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H.TO - Q3 2017 Hydro One Ltd Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Hydro One Limited Third Quarter 2017 Results Investment Community Teleconference. (Operator Instructions) As a reminder, this call is being recorded.

I would now like to turn the call over to Omar Javed with the Hydro One management team. Please go ahead.

Omar Javed - *Hydro One Limited - Director, Investor Relations*

Thank you, Crystal. Good morning, everyone, and thank you for joining us. I'm here in Toronto with Hydro One's President and CEO, Mayo Schmidt; our Senior Vice President of Finance, Chris Lopez; Greg Kiraly, our Chief Operating Officer; Ferio Pugliese, our Executive Vice President of Customer Care and Corporate Affairs; and Paul Barry, our Executive Vice President of Strategy and Corporate Development.

We'll provide some brief comments on our third quarter results and then spend the majority of the call answering as many of your questions as time permits. There are also several slides which illustrate some of the points we'll go over in a moment. They should be up on the webcast now, or if you've dialed into the teleconference, you can also find them on Hydro One's website in the Investor Relations section under Events and Presentations.

As the discussion this morning will likely touch on estimates and other forward-looking information, you should review the cautionary language in today's earnings release and our quarterly MD&A, which we have filed this morning regarding the various factors, assumptions and risks that could cause our actual results to differ as they all apply to this call.

With that, I will turn the call over to Mayo Schmidt.

Mayo M. Schmidt - *Hydro One Limited - CEO, President and Director*

Thank you, Omar, and good morning, everyone. Our team is quite excited to have the opportunity to talk about our third quarter results. Let me start by providing the review of the quarter and where we are in our transformation as a North American leading utility.

We have introduced innovative productivity programs in our operations, with a strong focus on customer advocacy and the success of new initiatives, enhancing and materially improving our relationship with all customers. Greg is prepared to discuss productivity initiatives. Additionally, Ferio and his team will highlight a number of high-impact customer initiatives during our discussion to follow this morning. Chris will follow my comments today to provide our analysis of the financial results.

The positive results that we saw this past quarter reflect retroactive revenues from the transmission rate decision as well as our significant momentum in 2 key areas using innovation to improve productivity and reliability and the introduction of customer centric programs designed to improve our customer's experience, while driving our accounts receivable to lower levels.

Some high or some key operational highlights in the quarter include: the growing productivity savings being achieved through our new vegetation management approach, our fleet optimization project and the execution of a more competitive procurement process. As you will recall, these initiatives which arose through our comprehensive analysis of Hydro One's operating platforms and customer service businesses on the arrival of the new leadership team.

In our focus on operational excellence, Greg's teams are leveraging innovation and targeted investments to transform and modernize our system to achieve productivity savings. We've introduced the new condensed vegetation management program that will result in immediate unit cost productivity savings through a more surgical approach and selective clearing of vegetation and will, over the long term, reduce the total program cost after clearing much of the heavier vegetation through the first tree trimming cycles.

We expect to achieve long-term productivity savings as well as improved reliability and community relations. This approach will target high-growth areas in our territories, areas with strong likelihood of causing an outage, our intent is to shorten the vegetation cycle to every 3 years down from every 10 years.

At the same time, we are leveraging telematics data to evaluate equipment utilization and productivity of the company's fleet in order to identify opportunities to reduce fleet size. So far, the fleet component is then identified as being released by -- reduced by potentially 10% or as many as 800 units. With several hundred to be removed from inventory over the balance of 2017 and continuing disposals into 2018.

Going forward, we will continue to leverage our telematics to continue removal of units through logistics planning, improvements in our dispatch and logistics programs, further rationalizing equipment, while improving productivity levels, allowing greater safety, reduced maintenance costs and a reduction in our carbon footprint.

Savings were also achieved through our strategic sourcing program designed to refocus our procurement strategy and leverage our $1 billion in spend annually across 18 materials and service categories. We have already successfully reduced the price for procured materials and services by consolidating spending to exercise purchasing power and by introducing a revised, more streamlined bidding process.

I am proud to report that Hydro One teams are successfully demonstrating a strong commitment for operational excellence and commitment to safety. Our crews demonstrated their expertise, hard work ethic and safety record during several big storms this quarter, both in Ontario and during the restoration effort in Florida.

Through our unique relationship with peers internationally, Hydro One mobilized 175 employees to Florida to restore power to people in desperate need of help after Hurricane Irma hammered the State of Florida, causing extensive damage and losses. Over a period of 14 days, Hydro One crews made the round trip to Miami, Florida and restored power to over 10,000 Florida power and light customers.

During our time in Florida, our employees were assigned challenging work in extreme heat conditions. Above all else, every crew member lived our core values and demonstrated how we work together to help others in need. The team earned the admiration and public recognition among their peers, the public, and the State administration involved in the rescue efforts in Florida.

Now further on the customer front, Ferio's teams have been listening, focusing and acting on customer preferences. We have introduced programs and policies to deliver maximum benefit at minimal cost to ratepayers. The execution of these programs, many of which have been profiled in previous quarters, served to improve our customer experience, build our relationships with those we serve, while reducing our service and bad debt cost. We have now enrolled nearly 90,000 residential and small business customers in the continued uptick of our enhanced paperless billing service, customized high-usage alerts and billing arrival notification. While this enhances the convenience for customers, it also serves to reduce our billing and our postage costs.

