Message

From:	Hanna Smith [/O=EXCHANGELABS/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/CN=F635B7CA1E924E76B641A64F40FCB20B-HANNA SMITH]
Sent:	2017-09-29 7:00:57 PM
To:	Tam Wagner [/o=ExchangeLabs/ou=Exchange Administrative Group (FYDIBOHF23SPDLT)/cn=Recipients/cn=70ad853871354761a98848de59c4c792-Tam Wagner]
Subject:	Review Request: Draft Email on HONI Tx Rate Decision
Attachments:	dec_order_HONI TX_20170928.pdf

Hi Tam,

Below for your review is a draft email summary of the OEB's decision on Hydro One's Tx revenue requirement application for 2017 and 2018. Would you please let me know what you think? Suggestions are welcome.

I'll work on updating the summary table and adding percentages as soon as I send this email.

Thank you for your assistance with this, particularly so late on a Friday!

Hanna
T: 416-969-6213
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Subject: Overview: OEB Decision on Hydro One Transmission Revenue Requirement for 2017 and 2018

Hello,

The OEB's decision on Hydro One Networks Inc.'s (HONI) transmission revenue requirement submission for 2017 and 2018 was released late yesterday (PDF attached).

This is the first such submission to reflect parent company Hydro One Limited's transformation from having the Province as the sole shareholder to having more than 50% of its shares publicly traded. The OEB noted in its decision that the shares of HONI are not publicly traded. Its structure and operations have not materially changed as a result of the transformation. Further, none of the almost $2,600 million transformation-related savings realized by HONI are allocated to transmission ratepayers in the application.

Of utmost concern to the OEB when considering the proposed costs were whether they would produce outcomes of value to HONI's transmission customers.

The OEB found the proposed costs to be appropriate overall, with the exception of the following areas:

- **Transmission System Plan and Capital Expenditures**: Requested capital envelopes were reduced by $126.1 M to $950 M for 2017 and $122.2 M to $1,000 M for 2018 largely as a result of inadequate planning and customer engagement.
- **Executive compensation**: Requested compensation amounts of $412.7 M for 2017 and $409.3 M for 2018 were reduced by approximately $15 M in each year because of transformation-related costs that do not benefit transmission customers.
- **Regulatory Income Taxes:** HONI will collect less regulatory income taxes from its transmission services customers in 2017 and 2018 to reflect the OEB's determination that the future cash tax savings arising from the transformation should be more fairly allocated.

A summary of the requested vs. approved costs can be found at the bottom of this email.

Also provided below is a summary of the OEB's assessments and recommendations/requirements on the following topics that are of interest to the IESO:

A. Planning
B. Sustainment
C. Customer engagement (including First Nations-specific engagement)
D. Line losses

Please let me know if you would like any further information.

Thank you,
Hanna
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Summary of Requested vs. Approved Costs (DRAFT)

	2017	**2018**	**2017**	**2018**
OM&A	413.1	411.2		
Depreciation	435.7	470.7		
Income Taxes	81.3	90.4		
Cost of Capital	676.1	714.9		
Total Revenue Requirement	1606.3	1687.2		
Deduct External Revenues	-28.2	-28.5		
Deduct Export Revenue Credit	-39.2	-40.1		
Deduct Regulatory Accounts Disposition	-47.8	-47.8		
Add Low Voltage Switch Gear	14.0	14.7		
Rates Revenue Requirement	1505.1	1585.6		
Rate Increase	1.6%	5.4%		

OEB Assessments and Recommendations/Requirements

A. **Planning**

Decision:

- Hydro One's proposed capital budget for 2017 and 2018 has not been fully justified largely as a result of inadequate planning processes. As a result, the OEB approves a capital envelope of $950 million for 2017 and $1,000 million in 2018, a reduction of $126.1 million in 2017 and $122.2 million in 2018.

