1.20	0.8 – 1.2
UGSd	1.25	1.25	0.8 – 1.8
GSe	1.07	1.07	0.8 – 1.2
GSd	0.88	0.89	0.8 – 1.8
ST	1.01	1.01	0.85 – 1.15
DG	1.35	1.00	
Streetlights	0.68	0.70	0.7 – 1.2
Sentinel Lights	0.67	0.70	0.7 – 1.2

VECC submitted that the increase for the GSd class was inappropriate and that the ratio for Distributed Generation need not be set to 1.00, but should be set to 1.15.

## **BOARD FINDINGS**

The Board finds that the proposed adjustments to the revenue to cost ratios are appropriate. Specifically, the Board will accept the increase to the General Service demand ratio to .89 and the reduction in the DG ratio to 1.00. The Board has indicated in various decisions that distributors are not obligated to adjust ratios closer to 1.00 once a class is within the Board's target range but may do so if adequately supported with evidence. The Board finds that Hydro One has adequately supported its proposal in this case.

### **8.4 HOPPER FOUNDRY**

Hopper Foundry ("Hopper") has paid for its electricity distribution services on a time-of-use ("TOU") rate structure since 1981 as a customer of Forest PUC. In 1992, the company received a grant under Ontario Hydro's Load Shifting Program to facilitate the shift of production to off-peak hours, including installation of a larger melting furnace. In Hydro One's previous cost-of-service application (EB-2007-0681), the Board ordered Hydro One to continue with the existing TOU rate structure until April 30, 2010. The Board noted that the two-year extension would enable Hopper Foundry to explore its options and to take steps in preparation for paying an ordinary approved distribution rate.

The Board heard evidence and arguments on three options for Hopper Foundry:

- Hopper Foundry suggested that it could remain on the status quo TOU rate structure,
- In the normal course, Hopper Foundry would be assigned to the General Service Demand-billed class ("GSd") in Forest.
- Hydro One suggested that the qualification for the Sub Transmission (ST) class could be extended to include Hopper Foundry and 13 other customers.

Board staff supported the second alternative, but recommended that the rate should be designed to limit the bill impact and suggested that a fourth alternative would be to design a succession of rates to enable a smooth transition from the status quo toward



rates approved for the demand-billed General Class. Board staff also submitted that, as part of this approach, Hydro One should be directed to provide a more detailed analysis of its rate classes and costs, to determine whether an additional rate class might be developed that would be consistent with cost allocation principles and yet more favourable to Hopper and similar customers. Hopper and CME supported this recommendation.

Hopper argued that it should be permitted to stay on its TOU rate. In its view, “this would recognize Hopper’s historic legacy position of having worked with Hydro One and its predecessor, Ontario Hydro, since 1981 to use the majority of our power off-peak.” The resulting shortfall for Hydro One would be \$60,000. In the alternative, Hopper submitted that it would be fair for it to be classified in the ST class, but ideally it should continue to benefit from time of use rate by being billed for demand based on on-peak energy demand.

The difference between the current rate and the GSd rate in terms of total bill impact was estimated at approximately 153%, but Mr. Roger testified that a more up-to-date calculation would yield an estimated impact of 190%. Hopper suggested that it would likely go out of business if it were required to pay GSd rates. As for the ST class alternative, Hopper would have a higher bill, with an impact of approximately 22%, but as a group the other customers that meet the same voltage and size criteria would have lower bills. The result would be an overall shortfall to Hydro One of approximately \$1 million. AMPCO submitted that Hopper should be included in the ST class.

CME submitted that it would be inappropriate to place Hopper Foundry in the GSd class because Hydro One is not in a position to meet the peak demand 24 hours a day and Hopper itself would be liable for the costs of any corrective action. CME further argued that Hopper’s willingness to operate off-peak is conservation behaviour that should be promoted. SEC and CME supported continuing with the special rate structure on a grandfathered basis.

## **BOARD FINDINGS**

The Board finds that assigning Hopper to the GSd rate would result in pronounced rate shock and would not adequately recognize the historical context of the situation. The Board concludes that of the options discussed during the proceeding, grandfathering Hopper’s current TOU rate would recognize the unique characteristics of Hopper and its

rate history with minimal adverse impacts on other ratepayers. The Board will direct Hydro One to grandfather the TOU rate structure for Hopper and will permit Hydro One to recover the revenue shortfall from ratepayers. If there is a material change in the circumstances related to this issue, then it should be brought to the Board at that time.

## **8.5 UNMETERED SCATTERED LOAD (USL)**

Hydro One considers USL to be a sub-class of its General Service energy-billed (“GSe”) class, and charges each USL connection at the monthly service charge of an ordinary load customer in that class less a credit that reflects the meter cost savings. This rate structure was approved most recently by the Board in the EB-2007-0681 decision.

Rogers Cable noted that the USL customers constitute a very small proportion of the class and as a result their cost characteristics are swamped by the costs of serving the other customers. Rogers Cable submitted that the load and cost characteristics of USL customers are unlike the typical metered customer in the class. It maintained that the Board’s approval of the current rate structure was granted with the note that the Board had insufficient information in the record of that case to evaluate an alternative rate structure. Rogers Cable noted that Hydro One did not produce information on what the revenue to cost ratio would be for the USL customers in response to an interrogatory in EB-2007-0681 and that the same situation has occurred in the current proceeding.

Rogers Cable noted that the monthly service charge for each unmetered connection is 28 times higher than the corresponding charge per connection for Streetlighting. Rogers Cable noted that Hydro One agreed that it could produce revenue to cost ratio for the USL customers as part of its next cost of service application and requested that the Board direct Hydro One to do so.

Hydro One responded that requiring it to provide evidence on the revenue to cost ratio of USL customers would in effect require it to create a separate class for USL.

## **BOARD FINDINGS**

The Board directs Hydro One to prepare evidence on the revenue to cost ratio for USL customers for its next cost of service application. There is evidence to suggest that such an investigation is warranted, in particular the magnitude of the difference in charges between USL and Streetlighting customers, and Hydro One has offered no

reason why such work would be inappropriate. Hydro One has indicated that performing the analysis would have the effect of creating a separate class for USL. This may well be warranted; the Board would note that many distributors have a separate rate class for USL customers.

## **8.6 MILTON LV ASSETS**

The Board indicated in its previous decision (EB-2007-0681) that Hydro One should sell to Milton Hydro certain LV assets that are used to serve Milton Hydro, thereby eliminating the issue of whether Milton Hydro is being charged a fair rate. Further, the Board stated that if the sale did not occur before May 2010, then Hydro One should bring forward evidence that could be used to construct a specific rate for Milton Hydro's circumstances.

Hydro One submitted that a rate could be designed for customers whose circumstances are similar to Milton Hydro's by using line-length as the charge determinant rather than billing demand. However, Hydro One also submitted evidence that it has made a proposal to Milton Hydro for the sale of LV facilities, but as of October 19, 2009 was still waiting for a response. There was no further evidence provided and there were no submissions on this issue.