Additionally to make e-billing even easier, we launched a new mobile-friendly website, offering streamlined self-service features to meet evolving needs of our customers. Overall customers are pleased with the new website and self-service features, initial results are positive, with increased usage of the website and self-service portal.

I'm also pleased to report to you the billing accuracy continues to surpass Ontario Energy Board requirements, achieving to date, 99.25%. We continue to advocate for the customer. Hydro One's leadership and Board of Directors support the recent launch of the Affordability Fund, a relief program of up to $200 million in funding, paid for by the province of Ontario and administered by Hydro One.

This is a program that Hydro One advocated for, which helps all customers who do not qualify for low-income programs but need assistance to make energy-efficient home improvement to bring down their monthly electricity bills. This year's Winter Relief Program builds on the leadership position Hydro One took last year by proactively reconnecting hundreds of families across Ontario living without power during the cold Ontario winters.

Following Hydro One's proactive leadership in reconnections in 2016, the Ontario Energy Board recently mandated winter reconnections for those Ontario customers that have fallen behind on their accounts, a decision which supports and we applaud.

We are committed to continuing to provide support and relief to customers, especially at a time when needed most.

Now lastly, Hydro One continues to be recognized for our leadership position at the provincial and national levels. In September, Hydro One was awarded Leader of the Year by our peers with the Ontario Energy Association. We were also recognized by the Canadian Council for Aboriginal Business for our commitment to Indigenous Canadians and communities in their Progressive Aboriginal Relations program. This designation follows committed participation in the Progressive Aboriginal Relations program and an external validation of corporate performance in our aboriginal relations. This program recognizes the company as a good partner, a great place to work and a champion for the prosperity of our aboriginal communities, businesses and individuals.

Now as we discussed in the call last quarter, we are very excited to combine with Avista to create a North American utility leader with a $34 billion enterprise value. This is a strategic acquisition of a high-quality, regulated transmission and distribution utility, top leadership team in the U.S. Pacific Northwest, which will place Hydro One in the Top 20 North American utilities, a truly historical achievement for Hydro One.

In the first full year, post-close, we expect the merger will be accretive to EPS. In the longer term, we expect to see increased opportunities for innovation, research and development and the efficiencies by sharing technology, best practices and business processes over a broader customer base and set of infrastructure.

On September 14, Hydro One and Avista Corporation marked a major milestone in the proposed transaction when we filed joint applications to request regulatory approval of the proposed merger. The applications have been filed as expected with state utility commissions in all 5 states: Washington, Idaho, Florida, Montana and Alaska as well as with the U.S. Federal Energy Regulatory Commission, FERC.

FERC approval is likely to proceed as no comments or requests for formal intervention we'll receive by the deadline, and given lack of opposition, the decision may be made in early January 2018.

In early October, Avista Corporation also filed the preliminary proxy for shareholder's approval of the merger with the U.S. Securities and Exchange Commission. In the coming months, we will file additional applications with a number of other American agencies, including the Federal Communications Commission and the Committee on Foreign Investments in the United States.

The leadership and regulatory teams of both Hydro One and Avista are laser-focused on a high-quality filing and an efficient process to achieve our stated outcome. This is our top priority.

It is also important to note the success of the Canadian deal offering associated with the Avista transaction, investor enthusiasm and strong demand for both retail and institutional customers -- with the investors, excuse me, resulted in oversubscription of the approximately $1.5 billion of convertible debentures. The securities sold out overnight and were 2x oversubscribed, a testament to the high level of investor support for the Avista transaction.

The energy landscape is rapidly changing, and Hydro One must be positioned as the leader of the launch on innovative solutions, new business and growth. At the same time, the company will continue its focus on strengthening its core business for the benefit of its shareholders, customers, communities and its people. By leading the customer service, operational excellence and innovation, we will ensure Hydro One is recognized as a North American leading energy company.

Now with that, I'll turn the call over to Chris for some additional color on the financial results. And I will stand by for your questions.

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

Thank you, Mayo and good morning, everyone. I'm pleased to report that EPS for the quarter was $0.37. After adjusting for onetime impact of the Avista transaction, the adjusted EPS is $0.40, which gives a 2.6% increase over last year. The transmission rate decision and positive cost performance after adjusting for onetime costs related to the Avista transaction, showed favorable results this quarter, which were partially offset by a lower ROE and the impact of milder weather.

Our third quarter revenue, net of purchase power, was higher than 1.3% year-over-year. This is reflective of the decision on our 2017-18 transmission rate filing on September 28, 2017, coupled with a few pressures that have been impacting results all year. The transmission rate decision resulted in increased revenue of approximately $55 million, which represents catch-up revenue earned during the first, second and third quarters of this year. This includes higher disposition of certain OEB-approved earnings accounts, higher export of service credits and higher rate revenues.

The acquisition of Hydro One's Sault Ste. Marie in the fourth quarter of last year, also contributed to higher transmission revenue.