Highlights of Rationale:

- Hydro One's proposed capital budget for 2017 and 2018 has not been fully justified mainly because of the lack of a comprehensive planning process.
- HONI has made continuing efforts to improve its planning process. However, the OEB finds that significant potential remains for improvement.
- Hydro One's proposed capital budget for 2017 and 2018 has not been fully justified mainly because of the lack of a comprehensive planning process.
- A utility's business plan for its regulated activities is fundamental to the evaluation of the proposals in its rate application. However, at the time of its rate application submission (May 2016), HONI had neither an approved strategic plan nor a finalized or approved business plan.
- HONI's evidence suggests significant gaps in its asset condition assessment process.
- Prioritization and optimization of proposed capital investments are inadequate. Indicators include:

- A significant increase in proposed capital spending in the current application from what was originally forecast for the test years in the previous application;
    - No compelling evidence to explain why proposed investments for the test years increased by $500 million in less than two years and by $300 million in seven months. Asset conditions are not expected to change this dramatically in such a relatively short period.
    - Historic variance between proposed and actual capital spending (especially sustaining capital) and consistent over-forecasting of in-service capital additions for nine consecutive years from 2007 to 2015 by an average of 14.6%.
- The proposed significant acceleration of the tower coating program and associated cost increase have not been fully justified in terms of risk management or economic benefit.
- Proposed stations investments, which represent the majority of the proposed Sustaining capital spending in both 2017 and 2018, have not been fully supported.
    - Some of the stations work can be deferred without much impact on reliability or concern over coordination with nuclear outages.
- The OEB has concerns about HONI's ability to complete the proposed capital investment program based on its historical performance.

Requirements/Recommendations:

- HONI needs to demonstrate that its planning process is robust and, equally or more importantly, that it is capable of successfully executing its capital program.
- HONI's planning processes should reflect:
    - a consistent, comprehensive asset condition assessment process which directly links to its Transmission System Plan (TSP) and the capital investment plan
    - an appropriate pacing of capital expenditures that achieves a proper balance of need and rate impact
    - Hydro One's ability to realistically execute the proposed capital program in a timely fashion
- HONI should continue to make improvements to its planning process addressing the issues noted in the decision and in Hydro One's internal audit.
- As part of its next transmission rate application, HONI must:
    - Provide a progress report on planning processes in its next transmission rate application.
    - Complete an independent third-party assessment of its TSP and file this assessment with its next transmission rate application that includes its asset condition assessment and capital investment planning processes.
    - Provide a report detailing its overall performance in the execution of the capital program relative to plan.

Additional Note:

- There was no recommendation for HONI to work more collaboratively with the IESO on station investment and regional planning processes, which had been identified by some intervenors as lacking.

B. Customer Engagement

Decision:

- Shortcomings in the customer engagement process meant that there was not compelling evidence of customer support for the proposed level of capital expenditures. This contributed to the reduction in capital envelope described in part A.

Rationale:

- The customer engagement process occurred too close to the completion of the TSP and the submission of the application to incorporate meaningful input.
- First Nations representatives were not engaged in a timely and meaningful way.
- The Reliability Risk Model (RRM) that HONI used to demonstrate the value of sustaining investments to customers was flawed.
    - It's unclear whether customers were able to relate the various levels of capital investment to actual system reliability since that relationship does not exist.
    - Without some form of correlation between the model results and actual system reliability, it would be impossible to determine whether a certain reduction in reliability risk is worth a certain level of capital investment.
- Some of the information presented to the participants may have been misleading.

Requirements/Recommendations:

- The process should be started sufficiently in advance of filing the application to allow for timely input to be incorporated in a meaningful way and to improve the level of customer attendance.
- HONI should seek timely and meaningful input from First Nations representatives.
- HONI should have discussions with LDCs to determine practical ways to seek some input from their end users to inform Hydro One's application.
- The information presented to the customers should be unambiguous and easy to understand.

C. Transmission Losses

Decision:

- Cost-effective reduction of transmission losses merits exploration by HONI and the IESO

Rationale:

- Responsibility for managing line losses lies with the IESO in some areas (e.g. regional planning) and with HONI in some cases (e.g. asset refurbishment or replacement).
- Some intervenors convincingly argued that the topic of line losses is worthy of investigation and action by HONI and the IESO.
- HONI has not provided any evidence of specific initiatives that it has undertaken or is planning to undertake to reduce line losses.

Requirements/Recommendations:

- HONI will work jointly with the IESO to explore cost effective opportunities for line loss reduction, explore opportunities for economically reducing line losses and report on these initiatives as part of its next rate application

Additional Note:

- The IESO expects to address the topic of line losses in the context of its regulatory scorecard at its upcoming revenue requirement hearing.