## **BOARD FINDINGS**

The Board's direction remains outstanding. Hydro One has not developed a specific rate for Milton Hydro's circumstances; nor has a sale been completed. Hydro One made a sale proposal to Milton in October, but is evidently still waiting for a response. The Board directs that if a sale is not completed in advance of the next cost of service proceeding Hydro One will come forward at that proceeding with a proposed resolution of this issue.

## **8.7 HARMONIZATION AND IMPACT MITIGATION**

Hydro One proposed to continue the mitigation plan approved in the previous cost-of-service application (EB-2007-0681). The guideline used by Hydro One is to limit the impact of changes in delivery cost to 10%, calculated as a percentage of the total bill of an average customer in any given class.

Board staff noted that the rate design for 2008 included mitigation for small customers that would have a bill impact greater than 15% and further noted that Hydro One had requested continuation of the deferral account associated with this mitigation.

The increase in the revenue requirement is larger than had been assumed earlier, which leaves less room under the 10% constraint for the increases that would achieve harmonization. As a result, the expected end point of the harmonization process has become 2012 for some Acquired Distributors, rather than 2011 as in the earlier rate design.

CCC supported Hydro One's proposal to continue to move from the existing approved rates to 2010 rates following the harmonization plan.

VECC also supported the continued harmonization plan, but expressed concern that the rate mitigation plan does not take adequate account of other changes to customers' total bills. VECC submitted that the Board cannot determine whether total bill impacts are reasonable without further information about the other components of the bill, but maintained that there was sufficient information available to conclude that the impact for the majority of customers will be greater than 10%. VECC concluded that without this information the Board cannot determine whether the bill mitigation plan is appropriate or that the bill impacts are reasonable.

## **BOARD FINDINGS**

The Board approves the continuation of the harmonization and associated mitigation plan previously approved, including the mitigation process for small customers faced with bill impacts of 15% or more. The Board recognizes that the period for implementation will likely be extended by one year for some Acquired Distributors. The Board finds that this is acceptable under the circumstances because it is consistent with the underlying principles of the harmonization process. The Board will not adjust the rate impact mitigation plan to take account of bill impacts arising from other non-distribution factors. While these are important aspects of customers' total bills, the Board finds that it would be inappropriate to defer the collection of Hydro One's revenue requirement, or institute other means of distribution rate mitigation, to address these other cost pressures at this time. The Board will continue to examine options for rate impact mitigation and affordability.

## 8.8 OTHER MATTERS

The Board notes Hydro One's proposal to derive Retail Transmission Service rates using the Uniform Transmission Rates approved for January 1, 2010. The Board accepts this approach.

The Board also notes that it has recently approved a microFIT rate. Hydro One is directed to incorporate this rate into its Draft Rate Order.

Hydro One also requested a number of changes to Specific Service Charges as shown in Exhibit G2/Tab4/Schedule1, page 19. The Board approves these charges as shown in this exhibit.

## 9. COMMUNICATION OF DECISION

On January 14, 2010, the Board issued its decision on the motion filed by the CCC seeking an order from the Board requiring Hydro One to publish an amended Notice of Application. In making its decision the Board also added:

“Although the motion is denied, the discussion which has taken place in the course of intervenor submissions has heightened the Board's awareness of the importance of clear communication of its final decision in this rates proceeding. The Board will seek to ensure that ratepayers understand the elements that drive rate changes resulting from this case and will also seek to ensure that, as much as possible, these changes are put into context for ratepayers.

So in that regard, the Board asks that parties include in their final arguments any proposals they may have that would assist the Board in designing appropriate, transparent communication of the final decision of this proceeding.”<sup>17</sup>

Although the Board's direction requested submissions on the communication of the final decision in this proceeding, parties also made submissions on possible changes to notices in proceedings.

The Board received submissions from CCC, CME and SEC.

### 9.1 NOTICE

CCC, CME and SEC each made substantial comment on possible improvements to the notice of application.

CCC submitted that this case has highlighted need to alter the way in which notice is provided to ratepayers of proposed rate changes. CCC recognized that communicating relevant and useful information to ratepayers is difficult for a complex application. However, in CCC's view, ratepayers deserve to be given notice of pending changes not only with respect to distribution rates, but also with respect to all elements of their bills.

CME submitted that the Board should adopt an integrated total price and bill impact approach when providing the public with advance notice of the relief being requested by

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<sup>17</sup> Tr. Vol. 11, p. 11

an applicant. CME recommended modifications to the Filing Requirements in its 2006 Rate Handbook and the Draft Filing Requirements pertaining to Green Energy Plans to require utilities to provide the integrated multi-year price and bill impact information.

SEC submitted that there is a need for more transparency in communications from the Board and the utilities to the public and for the Board to have information on the real total bill impacts when it is making decisions. SEC suggested that utilities should be required to present a total price and bill impact analysis of their spending plans over a five year planning horizon and include an estimate, on a rolling five year basis, of all elements of the total price and bill received by electricity consumers. SEC urged the Board to develop a method that delivers the “transparent mechanism” sought by CME, test it internally to see how it can work, and subject it to a consultation process to get input from stakeholders from all points of view.

Hydro One responded that many of the factors that affect the customer bills are external to Hydro One, outside of its control and beyond its ability to forecast. Hydro One submitted that the proposal made by intervenors will result in a fundamental change to the methodology of assessing rate impacts and would require the Board to provide forecasts to the utilities on many portions of the customer’s bill.

## **BOARD FINDINGS**

The issue of notice was already determined in this proceeding in the Board’s decision on CCC’s motion. The Board will not make a further finding on notice other than to observe that the Board continually seeks to improve the transparency and clarity of its communications. The parties have articulated some interesting ideas for improvement in notices, some which may be achievable and some not. The Board will consider these submissions going forward.

### **9.2 COMMUNICATION OF DECISION AND RATE ORDER**

CCC submitted that Hydro One should provide more information to its customers about the final approved rates than it has in the past. CCC noted that past practice has consisted largely of Hydro One informing its customers that the Board has approved a rate increase and submitted that at a minimum Hydro One should be directed to provide the following in its notice to customers:

1. Hydro One applied to the Ontario Energy Board for a rate increase for 2010 and 2011;
2. The rate increases are due, in part, to cost increases related to the implementation of the *Green Energy and Green Economy Act, 2009*, the installation of smart meters, and a higher common equity return;
3. The average distribution rate impacts and bill impacts are X, but the actual impact for customers will depend upon usage;
4. Other components of the bill are also rising, so ultimately, assuming usage levels stay the same, the bill will increase further due to those impacts;
5. Those impacts include the cost of the electricity itself, which is paid through the Provincial Benefit Charge or the Regulated Pricing Plan charge on the bill, the introduction of the Harmonized Sales Tax, the introduction of the Government's Special Purpose Fund Charge (when approved);
6. Hydro One will be introducing time-of use rates in 2010, which will impact the bill. It may be higher or lower depending upon the ability to use electricity at off-peak times.

CME submitted that the Board should adopt an integrated total price and bill impact approach when notifying the public of the results of its decisions.