The upswing in transmission revenues resulting from the rate decision were largely offset by the impact of milder weather in the quarter, which affected peak demand. The average monthly Ontario 60-minute peak demand was 9.3% lower this quarter compared to the same period last year. Distribution revenues were also impacted by the milder weather as consumption levels declined.

Lastly, as noted in the previous 2 quarters, the OEB-approved allowed return on equity was formulaically adjusted down with -- late last year, reflecting the prevailing interest rates at that time.

The allowed ROE declined from 9.19% in 2016 to 8.78% in 2017, which resulted in lower earnings for both the distribution and transmission segments. Since then, these rates have been steadily increasing. If we were to calculate the ROE today based on the formulaic mechanism, which includes the current long bond rates and utility spreads, the ROE would be approximately 9%.

On the OM&A front, cost this quarter increased by 4.9% from last year. This increase is mainly due to isolated factors and once normalized, the OM&A levels are actually 3.8% lower year-over-year.

Although we spoke about the Avista acquisition last quarter, the transaction actually occurred during the third quarter. As a result, we have recognized related nonrecurring consulting costs, which contributed to the increase of $25 million of OM&A cost in the other segment. Within our distribution segment, OM&A decreased by 6.9%.

It's important to note that included in our distribution OM&A for this quarter are the storm restoration costs associated with Hurricane Irma, restoration efforts in Florida, which have fully recovered in revenue with no impact to net income. Adjusting for this item, the distribution OM&A would have been lower by approximately 11.3%, which reflects operational improvements, such as the vegetation management initiatives discussed by Mayo earlier on this call.

Below the operating cost line, we had similar factors affecting our results as in prior quarters this year, an increased weighted average long-term debt portfolio, including long-term debt assumed as part of the Hydro One's Sault Ste. Marie acquisition, resulted in higher financing charges, and increased depreciation was due to rate price growth. Also affecting financing charges this quarter was an increase in interest of approximately $8 million on the convertible debentures issued in August, which were sold to satisfy the equity components of the Avista acquisition.

Moving on to the end of the quarter, in October, we entered into a deal contingent borrowing exchange forward agreements to convert CAD 1.4 billion to U.S. dollars. This agreement mitigates defined currency risk related to the portion of the acquisition, purchase price financed with convertible debentures. The contract can be executed any time up to March 31, 2019, and the deal contingent fee could be in the range of $27 million to $47 million.

Moving over to investing activities, assets placed in service are lower this quarter, which is also affecting the year-to-date comparison. While distribution assets placed in service are up by 8.9% this quarter, transmission assets placed in service are down significantly from the prior year. There were a number of large transmission projects that had significant portions put into service during the third quarter of 2016, including the Guelph Area Transmission Refurbishment project, the Toronto and Midtown Transmission Reinforcement project and the Richview transmission station circuit breaker replacement project.

Capital investments of $380 million were made during the quarter. In the transmission business, the amount of capital investment were similar to last year as we continue our investments in 3 major transmission stations. A new transmission station in Clarington, the rebuild of a critical switch house supporting the Bruce power nuclear facilities and the Leamington transmission station, which will serve low growth in the Essex County.

In the distribution business, capital investments are lower than the prior year as we attempt to manage our rate base additions over 2016 and 2017 to align to OEB-approved levels. As a result, the year-over-year change is related to the work that was started in 2016 and is completing in 2017.

In terms of our regulatory updates, on the transmission side, as mentioned earlier, we received the decision from OEB during the quarter on the 2017-2018 rate application that we had filed back on May 31, 2016. As a reminder, this was a 2-year cost of service filing and the next transmission filing, which we expect to make in the second quarter next year, will be a 5-year filing under the OEB incentive base regulatory framework for the 2019 to 2023 period.

Following the decision, we filed a Draft Rate Order and on November 9, received a subsequent decision which confirmed the revised revenue requirement and reflects the impacts of the OEB's decisions, including a reduction in OM&A expense of $15 million related to compensation, a reduction of $31 million in income tax expense related to the deferred tax asset; and a reduction to capital expenditures of $126 million among others for the 2017 rate year.

On October 18, 2017, we filed a motion to review on various portions of the decision that give rise to the reductions in the improved revenue requirement. This include objections that a portion of its mix savings resulting from the government of Ontario's decision to sell its ownership interest in Hydro One Limited and its subsequent IPO should be applied to reduce the revenue requirement and a cost related to the Ombudsman's office should not be included in rates.

On October 27, we also filed an appeal of the decision to the Ontario Divisional Court, which is steady pending the outcome of the OEB review and various motion.

The revenue recorded this quarter for the transmission decision was calculated using a revenue requirement that was inclusive of 100% of the tax savings resulting from the government of Ontario's decision to sell its ownership interest in Hydro One. We believe the OEB direction to include only a portion of these savings and the revenue requirement was based on 4 principal areas in the tax and determination, which are clearly articulated in Hydro One's positions filed.

On the distribution side, we filed -- we gave update on June 7 to 2018-2022 distribution rate application, which resulted in lowering the average annual impact and distribution rates over the 5-year term from an increase of 3.7% to an increase of 3.5% per annum.

The OEB later issued correspondence indicating that the timing in key dates leading up to the oral hearing has been postponed and that should there be changes, it would be provided at a later date. We look forward to engaging with the OEB and demonstrating our position. At this time, we cannot estimate when a decision would be anticipated.

In terms of financial strength, we continued to have a very strong balance sheet, with conservative leverage and strong investment grade credit rating. Our weighted average cost of debt is a low 4.3%, our redemption schedule is very smooth, with an average term of 15.1 years, and we have significant liquidity.

As previously mentioned, we completed the sale of $1.54 billion convertible unsecured subordinated debentures on August 9 as part of the Avista financing strategy. These convertible debentures are represented by installment receipts that trade on the Toronto Stock Exchange.

I'll stop there, and we'd be pleased to take your questions.

Omar Javed - *Hydro One Limited - Director, Investor Relations*

Thank you, Mayo and Chris. We'll ask the operator to explain how she'd like to organize the Q&A pooling process. Please go ahead, operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Mona Nazir from Laurentian Bank.

Mona Nazir - *Laurentian Bank Securities, Inc., Research Division - Senior Special Situations Analyst*

So the first question I had is just related to the $18 million in Avista-related costs. How do we expect that to trend? Or how do you expect that to trend into Q4 and as we get into 2018, closer to the closing date?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

Mona, it's Chris Lopez here. So the cost that was reflected there was the cost of the success fees of the bankers and some of the advising fees that were early in the process. So I wouldn't expect it to continue at that rate into Q4. However, it will have an uptick towards the end of the transaction as we move into the more detailed part of the regulatory filings and the hearings. So I expect it to pick up in Q1 and into Q2 and Q3 next year when the deal is closed.

Mona Nazir - *Laurentian Bank Securities, Inc., Research Division - Senior Special Situations Analyst*

Okay, and just touching on the recent OEB transmission decision. In the history of the company, have you ever had to appeal either appealing directly to the OEB or going through this kind of court appeal process?

Mayo M. Schmidt - *Hydro One Limited - CEO, President and Director*

No, and this is Mayo. No, we have not. This is -- this would be a new event for the organization but we feel strongly about our position. The communication between the organization has been clear. And frankly, I don't think that expected by the OEB in any case.

Mona Nazir - *Laurentian Bank Securities, Inc., Research Division - Senior Special Situations Analyst*

And then just lastly from me before I step back. The diversification brought on by Avista on both a geographic basis and new vertical, I know it's still early days in the process, but I'm just wondering your thoughts on how to capitalize on your new footprint. And do you expect much change to the business mix and geographic reach over the next 5 years? Or do you kind of visualize keeping with what we see now? And that's assuming Avista closes.

Mayo M. Schmidt - *Hydro One Limited - CEO, President and Director*

Thanks, Mona. I would just start with the point, we have a strong view that the regulatory process will be efficient, that it will be a successful outcome. Secondly, is we see opportunities in a number of areas, whether it's procurement or IT services, et cetera, to share in the productivity and efficiency between the 2 organizations. And of course, the leverage that comes with the collective balance sheet to the 2 organization positions us to be, I think, strong in terms of procuring what is hundreds of thousands of poles and thousands of miles of wire, et cetera. The thing that I think we embrace most about the transaction is not only the quality of the leadership team but really 2 other key components. One is it's a company that has a deep history of innovation that goes back over 100 years. And you may be aware that they actually own the patent of the first electric stove. That's how far back their innovative history goes. And they've had a considerable number of successes that will complement the work that we're doing on innovation here. And I think also we think about -- when you talk about verticals, this is a really unique opportunity to not only buy a fully regulated business in a transmission and distribution businesses, which is, of course, a core competency for our organization, but also it gives us a really nice exposure, which we have skills in, on the gas distribution and also on the generation that's a renewable, such as the hydroelectric. So we're buying really deep value, long-term assets that should continue to produce year after year after year, over the next century. So we're quite excited about that. And at the same time, the size of the new opportunities, which is, of course, gas distribution, is very much appropriate, considering the way that the business relies in the transmission distribution. So we like the exposure, we like the size of it, and frankly, the business of this is large enough, but it's very meaningful. But it's not so large as to be any kind of a distraction for both overall running of the business here in Ontario but also the gain and efficiencies of the collective organizations.

Operator

Our next question comes from Andrew Kuske from Crédit Suisse.

Andrew M. Kuske - *Crédit Suisse AG, Research Division - MD, Head of Canadian Equity Research, and Global Co-ordinator for Infrastructure Research*

The question might be for Chris, and it's just on the OM&A reductions. And I appreciate the detail you went into, but can you talk maybe a little bit more about just the OM&A? So on an overall basis, it's obviously up. But it's skewed by the $33 million in other, which includes a lot of the Avista costs. But if you drill into distribution, in particular, your costs are down. So what's the dynamic there? And what part is really timing versus structural?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

So why don't I split out the onetime event. My comments were around the overall OM&A cost are down 4%, and that is structural if you strip out the onetime events. And structural was really being driven by vegetation management and reduction in (inaudible) costs. And some of that, in fact, if you strip out for that, really, are the Avista transaction, and there was the cost associated with the Florida hurricane that is recovering now, it's onetime, it was recovered in revenue, and that's approximately $7 million.