CME urged the Board to report the results of its decision in this case and its likely impact on total bills in a manner that does not assume that all other elements of the bill, other than Hydro One's distribution charges, will remain constant, and recommended that the communications include an estimate of the total bill impact including impacts beyond those related to the application.

CME suggested that it should be assumed that increases in the other components of the bill will be in the same order of magnitude as the combined percentage increase in the bill that flows from the distribution revenue requirement the Board approves for Hydro One in this case, and from the portion of the Transmission revenue requirement for 2010 that will be paid by Hydro One distribution customers.

Hydro One responded that the communication of the final decision could contain a clear statement that the Board's decision is only in relation to Hydro One's current distribution



rate application for rates in 2010 and 2011 and that the total overall bill of Hydro One's customers will be influenced, higher or lower, by factors that are external to the present distribution rate application. Hydro One also submitted that the Board may wish to provide information about the *Green Energy and Green Economy Act, 2009* and any approval of Hydro One's Green Energy Plan.

## **BOARD FINDINGS**

The Board found the submissions of parties helpful and believes that the communication of this decision in Hydro One's customer rate notices, particularly regarding the factors driving rate changes and the context of the rate changes, must be carefully crafted. It is the responsibility of the Board and the applicant to ensure that ratepayers receive clear, transparent information.

All parties who made submissions commented that the communication must clearly inform ratepayers that the rate increase resulting from this decision is only one component of a many-faceted customer bill and that other components will also change during the rate period. The Board concurs. The Board agrees with the statement of SEC that "A bill analysis of 30% of the total bill, while holding other elements constant, is not a "total" bill analysis. It is a "partial bill" analysis". Hydro One's customer rate notices must be clear on this point. However, the Board does not agree with CME that the applicant or the Board should attempt to quantify the bill changes that are likely to occur as a result of these other components; to do so would be speculative and could confuse things further.

The Board approves the customer rate notices of gas distributors and finds that it is also appropriate to require the same kind of approval in the case of Hydro One. Hydro One shall submit draft customer rate notices to the Board for approval before the notices are sent to customers. The Board found the submissions of CCC most helpful. The Board directs Hydro One to include the items below in its customer rate notices:

- That Hydro One applied to the Ontario Energy Board for a rate increase for 2010 and 2011;
- That those rate impacts are due, in part, to cost increases related to higher costs for compensation, various work programs, capital costs for physical infrastructure and systems, implementation of the GEA, and a higher cost of capital;

- That the average distribution rate impacts and bill impacts are X, but the actual impact for customers will depend upon usage; bill impacts should be shown as an average % of the distribution component of the bill and an average actual dollar amount for residential customers and GS<50 customers;
- That other components of the bill may also rise, so ultimately, assuming a customer's usage levels stay the same, the bill may increase further due to those impacts;
- That those impacts include the cost of the electricity itself, the introduction of the Harmonized Sales Tax, the introduction of the Government's Special Purpose Fund Charge (when approved);
- That Hydro One will be introducing time-of use rates in 2010, which will impact a customer's bill. It may be higher or lower depending upon the customer's ability to use electricity at off-peak times.

These points are in addition to any other information that Hydro One commonly includes in its billing notices, such as contact information, etc.

## 10. IMPLEMENTATION DATE

Hydro One originally requested a change to its rate implementation date to January 1, 2010 from the customary May 1 date. Hydro One's rationale was that the earlier rate implementation date would facilitate the incorporation of the new Hydro One Sub-Transmission (ST) rates by other LDCs into their own rates that would usually take effect on May 1. The new implementation date would also align Hydro One's financial year with its rate year. Evidence filed before the Cost of Capital update indicated that this change would increase Hydro One's revenue by \$44 million in 2010.

Hydro One has subsequently indicated that it would not pursue the January 1, 2010 date but would accept an implementation date as soon as possible in 2010 upon the completion of the proceeding. It was still requesting that 2011 rates be implemented on January 1, 2011. Hydro One did not apply to the Board for interim rates as of January 1, 2010.

A number of intervenors argued that the Hydro One's proposal was premature, especially in light of the Board's consultation on the issue.

### BOARD FINDINGS

The Board finds that Hydro One's proposal to change the effective date for its 2011 rates from May 1, to January 1 is reasonable, and approves it.

The Board notes that one of the reasons cited by Hydro One for the implementation of the effective date change, which was to allow other Local Distribution Companies to incorporate Hydro One's approved rates as input to their rates, may in the future, not be as compelling, given that a number of other distributors may desire for a January 1<sup>st</sup> rate implementation date going forward. A Board policy consultation to address the issue of aligning rate years with fiscal years for electricity distributors has been initiated (EB-2010-0423).

The Board considers that Hydro One, as the largest transmitter and distributor in the Province may well realize efficiencies in aligning its rate year with its fiscal year.

## 11. RATE IMPLEMENTATION

The Board has made findings in this decision which change the 2010 and 2011 revenue requirement and therefore change the distribution rates from those proposed by Hydro One. In filing its draft Rate Order, it is the Board's expectation that Hydro One file detailed supporting material, including all relevant calculations showing the impact of this decision on the Hydro One 2010 and 2011 revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates for 2010. (Final rates for 2011 will be determined when the cost of capital parameters for 2011 are published by the Board later in 2010.) Supporting documentation shall include, but not be limited to, filing a completed version of the Revenue Requirement Work Form excel spreadsheet (or a similar document), which can be found on the Board's website. Hydro One should also show detailed calculations of the revised retail transmission service rates and variance account rate riders reflecting this decision.

Hydro One applied for rates effective January 1, 2010. The Board approves a May 1 effective date and notes that there is sufficient time to implement the rates on May 1, 2010 as well. In the same manner, the recovery of external funding from all provincial ratepayers for Green Energy Plan initiatives shall also be effective May 1, 2010. Further, the Board has made numerous findings throughout this Decision which would change the as-filed revenue requirement claimed by Hydro One and would also necessitate certain rate riders and rate adders. These are to be properly reflected in a Draft Rate Order incorporating an effective and implementation date of May 1, 2010 for the new rates.

In addition, this decision also approves the recovery of external funding from all provincial ratepayers for Green Energy Plan initiatives. Accordingly, Hydro One should also propose annual external funding amounts for 2010 and 2011 based on the specifics in this decision. These funding quantities should include separate amounts related to the Express Feeder expenditures and the remaining Renewable Generation expenditures. Hydro One should include calculations detailing exactly how these amounts were determined.

The Board orders that Hydro One will implement rate riders on its Service Charges and Distribution Volumetric Rates from the implementation date to December 31, 2011.

If any specific matter has not been dealt with for purposes of drafting the Rate Order to implement the new rates or dispose of the deferral/variance accounts, the Company shall clearly identify these in its filing.

A Rate Order will be issued after the steps set out below are completed.

1. The company shall file with the Board, and shall also forward to intervenors, a Draft Rate Order attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision, by April 16, 2010.
2. Intervenors may file with the Board and forward to the company responses to the company's Draft Rate Order by April 23, 2010.
3. The company shall file with the Board and forward to intervenors responses to any comments on its Draft Rate Order and a revised Draft Rate Order by April 27, 2010.