Andrew M. Kuske - *Crédit Suisse AG, Research Division - MD, Head of Canadian Equity Research, and Global Co-ordinator for Infrastructure Research*

Okay, that's helpful. And then just on the vegetation management, if we can maybe get into a little bit of just the dynamics there, it sounds like you've truncated the old schedule of vegetation management to something a bit shorter in duration and maybe being a bit more aggressive in going out and tackling certain issues. And obviously, that has knock on effects in the productivity, reliability. But are your expenses more front-end loaded? And then do you really reap the benefits of that on a longer-term basis?

Gregory K. Kiraly - *Hydro One Limited - COO*

Yes. So this is Greg Kiraly, Chief Operating Officer. So we've just undergone the commencement of this new vegetation management program based on a lot of best practices of U.S. utilities and other Canadian utilities, and it moves that cycle from a 10-year time frame to a 3-year. So we're going to accomplish more circuit kilometers of clearing, but we're going to be more surgical in our approach. So we're not going to do a complete clearing, but we're going to clear the vegetation that has the most significant impact and potential for an outage on our system. So when we do that, of course, we reduce the unit cost because we're covering circuit kilometers, many more circuit kilometers with this new approach. We're still going to need a significant amount of dollars and dollars that we submitted in our rate case application for the first couple of years, because we're going to be removing a lot of dead, dying and diseased trees that could fall into our lines based on this new approach. And then over the long term, after we get through a cycle or 2, and much of that heavier vegetation is weeded out, then we'll be able to achieve total cost savings that will be on the decline in the out years. But immediate unit cost savings upfront and then total cost savings over the long-term.

Operator

Our next question comes from Rob Hope from Scotia Bank.

Robert Hope - *Scotiabank Global Banking and Markets, Research Division - Analyst*

And just starting off south of the border with Avista, and I realize it's early days, but any thoughts on potential implications of the U.S. tax policy changes there, either pro or con?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

It's Chris Lopez here. So it's very, very early days, as you've just pointed out, and I think the only item that was of any significance that came out was the suggestion that the tax that will be cut to 20%. So that would have a $0.01 or so up to $0.02 impact on the accretion. But we would find a way to manage that. And again, it's very, very early days and that's without any optimization. So we'll continue to monitor and look at it and see how we can offset any impact on the change in the tax breakdown there.

Robert Hope - *Scotiabank Global Banking and Markets, Research Division - Analyst*

All right, that's helpful. And then moving back north of the border, just when looking at Q3, just help us understand, so the $0.40 that you booked, I guess was inclusive of the transmission decision for all aspects except for the tax changes there? And then just want to get a sense of how much of a magnitude that would've been during the quarter?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

Yes. So you summarized it correctly. And the magnitude during the quarter is approximately $50 million.

Robert Hope - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Okay. And then just in terms of timing, when would you expect to get this review in variance application? Or court challenge finalized? Or to completion?

Mayo M. Schmidt - *Hydro One Limited - CEO, President and Director*

I would say that one is over the course of the balance, which we only have a couple of months left in the year we're in, is the process will begin. I expect, the first quarter, there will be a lot of activity. But it would not be predictable to say that it's going to happen in the first quarter, first 2 quarters. But I think just using a reasonable judgment, the expectation would be, I think, it would be late in the first quarter or potentially into the second. And we can use history as a guide. Of course, the ruling we just received on the transmission filing was retroactive to January 1. So that's the information that we have. And it's early days in the process. But as I mentioned earlier, Rob, it was not unexpected that in fact, we would be responding in a way that we have with the OEB, with the (inaudible) information.

Operator

Our next question comes from Jeremy Rosenfield with Industrial Alliance.

Jeremy Rosenfield - *Industrial Alliance Securities Inc., Research Division - Equity Research Analyst*

Just a couple of questions. First, I'm curious if you have heard anything as to why the OEB has not yet published its update for the ROE officially? And if there has been any indication to you specifically as to when they may publish that?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

Jeremy, it's Chris Lopez here. So we haven't heard anything specifically, but we anticipate we'll have that update within the next 2 weeks. As we've indicated previously, it's formulaically calculated. So it's not a matter of interpretation, it's just a matter of publishing.

Jeremy Rosenfield - *Industrial Alliance Securities Inc., Research Division - Equity Research Analyst*

Yes. I'm aware of that. Just in the past, they have typically published it within October. And now it seems later. So I was wondering if there had been any implication as a result of that. But if not, that's very good. Just moving forward, from a more maybe broad perspective, looking at the Ontario long-term energy plan, which was published recently, are there any takeaways that you can highlight for us from the plan that would lead into how you are going to develop the business going forward?

Ferio Pugliese - *Hydro One Limited - EVP of Customer and Corporate Affairs*

Jeremy, it's Ferio here. We are taking an extensive review of the long-term energy plan. It is certainly based on input from the industry across Ontario. At first blush, we believe that there's certainly opportunities there, with what has been suggested with the additional FIT contracts and green energy initiatives. But we continue to do a deeper dive into what other potential there is for us to see initiatives for innovation that would apply to the business. It's the third volume of documents that have been produced in Ontario. And what we feel with this plan is it actually gives some sense of certainty to costs and program, certainly, over the long-term. So we're continuing to feel [terrific]. Time will tell here in the coming months as to what opportunities we evaluate that we feel we can add commercial value to the business front.

Operator

Our next question comes from Linda Ezergailis from TD Securities.

Linda Ezergailis - *TD Securities Equity Research - Research Analyst*

I'm still going through your results, so I apologize if some of my questions have been addressed in your write-up. But I'm just wondering, maybe when you talk about some of the initiatives you're taking around vegetation, fleet management, procurement, notionally for each of those buckets, how might we think of the relative proportion of benefits being in your distribution versus the transmission business?

Gregory K. Kiraly - *Hydro One Limited - COO*

Greg Kiraly here. I would say most of those productivity initiatives are in our distribution business. Certainly, there some in our transmission business as well. And all of those, collectively, those initiatives have really helped us achieve the financial results that we reported here today.

Linda Ezergailis - *TD Securities Equity Research - Research Analyst*

And so how much more would you say would there be left to go? Are you 3 quarters of the way there? Or...

Gregory K. Kiraly - *Hydro One Limited - COO*

Well we've -- we're on track right now to achieve our forecasted savings for the year, and we've built productivity savings into our budget as we have in our 5-year distribution rate case moving forward as well as we're going to do more transmission rate case. So both shareholders and customers are going to benefit from these productivity savings where we're on track to achieve our targeted savings for the full year of 2017.

Linda Ezergailis - *TD Securities Equity Research - Research Analyst*

And just a follow-up question with respect to your accounting treatment of the transmission decision. For the fourth quarter, how will you be booking your financials, both for your kind of ongoing operations? And will there be may be a onetime impairment charge when it attacks or an adjustment to FFO on the annual basis that you disclosed in your write-up? Or would that decision be made to make that change once a final resolution comes, either from a review in variance decision or an appeal? And how are your accountants advising that you approach that?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

It's Chris here. It's the latter of what you proposed there, what you indicated. So we remain of the opinion that it's probable that we'll prosecute our case to success. And while that remains true, we would defer any impairments as to such time that, that became -- it would change. And that could be in the event of a decision or it could be of the fact that comes up a lot likely it will be the decision in the motion to review and vary that would set that out. So that's what it would be. And the accounting is set out in the notes in the MD&A. It talks about a onetime impairment in the event that we are unable to defend our position. And then going forward, it also, in the MD&A, it highlights the impact of the FFO going forward.

Linda Ezergailis - *TD Securities Equity Research - Research Analyst*

Sorry, so the FFO will not -- how will you be booking cash flow? Because your FFO does go down as your new rates come into effect. Do they not? Or do you reverse that back to normalize for that?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

Yes, so the new rates have come into effect. And that rates we are accounting on is we expect to recover the full amounts of the tax benefit at this point. So at the point when that is no longer true, we would book a onetime impairment, and then the FFO will be reduced at that point.

Operator

Our next question comes from Robert Kwan from RBC Capital Markets.

Robert Michael Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

If I can just follow on the financial impacts. So if the R&V is unsuccessful, you've laid out the $50 million to $60 million annual FFO impact, just wanting to drill down the development of that figure. So does that include a similar impact on the distribution side of business?

Mayo M. Schmidt - *Hydro One Limited - CEO, President and Director*

Yes.

Robert Michael Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay, so is that really just to build out to have your year outlined depending on the year, let's call it, $25 million of tax on the transmission side that assumes the full $50 million OM&A disallowance with no mitigation, and then, call it, high teens on the distribution side of things? On the tax?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

Yes. So the FFO impact that is outlined in the MD&A is purely related to the tax. In regard to the other impacts, we will look at ways to recover that and (inaudible) in our business by reducing corporate overhead or whatever that needs to be.

Robert Michael Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

Got it. Okay. And then from the earnings side of things, how do you expect that to play through? Is the tax an actual impact on the income statement? Or is that going to be swept away by a rate-regulated accounting?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

No. The time -- so today, there is no impact because we've remained obviously that we can defend the position that it will be recovered. At the point when that is no longer true, and there will be a onetime write-off -- or onetime fit to earnings and then in the MD&A, we've set out what that range is based on the current ownership and the calculation put forth by the OEB, that could be for the distribution and the transmission business, up to $885 million as a onetime impairment charge, with no further impacts on any income after that. However, there will be an impact on FFO because we won't be collecting a higher rate going forward.

Robert Michael Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay. So the ongoing impact to earnings is 0. But that's because of rate-regulated accounting principles?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

As we sit today, yes.

Robert Michael Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay. That's great. That last question I've got is you've got this disclosure about in-sourcing of the back office. And we've seen with some others you've done this. This has been a positive event given rate base investment to set up the operations. Is that the case here?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

Can you provide some more clarity when you talk about back office?

Robert Michael Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

So I think there's a disclosure that you've got an outsourced customer service or function that contractors prior to the end of the year and you're going to be in-sourcing the operation?