A cost awards decision will be issued after the steps set out below are completed:

1. Intervenors eligible for cost awards shall file with the Board and forward to the company their respective cost claims no later than April 30, 2010.
2. The company may file with the Board and forward to intervenors eligible for cost awards any objections to the claimed costs by May 7, 2010.
3. Intervenors, whose cost claims have been objected to, may file with the Board and forward to the company any responses to any objections for cost claims by May 14, 2010.

The company shall pay the Board's costs of and incidental to, this proceeding upon receipt of the Board's invoice.

**DATED** at Toronto, April 9, 2010

**ONTARIO ENERGY BOARD**

*Original Signed By*

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**Pamela Nowina**  
Presiding Member

*Original Signed By*

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**Cynthia Chaplin**  
Vice- Chair

*Original Signed By*

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**Paul Sommerville**  
Member

## APPENDICES

**APPENDIX 1**

**HYDRO ONE NETWORK INC.  
2010 AND 2011 ELECTRICITY DISTRIBUTION RATES**

DECISION WITH REASONS

BOARD FILE NO. EB-2009-0096

April 9, 2010

**PROCEDURAL DETAILS  
INCLUDING LISTS OF PARTIES AND WITNESSES**



## **PROCEDURAL DETAILS INCLUDING LISTS OF PARTICIPANTS AND WITNESSES**

### **THE PROCEEDING**

On July 13, 2009 Hydro One Networks Inc. (“Hydro One”) filed an application for 2010 and 2011 distribution rates, including its Green Energy Plan. The Board assigned file number EB-2009-0096 to the application and on August 4, 2009, the Board issued a Letter of Direction and Notice of Application to Hydro One Networks Inc.

The delivery rate increase for an average customer was expected to be 9.5% in 2010 and 13.3% in 2011 and these increases were reflected in the Notice published in Ontario newspapers in August 2009.

In response to the Notice, the Board received 19 requests for intervenor status. The Board approved these interventions which are listed below. The Board also received 162 Letters of Comment from ratepayers across Ontario, the vast majority expressing concern with the high level of the proposed rate increases in 2010 and 2011.

The Board issued Procedural Order No.1 on September 9, 2009, establishing the procedural schedule for a number of early events. The Board indicated that it intended to proceed by way of an oral hearing preceded by written interrogatories and a settlement conference. The Board attached a draft issues list to the procedural order and invited submissions on the items on the list from Hydro One and the intervenors for the Board’s consideration.

Procedural Order No. 2 was issued on September 25, 2009 with the Board’s Issues List decision and the approved Issues List. Also on September 25, 2009, Hydro One filed an evidence update including a Vegetation Management Benchmarking Study and an update to its Green Energy Plan.

On November 3, 2009, the Board issued Procedural Order No. 3, addressing procedural matters for the filing of intervenor evidence and an expedited settlement process. The start date for the oral hearing was set for December 7, 2009.

A settlement conference was held on November 18, 2009. The parties used the conference to review the issues and narrow the scope of the oral hearing. The document filed as a result of the settlement discussion is attached as Appendix 2.

In Procedural Order No. 4, issued November 25, 2009, the Board indicated that it would deal with Issue 9.3 - allocation of costs between a global recovery mechanism and Hydro One ratepayers - in January 2010 and set the date for the resumption of the oral hearing in 2011 for January 11, 2010.

The oral hearing for this proceeding took place on December 7, 8, 10, 11, 14, 15, 17, 18, 2009 and resumed on January 11 and 12, 2010. Hydro One presented oral Argument-In-Chief on January 14, 2010.

On December 15, 2009, the Board issued an oral decision on submissions from parties regarding the Report of the Board on Cost of Capital for Ontario's Regulated Utilities, EB-2009-0084, issued on December 11, 2009. A copy of this decision is attached as Appendix 3.

Consumers Council of Canada (CCC) brought a motion before the Board on January 12, 2010 requesting that the Board order Hydro One to republish its Notice citing the change in rate impact due to updated evidence and to correct a number of other perceived deficiencies in the Notice. On January 14, 2010 the Board denied the motion and ruled that a new Notice would not be required. A copy of this decision is attached as Appendix 4.

On February 18, 2010 The Board issued a partial decision on Issue 9.3. In this decision, the Board indicated that it did not require further discovery or examination on this issue in order to make its determination.

The Board approved the methodology proposed by Hydro One in this rates proceeding for the allocation of Green Energy Plan costs for rate setting purposes, on a provisional basis.

The Partial decision is attached as Appendix 5.

## PARTICIPANTS AND REPRESENTATIVES

A list of participants and their representatives who were active either at the oral hearing or at another stage of the proceeding is shown below. A complete list of intervenors is available at the Board's offices.

Board Counsel and Staff	Michael Millar Jennifer Lea
	Harold Thiessen Rudra Mukherji
Hydro One Networks Inc.	Don Rogers Anita Varjadic
	Greg Van Dusen Henry Andre
Society of Energy Professionals	James Hayes Richard Long
Pollution Probe	Murray Klippenstein
Consumers Council of Canada	Robert Warren Julie Girvan
Canadian Manufacturers and Exporters	Peter Thompson Vince DeRose
Association of Major Power Consumers of Ontario	David Crocker Wayne Clark Shelley Grice
Energy Probe Research Foundation	Peter Faye David MacIntosh
School Energy Coalition	Jay Shepherd John De Vellis
Rogers Cable Communications	Ian Mondrow
Electrical Contractors Association of Ontario	Ian Mondrow
Green Energy Coalition	David Poch
Vulnerable Energy Consumers' Coalition	Michael Buonaguro
Hopper Foundry	John Vickers
Power Workers' Union	Richard Stephenson

## WITNESSES

There were 19 witnesses who testified at the oral hearing.

The following Hydro One employees appeared as witnesses at the oral hearing:

Mark Graham	Director, Partnerships and External Relations, Major Projects Coordination
David Curtis	Director, Asset Management Processes and Policies
Ron Salt	Manager, Distribution Development
Sandy Struthers	Senior Vice President and Chief Financial Officer
Greg Van Dusen	Director, Regulation Distribution Applications and Regulatory Affairs
David Adams	Acting Director, Customer Care
Grant Clark	Superintendent, Forestry Services
Raymond Gee	Director, Distribution Planning and Asset Management
Richard Stevens	Project Director, Smart Meter and Smart Grid
Paul Malozewski	Senior Manager, Business Planning and Special Studies
Keith McDonell	Manager, Human Resources and Operations
Marc Villett	Manager, Financial Planning and Analysis
Mark Winters	Chief Information Officer

Stanley But	Manager, Economics and Load Forecasting
Mike Roger	Manager, Pricing
Colin Fraser	Manager, Financial Reporting and Accounting Policy

In addition, Hydro One called the following witness:

John Todd	Principal, Elenchus Research Associates Inc.
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Witnesses called by intervenors:

For School Energy Coalition:

C.K. Woo	Senior Partner, Energy & Environmental Economics, San Francisco, California, USA
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For Hopper Foundry:

John Vickers	Hopper Foundry, Forest, Ontario
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**APPENDIX 2**

**HYDRO ONE NETWORK INC.  
2010 AND 2011 ELECTRICITY DISTRIBUTION RATES**

DECISION WITH REASONS

BOARD FILE NO. EB-2009-0096

April 9, 2010

**SETTLEMENT PROPOSAL, NOVEMBER 23, 2009**

# Rogers Partners LLP

Barristers & Solicitors

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November 23, 2009

Our File Number: 72738

Ms. Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge Street  
P.O. Box 2319, Suite 2701  
Toronto, ON M4P 1E4

Dear Ms. Walli:

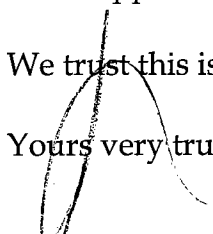
Re: EB-2009-0096: Hydro One Networks

Further to the Board's procedural order number 3 issued November 3, 2009, a settlement conference was held on November 18, 2009. Hydro One Networks and a number of intervenors attended. The parties used the settlement conference to review the issues and endeavour to narrow the scope of the oral hearing. There is no settlement proposal to present to the Board.

The applicant and the intervenors who participated in the conference were able to identify some issues that would not be the subject of questioning during the oral hearing, but rather left to argument only. Attached for the Board's reference is a copy of the approved Issues List identifying the above.

We trust this is satisfactory.

Yours very truly,

  
Anita M. Varjacic  
AMV/smg

# Rogers Partners LLP

Barristers & Solicitors

- c: Interveners
- c: Michael Miller - Board Counsel
- c: Harold Thiessen - Board Staff
- c: Hydro One



**Appendix “B”  
Hydro One Networks Inc.  
EB-2009-0096  
APPROVED ISSUES LIST**

	Oral Hearing	Final Argument
<b>1. GENERAL</b>		
1.1 Has Hydro One responded appropriately to all relevant Board directions from previous proceedings?	√	
1.2 Are Hydro One’s economic and business planning assumptions for 2010/2011 appropriate?	√	
1.3 Is service quality, based on the OEB specified performance indicators, acceptable?	√	
1.4 Is Hydro One’s proposal to change the effective date for implementation of its proposed distribution rates to January 1, 2010 rather than the conventional May 1 <sup>st</sup> effective date appropriate and has Hydro One appropriately addressed the revenue consequences of proposed change?	√	
1.5 Is the overall increase in 2010 and 2011 revenue requirement reasonable given the impact on consumers?	√	
<b>2. LOAD and REVENUE FORECAST</b>		
2.1 Is the load forecast and methodology appropriate and have the impacts of Conservation and Demand Management initiatives been suitably reflected?	√	
2.2 Is the proposed amount for 2010/2011 external revenues, including the methodology used to cost and price these	√	
<b>3. OPERATIONS, MAINTENANCE and ADMINISTRATION COSTS</b>		
3.1 Are the overall levels of the 2010/2011 Operation, Maintenance and Administration budgets appropriate?	√	
3.2 Is the 2010/2011 vegetation management budget appropriate?	√	
3.3 Is the proposed level of 2010/2011 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 and determine the distribution overhead capitalization rate for 2010/2011 appropriate?	√	
3.5 Are the 2010/2011 Human Resources related costs (wages, salaries, benefits, incentive payments, labour productivity and pension costs) including employee levels, appropriate? Has Hydro One demonstrated improvements in efficiency and value for dollar associated with its compensation costs?	√	
3.6 Is Hydro One’s depreciation expense appropriate?		√
3.7 Are the amounts proposed for capital and property taxes appropriate?		√

	Oral Hearing	Final Argument
3.8 Is the amount proposed for income taxes, including the methodology, appropriate? – <b>Possibility of questions from CME dependent on the final determination resulting from the ‘Consultation Process on Cost of Capital’ (EB-2009-0084)</b>		√
3.9 Is the proposed spending on loss reduction efforts appropriate?		√
<b>4. CAPITAL EXPENDITURES and RATE BASE</b>		
4.1 Are the amounts proposed for Rate Base appropriate?	√	
4.2 Are the amounts proposed for 2010/2011 Capital Expenditures appropriate including the specific Sustaining, Development and Operations categories?	√	
4.3 Is the proposed level of 2010/2011 Shared Services and Other Capital expenditures appropriate?	√	
4.4 Are the methodologies used to allocate Shared Services and Other Capital expenditures to the distribution business consistent with the methodologies approved by the Board in previous Hydro One rate applications? – <b>Narrowed scope focused on use of actual versus forecast figures</b>	√	
4.5 Are the inputs used to determine the Working Capital component of the Rate base appropriate and is the methodology used consistent with the methodologies approved by the Board in previous Hydro One rate applications? – <b>Scope narrowed to the inputs utilized.</b>	√	
4.6 Does Hydro One’s Asset Condition Assessment information and Investment Planning Process adequately address the condition of the distribution system assets and support the O&MA and Capital expenditures for 2010/2011? <b>The extent to which the expenditures are supported is subsumed within issues 3.1 and 4.2</b>		√
4.7 Are the proposed capital expenditures to reduce electricity system losses appropriate?		√
<b>5. CAPITAL STRUCTURE AND COST OF CAPITAL</b>		
5.1 Is the proposed Capital Structure and Rate of Return on Equity for Hydro One’s distribution business appropriate? – <b>Possibility of questions from CME dependent on the final determination resulting from the ‘Consultation Process on Cost of Capital’ (EB-2009-0084)</b>		√
5.2 Are Hydro One’s proposed costs and mix for its short and long-term debt for the 2010/2011 test years appropriate? – <b>Narrowed scope limited to the mix and rates for short and long-term debt for the 2010/2011 test years</b>	√	
<b>6. DEFERRAL and VARIANCE ACCOUNTS</b>		
6.1 Is the proposal for the amounts, disposition and continuance of Hydro One’s existing Deferral and Variance Accounts appropriate?	√	