Ferio Pugliese - *Hydro One Limited - EVP of Customer and Corporate Affairs*

It's Ferio here, I can take that question. Yes, we are just working through the process of bringing the call center operation, our customer service operation back in-house and in-sourcing it. And this has been based on discussions and negotiations that we've had with both of our unions with PW and society and have been able to reach arrangements that are cost-effective and flexible that will allow us to in-source that at a lower cost structure and at a declining cost structure basis. Right now, as we've moved to more flexible channels by using and opening up digital talents for e-billing and so on, it's reducing call volumes into our call center. Bringing the call center back in through those lower call volumes and now at a declining rate of cost per call gives us the price flexibility and the cost advantage of operating a more efficient call center on our own. But in addition, this speaks to some of the points that Mayo made in his opening words about us also driving for a greater quality of experience with our customers. The intent with the in-sourcing of the call center as well as we've obtained through our contract negotiations with both the PW and the society is flexible work times that allow the call center agents now to work just beyond the basics of entertaining customer escalations and complaints we action now and use the call center agents to expand the level of service they're providing. And if we were to get into other commercial arrangements or some other services, we could now use that call center to do as such. So we view that as a strategic advantage. It gives us the control over the customer experience better than we have today at a better cost price point, and in addition, delivering better quality of service to our customers.

Robert Michael Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

Right. But is there a capital cost setting up the infrastructure to handle all of this?

Ferio Pugliese - *Hydro One Limited - EVP of Customer and Corporate Affairs*

No, there is none. There is no capital cost. We own the facilities and have for years. And in essence what we'll be doing is just -- in essence, terminating the contract with our outsourcer, in-sourcing that contract and with the new terms and conditions, we're actually in-sourcing it at a lower cost base.

Robert Michael Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

Got it. So it's just sort of people OpEx valuation.

Ferio Pugliese - *Hydro One Limited - EVP of Customer and Corporate Affairs*

Yes.

Operator

Our next question comes from Robert Catellier from CIBC Capital Markets.

Robert Catellier - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

I wondered if you could discuss, based on your initial contact with the regulators and stakeholders about the Avista acquisition, what your sense is of the required concessions or contributions that you need to make to have the deal approved and compare those to your accretion expectations.

Mayo M. Schmidt - *Hydro One Limited - CEO, President and Director*

Let me take that. So maybe there's 2 levels to answer that question. One being -- This is Mayo. I've met with the commissioners of 4 out of the 5 states, and I intend to meet with the fifth one this month in the next 1.5 weeks. I would say that the meetings were very constructive, very positive. And quite frankly, quite welcoming. And I'd say that it was 2 reasons. One is the activities of this organization over the last few years have, specifically 2 years, have demonstrated a real strong customer focus, which is important, the activities that they've embraced. And secondly is bringing an organization with the, not only the good reputation, but also the balance sheet that Hydro One has been seen as highly attractive to the states, both the governors that I've met and also the state commissioners. It's early yet, and we just filed in mid-September and October was a period of time where there were a lot of questions being answered. So we've received from different states, different numbers of questions. But some standard question at the request, which under Jamie Scarlett, the team is executing on those responses. We've got a very strong regulatory team, both here at Hydro One and at Avista, that are working collaboratively. So we don't think it's an exercise that's going to be too arduous for us. We don't know at this period of time yet what the expectation of net benefit will be. But at the same time, we have recognized there needs to be one. And we will be providing with -- and we haven't counted our view within the accretiveness of the transaction. There is a recognition of what our expectation may be of what their request, ultimately, will be, and we expect by next quarter, we'll have more clarity on that, Robert.

Robert Catellier - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Okay, that's helpful. And then just we haven't had any update, I think, on this, your CFO search. So can you give us an update there, please?

Mayo M. Schmidt - *Hydro One Limited - CEO, President and Director*

I'm happy to. So as you would expect, the organization has done an extensive search looking in Canada and also in the U.S. And I would say that I've met with a number of candidates. I've got more to meet with. We surfaced some very high-quality individuals. We're in the process now of narrowing to a short list over the next course for the next few weeks and including this week and next I will be meeting with candidates. And I would say that my goal and the goal of the Board of Directors and the full leadership team here is to hire and attract and retain a high-caliber candidate that is, in fact, has the competencies of the leadership team that we've built around Hydro One, which I think is quite strong. And so I think it's a combination of both the personality but also a competence fit. And I think, I like what I am seeing as we've narrowed it now down into a shorter list. And Judy McKellar, who is the Chief Resource Officer, and I are working through that list. And we'll get to a conclusion here, I think, in the coming -- well, I think in the balance of this year will be the expectation, assuming that people are available to complete the interviews.

Robert Catellier - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Okay. My last question then is on the actual tax rate in the quarter. Maybe, Omar, this is something we can take offline. But it was a year-over-year decline. So is there any obvious explanation for that?

Omar Javed - *Hydro One Limited - Director, Investor Relations*

Rob, happy to touch base with you and provide you with more color on the expected tax rates. I believe that you're correct in your assessment.