	Oral Hearing	Final Argument
6.2 Are the proposed new Deferral and Variance Accounts appropriate?	✓	
<b>7. COST ALLOCATION and RATE DESIGN</b>		
7.1 Is Hydro One's cost allocation appropriate including the analysis of the relationship between density and cost allocation?	✓	
7.2 Are the proposed revenue to cost ratios for each class appropriate?	✓	
7.3 Are the fixed-variable splits for each class appropriate?	✓	
7.4 Are the proposed rate impact mitigation plans appropriate and are the resulting customer bill impacts reasonable? - <b>Narrowed scope focused on the Hopper Foundry and Milton Hydro issues</b>	✓	
7.5 Are the proposed Retail Transmission Service rates appropriate?		✓
7.6 Is the proposal for regulatory asset rate rider #6 appropriate?	✓	
7.7 Are the proposed Distribution Loss Factors appropriate?	✓	
<b>8. SMART METERS</b>		
8.1 Is the 2010/2011 smart meter O&M and Capital budget appropriate?	✓	
8.2 Are the amounts for Smart Meter related variance accounts appropriate?	✓	
8.3 Is the treatment of stranded meter costs appropriate?		✓
8.4 Is Hydro One's regulatory treatment of Smart Meter costs appropriate including the smart meter funding adders proposed for 2010/2011?	✓	
<b>9. GREEN ENERGY PLAN</b>		
9.1 Does Hydro One's Green Energy Plan meet the Board's filing guidelines and the objectives set out in the Green Energy and Green Economy Act, 2009?	✓	
9.2 Has Hydro One appropriately addressed the Green Energy Plan expenditures in the context of its overall Capital and O&M budgets?	✓	
9.3 Is Hydro One's methodology for allocating Green Energy Plan O&M and Capital costs between the OPA (Global Adjustment Mechanism) and Hydro One appropriate?	✓	
9.4 To what extent should the Board approve any projects or expenditures relating to the Green Energy Plan that are scheduled to occur beyond the test years (i.e. 2010 and 2011) in the current application?	✓	
9.5 What is the Board's role with regard to the approval of the Green Energy Plan? What criteria should the Board use when determining whether to approve the Green Energy Plan? If the Board approves the plan, what are the impacts of that approval?	✓	

**APPENDIX 3**

**HYDRO ONE NETWORK INC.  
2010 AND 2011 ELECTRICITY DISTRIBUTION RATES**

DECISION WITH REASONS

BOARD FILE NO. EB-2009-0096

April 9, 2010

**ORAL DECISION ON COST OF CAPITAL SUBMISSIONS,  
DECEMBER 15, 2009**

**Oral Decision on Cost of Capital issues.  
Excerpt from the oral hearing transcript EB-2009-0096, Volume 6, December 15,  
2009, page 146 line 25 to page 148 line 13.**

MS. NOWINA: Please be seated.

Before we continue with Mr. Faye, I am going to give you our guidance on the cost of capital issue now. I am going to read it, because I want to make sure that we're very clear on what our guidance is.

The Board has considered the submissions of Mr. Warren on behalf of CCC, CME and VECC, and has also reviewed and considered the letter filed by Mr. Shepherd this morning on behalf of Schools which requests that the Board determine the components of the cost of capital for Hydro One based on the evidence in this proceeding.

Mr. Shepherd's letter further requests the applicant be required to answer additional interrogatories from the applicant to assist with the filing of expert evidence.

The Board does not intend to reopen the cost of capital policy, which was only recently determined after a lengthy and thorough review by the Board.

The Board was assisted in this review by a wide variety of interested parties and experts, many of whom are intervenors in this proceeding.

The Board considers the cost of capital policy to be sufficiently robust to apply across the Board to all electricity LDCs. The prior policy also applied to all LDCs.

The Board does, however, recognize that it is open to

parties to argue that there may be certain circumstances where the policy should not be applied.

The Board will, therefore, allow the filing of evidence that establishes the specific circumstances, which exist in this case and with this applicant, which would make the application of the policy inappropriate.

The Board sees no need to require the applicant to file further evidence justifying the application of the Board's policy at this time.

Also, absent further information from intervenors on the nature of their evidentiary filing, the Board will not make a provision for interrogatories of Hydro One at this time.

The Board will make a determination on the schedule for filing of intervenor evidence after the intervenors have provided more information on the nature of their evidence. We expect this information by the end of this week.

The Board will allow Hydro One to file reply evidence, if they wish.

**APPENDIX 4**

**HYDRO ONE NETWORK INC.  
2010 AND 2011 ELECTRICITY DISTRIBUTION RATES**

DECISION WITH REASONS

BOARD FILE NO. EB-2009-0096

April 9, 2010

**ORAL DECISION ON CCC MOTION, JANUARY 14, 2010**

**Decision on CCC Motion**

**Excerpt from the oral hearing transcript EB-2009-0096, Volume 11, January 14, 2010, page 1 line 9 to page 11 line 28.**

MS. NOWINA: On January 12th the Board heard a motion by the Consumers Council of Canada, CCC, seeking an order from the Board requiring Hydro One to publish an amended notice of application in this proceeding. The motion alleges that there were certain defects in the original notice, which was published in various newspapers across the province in August 2009.

One of these alleged defects results from updates to the evidence that occurred after the notice was issued, specifically, an update to the amount being requested for the cost of capital.

The other alleged defects do not relate to any changes in the evidence; that is to say that, in CCC's view, these defects existed from the outset. The complete notice of motion was filed with the Board as Exhibit K10.3. The motion was filed towards the end of the evidentiary portion of the hearing and several months after the notice was issued.

CCC's motion was substantially supported by School Energy Coalition, Canadian Manufacturers & Exporters, the Association of Major Power Consumers of Ontario and the Vulnerable Energy Consumers Coalition.

The motion was opposed by the Power Workers Union and Hydro One.

The Board also heard submissions from Board Staff.

For the reasons I will describe in a moment, the motion is



denied.

Drafting a notice for a complex hearing is an important responsibility of the Board. The Board discharges its responsibility by converting a highly technical application of several thousand pages into a two- to three-page summary.

It must be able to be published in a newspaper, and to be read quickly and easily. It must accurately summarize the general potential impacts of the application. It must use language that can be understood by a person who has no background whatever in the complex field of utility rate setting.

It must find a balance between including too much information, which could be confusing in addition to being impractical, and including too little information such that the reader is unable to understand how the application may impact him or her.

Due to the length and the complexity of the hearing process, a number of changes may occur to the application after the notice is issued. There may also be other factors external to the application itself that have an impact on rates.

The Board notes that the notice also provides information on how the application itself can be accessed through both the Board's and Hydro One's websites. In this way, an interested person is invited to supplement the information imparted by the notice by reading as much of the detail of the application as he or she may wish.

The Board is satisfied that the notice in this case strikes

an appropriate balance and provided readers with the necessary information for them to determine if they wanted to participate further.

I will now move on to the Board's analysis of the particular issues raised in this motion.

Before considering the specific alleged defected identified in CCC's motion, the Board will review the legal test for determining what constitutes appropriate notice.

Mr. Warren included two cases in his book of authorities: the Ontario Court of Appeal decision, Nolan and Ontario, and the Divisional Court case re Central Ontario Coalition concerning Hydro One Transmission Systems and Ontario Hydro.

Mr. Warren identifies the relevant test for determining the adequacy of notice from the Nolan case, specifically from paragraph 147 of that decision, where it states, and I quote:

"When determining whether adequate notice has been given, two questions must be asked: (1) was the content of the notice accurate and sufficient; and (2) were all affected parties given notice?"

The test is further described in the Central Ontario Coalition case. At page 27 of that decision, the court stated, and I quote:

"In any event, it is well established that where the form content of notice is not laid down, it must be reasonable in the sense that it conveys the real intentions of the giver and enables the person to whom it is directed to know what he must meet."

Page 28 of that decision references the Ontario Court of Appeal's Ontario Racing Commission decision, in which the Court said, quote:

"The cases establish beyond peradventure that whether a notice given in any particular case is sufficient depends entirely upon the circumstances of the case."

All parties essentially agree that these are the tests to be applied. Where the parties differ is with regard to the results of applying these tests to the facts of this case.

Five alleged defects in the notice are itemized at paragraph 12 of the motion. The Board will address each of these in turn. The first alleged defect, which is listed as part (a) in paragraph 12, is that the notice did not disclose Hydro One's ratepayers the true amount of revenue for which Hydro One seeks approval and the bill and rate impacts of that amount.

The notice stated, quote:

"Hydro One Networks Inc. is seeking approval of \$1,181,000,000 as the 2010 revenue it requires to provide electricity distribution, and \$1,294,100,000 as the 2011 revenue it requires to provide electricity distribution. Hydro One Networks Inc. indicates that if the application is approved as filed, an average customer would experience an increase on the delivery portion of their electricity bill of approximately 9.5 percent in 2010 and 13.3 percent in 2011."

The notice goes on to describe potentially different

delivery bill changes that arise as a result of Hydro One's ongoing harmonization plan.

On December 11, 2009, the Board issued its revised policy on the cost of capital. The ultimate result of that policy in this case is the cost of capital applied for has increased by \$44 million in 2010 and \$29 million in 2011. Obviously, the revenue requirement and rate impacts described in the notice did not include these increased costs, which arose some six months after the application was filed and over two months after the notice was published.

Had these costs been included and the net effect of certain other evidentiary updates been accounted for, the revenue requirement presented in the notice would have been \$1,194,000,000 for 2010, and \$1,293,000,000 for 2011.

The associated rate impacts for the delivery component of an average residential customer would have increased from 9.5 percent to 14.1 percent for 2010 and decreased from 13.3 percent to 11.6 percent for 2011.

The concern expressed by CCC and the supporting intervenors is that the increase to the applied-for revenue requirement and, in particular, the increase in the rate impacts is material, and that anyone that reads the notice was not presented with an accurate picture of the potential outcomes of the proceeding.

The Board does not accept this argument. No one disputes that the notice was correct in this regard when it was published. The issue is whether the change caused by the increased cost of capital is such that the notice no longer

passes the test for being accurate and sufficient.

It is true that the specific numbers have changed. However, even before the change in the cost of capital, Hydro One had filed various other updates to the application. These updates impacted the requested revenue requirement and the associated percentage rate impacts. However, the Board did not reissue the notice, and no party requested that it should.

In fact, in most cases before the Board there are changes, to one degree or another, in an application after the notice is issued. It would be both impractical and unhelpful if the Board were required to re-issue a notice every time there was an update to an application. The test should be whether there is a material inaccuracy that would lead to a genuine misunderstanding regarding how the application could impact the reader, or, as the court stated in the Ontario Racing Commission's case, a misunderstanding about the case to be met.

The small change in overall revenue requirement and the somewhat larger changes in the delivery charge impacts do not, in our view, materially change the nature of, the degree of, or the effect of the application on consumers. The increases described in the notice remain directionally correct. A person reading the notice would appreciate that Hydro One is seeking a significant rate increase. The additional revenue now being requested by Hydro One for 2010 is not of such a magnitude that it fundamentally alters the nature of the application of what is being sought, or how it could impact ratepayers. Hydro One was seeking a significant rate increase when the notice was issued,

and it is seeking a significant rate increase now.

The Board's notices include information on average rate impacts in an attempt to provide ratepayers with a sense of the level of the increase being sought. It is in fact an average, and any individual customer's rate impacts will in all likelihood be different. The Board concludes that a reasonable person reading the notice would not have been misled as to the implications of the application.

The second and third alleged defects are related and will be considered together. The second alleged defect is that the notice did not disclose to Hydro One's ratepayers that they would be responsible for paying a portion of the costs of the Green Energy plan that are not included directly in the rates for which Hydro One has sought approval. The third alleged defect is that the notice did not disclose to ratepayers outside Hydro One's territory that they would be responsible for paying some portion of the Green Energy plan. Hydro One's application anticipates that funding for its proposed Green Energy plan will come from two sources: its own ratepayers directly through their distribution rates, and from all ratepayers in the province through a yet to be determined provincial recovery mechanism that will be added to all ratepayers' bills.

The portion of the Green Energy plan funded directly by Hydro One's ratepayers is included in Hydro One's revenue requirement and request for new rates. However, in CCC's view, the notice is not clear for two reasons: It does not sufficiently explain that Hydro One's ratepayers will have to

pay an additional amount for the Green Energy plan through the provincial mechanism, and it does not sufficiently explain to non-Hydro One customers that their rates will ultimately include some amount for the Green Energy ^Plan.

The Board does not agree. Paragraph 2 of the notice states:

"Hydro One Networks has also included in its 2010-2014 Green Energy plan as part of this application. The Board's decision on this aspect of the application may have an effect on all electricity customers in Ontario."

The notice explicitly states that approval of the Green Energy plan may have an impact on all electricity customers in Ontario. Hydro One's customers, of course, are electricity customers in Ontario. In the Board's view, a reasonable person would understand that the Green Energy plan could impose costs on him or her, in addition to those noted elsewhere in the notice. In addition, in this case, the actual potential impacts in the rate period relating to the portion of the plan that may be funded from all provincial ratepayers is extremely small. The Board finds that it would not have been helpful to have included this specific impact in the notice.

Mr. Warren also argued that the use of the word "may" was not appropriate and that the notice should have been more clear that the "effect" in question was a rate increase. In the Board's view, the word "may" is appropriate. The Board could reject Hydro One's Green Energy plan. No decision has yet been

made on this issue. The notice is clear that there may be effects on all provincial ratepayers, and that they should participate in the proceeding if they have any concerns about this. The Board also concludes that a reasonable person would understand that the effect in question would be financial.

The fourth alleged defect is that the notice did not disclose that many of Hydro One's ratepayers will experience a total bill increase in excess of 10 percent. The notice does state that average customers will not have total bill impacts in excess of 10 percent for 2011; however, Mr. Warren's point appears to be that many customers that are not average will have impacts that exceed 10 percent, particularly those customers who consume less than 1,000 kilowatt-hours per year.

Although it is true that a customer that does not use the average amount of power, 1,000 kilowatt-hours in this case, may have impacts greater than 10 percent, the notice is not inaccurate in this regard -- it clearly references average customers and states that average consumption used for the calculations is 1,000 kilowatt-hours per year. A reasonable reader of this notice would realize that if they were not an average customer, then their specific bill impact would be different. It is important to note that the applicant has undertaken a mitigation program to prevent any total bill impact greater than 10 percent for an average customer. The Board is satisfied that the notice is appropriate in this regard.

The fifth and final alleged defect is that the notice did not disclose to Hydro One's ratepayers the fact that the amount



for which approval is sought will be added to amounts derived from factors such as the global adjustment and transmission costs, as well as the harmonized sales tax.

Mr. Warren conceded in his argument that there may not be a legal requirement for the Board to include this type of information in its notices.