Robert Catellier - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

So Omar, you don't think it's still likely to continue? It's just timing issues or something like that?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

Chris Lopez, here. We've had a number of tax returns. I think maybe as we have some provisions against some of those tax returns. So we're able to clear those provisions now. So it's a onetime benefit if you like. So you'll see the rates stay within the range that we expected that we've put out there that's pointing to 16%. But for the quarter, it was low.

Mayo M. Schmidt - *Hydro One Limited - CEO, President and Director*

That's correct.

Operator

And we do have time for a couple of more questions. Our next question will come from Linda Ezergailis from TD Securities.

Linda Ezergailis - *TD Securities Equity Research - Research Analyst*

I wanted to understand more the FFO effect of $50 million to $60 million and the assumptions behind that, just to clarify, it's transmission and distribution potential tax effects if you're not successful in your appeal. What is the assumption in terms of ownership of the public versus the government? Would this go down with the dilution from the Avista shares once that transaction closes? Or is that number already reflecting a higher share count? Or is that not a factor?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

Linda, it's Chris. Yes, on all counts. You summarized it very clearly. It currently reflects the decision that the OEB has put on file, which is at the lower provincial -- at a higher provincial investments announced. Once we -- once they dilute it further and they can go down to 40%, they're currently at 51% in that calculation, this amount will go down. The write-off will go down and the FFO impact will also go down.

Linda Ezergailis - *TD Securities Equity Research - Research Analyst*

So what would that -- will this number be once the Avista transaction closes and those shares get converted?

Chris Lopez - *Hydro One Limited - Senior Vice President, Finance*

Yes, so there's 2 pieces to that. There's the Avista transaction sales and the commitment from the government in 2018 to sell shares to [persons] and unions. If both events appear, it takes that down to 41%. The write off will drop by $150 million to $200 million, and FFO, the FFO impact will go down by 15% to 20%.

Linda Ezergailis - *TD Securities Equity Research - Research Analyst*

Okay. And just a follow-up, bigger picture question maybe for Mayo, there is a provincial election next year. I'm wondering if you'll engage the various parties or if you're aware what their platform is with respect to electricity policy and how it might affect Hydro One, if at all, with -- if any of the different parties were to come.

Mayo M. Schmidt - *Hydro One Limited - CEO, President and Director*

Sure, Linda. Thank you for that very interesting question. I would say we -- one is we have and do engage with them. Let me be clear about that engagement. We, as an organization, of course, would not want to be tone deaf to government policy in any length. But important to note that the government is, of course, a shareholder, not a manager of the business. So in our communications, really, to a level just to understand where they intend to take electricity policy or hydro policy for the province, which we see in the long-term energy plan and which is, of course, focused on innovation and opportunities that we see there. Secondly is the work that we've done with the current government, which when you think about the third Hydro plant, which has reduced power by $0.25 for every customer and $0.31 -- 31% excuse me, for Hydro One customers, done and completed after our first meeting within 14 days. It's a rather extraordinary outcome, which is a $3 billion per annum reduction. Then the Affordability Plan, which was $200 million -- up to $200 million that was deposited in Hydro One's account because we're the administrator of that program and then a change in reduction in the distribution charges. Those are really illustrations of the level of collaboration that affect our organizations had constructively on the relationship. But then going to the second part, which gets to again your question, there's no doubt that hydro or electricity policy is going to be debated and the 2 levels are, one is the privatization of Hydro One, which of course is, I'll use the word noise in the marketplace. And I think we all, as commercial people, realize that, that's done complete. And this organization is fully functioning, operating, even has its first acquisition underway. So that sort of a legacy debate and argument is probably going to get some profile. And then of course, the Fair Hydro Plan which is some debate between different branches of opposition in current government, simply around how it's going to get paid for, which the Finance Department is dealing with, which is outside of our purview. So I would just sum it up to say, there will be, let's use the word, noise in the marketplace related to Hydro. I don't think in any way it's going to affect our commercial operations. I think that all parties have admired the work that's been done in this organization to both be effective and successful commercially and also have a very positive public improvement of relationship. So I would say our customer relationships are at an all-time high in the history of this company. Even the work that we're doing, which you might say is our corporate social responsibility has resulted in a record low accounts receivable. So people are paying more bills than they ever have. Our receivables are at the lowest level than we've ever experienced. Relationships are at the highest level, our (inaudible) are at the highest level. And yes, there is noise. But I think it's -- the feedback we have, this is not personal to Hydro One, it's just simply is the politics of what resulted in an $11 billion global adjustment that weighs on the shoulders of every resident that's been a case of policy for the last 10 years. So hopefully, that's a nice purview of what we see is what will be sort of an election outcome. And following that, we just think the conversation around Hydro is going to diminish significantly.

Operator

And I am showing no further questions from our phone lines. I would now like to turn the conference back over to Omar Javed for closing remarks.

Omar Javed - *Hydro One Limited - Director, Investor Relations*

Thank you, Crystal. The management team here at Hydro One thanks everyone for investing their time with us this morning. We appreciate your interest. And to the extent you have any questions that weren't answered, please feel free to reach out, and we'll get them answered for you. Thank you again, and enjoy the rest of your day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a wonderful day.