Bill increases caused by factors outside of the proceeding are not within the Board's jurisdiction to consider in the proceeding. These increases, such that they occur, do not flow from the Board's section 78 powers. This proceeding will not have an impact on those outside costs. Mr. Warren did suggest that the Board might, as a matter of policy, attempt to provide more information regarding potential impacts from these outside costs.

The Board further notes that it would be very difficult to accurately describe or anticipate exactly what outside costs might increase, and by how much. Again, an attempt to provide additional information might serve to confuse rather than clarify. The Board therefore does not accept this argument, and finds the notice to be adequate in this regard.

Although the motion is denied, the discussion which has taken place in the course of intervenor submissions has heightened the Board's awareness of the importance of clear communication of its final decision in this rates proceeding. The Board will seek to ensure that ratepayers understand the elements that drive rate changes resulting from this case and will also seek to ensure that, as much as possible, these

changes are put into context for ratepayers.

So in that regard, the Boards ask that parties include in their final arguments any proposals they may have that would assist the Board in designing appropriate, transparent communication of the final decision of this proceeding.

So that completes our decision on the motion.

**APPENDIX 5**

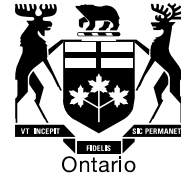
**HYDRO ONE NETWORK INC.  
2010 AND 2011 ELECTRICITY DISTRIBUTION RATES**

DECISION WITH REASONS

BOARD FILE NO. EB-2009-0096

April 9, 2010

**PARTIAL DECISION - ISSUE 9.3, FEBRUARY 18, 2010**



EB-2009-0096

**IN THE MATTER OF** the *Ontario Energy Board Act 1998*,  
S.O.1998, c.15, (Schedule B);

**AND IN THE MATTER OF** an application by Hydro One  
Networks Inc. for an order or orders approving or fixing just  
and reasonable distribution rates and other charges for 2010  
and 2011.

**BEFORE:** Pamela Nowina  
Vice Chair and Presiding Member

Paul Sommerville  
Member

Cynthia Chaplin  
Member

## **PARTIAL DECISION ISSUE 9.3**

### **Background**

On July 13, 2009 Hydro One Networks Inc. (“Hydro One”) filed an application for 2010 and 2011 distribution rates, including its Green Energy Plan. The Board assigned file number EB-2009-0096 to the application and issued an approved issues list on September 22, 2009. The oral hearing for this proceeding took place in December 2009 and January 2010, concluding with Hydro One’s Argument-in-Chief on January 14,

2010. Board staff and intervenor submissions were submitted on February 1, and February 8, respectively. Hydro One submitted its Reply Argument on February 12, 2010.

One of the issues in the EB-2009-0096 proceeding was Issue 9.3:

**Issue 9.3 – Is Hydro One’s methodology for allocating Green Energy Plan O&M and capital costs between the OPA (Global Adjustment Mechanism) and Hydro One appropriate?**

In a separate but related matter, on September 25, 2009, the Board initiated a consultation process (EB-2009-0349) to address how the Board should, in accordance with the requirements of Ontario Regulation 330/09, determine the direct benefits that accrue to the consumers of a distributor when that distributor has incurred costs to make an eligible investment in its distribution system to accommodate a renewable energy generation facility. These are costs commonly included in a Green Energy Plan. As a consequence of the determination of the direct benefits, the cost allocation between provincial ratepayers and the ratepayers of the individual distributor making the investment will be determined.

On January 18, 2010, in response to the Board’s direction in the distribution rates case, Hydro One submitted a proposal for dealing with issue 9.3, relating to the determination of the direct benefits associated with Hydro One’s proposed investments to connect renewable energy generation facilities.

Hydro One proposed that the issue be dealt with in this proceeding in advance of the Board's policy determination on this issue as part of EB-2009-0349. Hydro One proposed that the argument schedule on all other issues proceed as previously determined and offered to produce its witness panel on issue 9.3 at the Board's convenience, as early as January 25, 2010.

On January 20, 2010, the Board responded that it had already indicated a preference for awaiting the release of the Board’s policy determination prior to hearing issue 9.3. However, the Board indicated that it would hear from Board staff and any interested parties before making a final determination on this matter. The Board asked that any parties with an interest in this matter include submissions on the appropriate timing for the hearing of issue 9.3 with their final submissions.

The Board further indicated that Board staff would include its proposal with its submissions (4 days prior to the deadline for intervenor submissions), and parties would be expected to comment on the appropriateness of staff's proposal. Hydro One was invited to respond in its reply argument.

In Board staff's February 1, 2010, submission, staff submitted that the Board could set the allocation between provincial ratepayers and Hydro One ratepayers on a provisional basis. Board staff explained this alternative as follows:

In this scenario, the Board would establish a deferral account in which the applicant would record amounts collected from its own ratepayers. A parallel account would be established to record recovery from provincial ratepayers.

When the Board makes its final determination of the percentage of direct benefits to Hydro One's ratepayers of [Green Energy] Plan expenditures in 2010 and 2011 (which may not be until the next rates case) the Hydro One ratepayer account can be credited or debited, and any over or under-collection from provincial ratepayers can be taken into account in setting the amount to be collected in subsequent years.

Staff further submits that if this approach is adopted, the Board need not reconvene the hearing at this time to determine the amount of direct benefits to Hydro One ratepayers. The Board could choose to adopt Hydro One's proposal or a different percentage allocation, for example, 15%, as a default allocation to Hydro One's ratepayers. The final allocation would be determined in a subsequent proceeding.

VECC, SEC, and CME generally agreed with the Board staff proposals. AMPCO agreed with the Board staff proposals but wanted an opportunity to cross examine the witness panel. The PWU supported the original Hydro One proposal on the issue.

Hydro One, in its February 12, 2010 reply argument, indicated that the Board staff approach was acceptable but made some specific comments on the design and clearance of the related variance accounts.

## **Decision**

The Board has decided to issue this partial decision in advance of the complete decision in this proceeding to provide Hydro One and other parties the information they need to participate fully in the Board's policy initiative EB-2009-0349.

The Board does not require further discovery or examination on this issue in order to make its determination.

The Board approves the methodology proposed by Hydro One in this rates proceeding for the allocation of Green Energy Plan costs for rate setting purposes, on a provisional basis. The consequences of this approval will be reflected in the Rate Order arising from this case. The allocation methodology and the resulting responsibility for Green Energy Plan costs for 2010 and 2011 will be subject to later revision to reflect the Board's final policy determination in EB-2009-0349. Deferral accounts will be established to track the difference between the allocation provisionally approved in this decision and the allocation that will be established as a result of the Board's policy. Hydro One will apply the results of that Board policy when it applies for disposition of the deferral accounts for 2010 and 2011.

The use of rate adders, the amounts to be allocated and the definitions of the deferral accounts will be established in the final decision in this proceeding.

**DATED** at Toronto, February 18, 2010

**ONTARIO ENERGY BOARD**

*Original Signed By*

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**Pamela Nowina**  
Vice-Chair and Presiding Member

*Original Signed By*

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**Cynthia Chaplin**  
Member

*Original Signed By*

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**Paul Sommerville**  
Member