

**OUTLINE OF ARGUMENT
HYDRO ONE NETWORKS INC.**

Introduction

Hydro One Networks Inc. (“Networks”) is a large distributor of electricity. It is committed to providing reliable service to its customers at a reasonable cost. It is also committed to prudently employ techniques of conservation and demand management.

Networks participated extensively in the Ontario Energy Board (“OEB”) process which resulted in the development of the Total Resource Cost Guide published on September 8, 2005, and the development of the 2006 Electricity Distribution Rate Handbook published May 11, 2005.

The company has an application pending before the Board for approval of distribution rates to take effect in 2006 (RP-2005-0020/EB-2005-0378). The oral phase of the hearing is set to commence January 9, 2006. The application is based upon the principles set out in the Rate Handbook.

On January 11, 2005, Networks applied to the Board for an Order approving its conservation and demand plans for the so-called “third tranche” CDM funding (RP - 2004 - 0203/EB - 2005 - 0198). After a two day oral hearing, the Board approved

Networks' CDM plans on condition that the company reallocate \$7.1 million previously directed to "smart" meter costs. After a consultation effort and further submissions, the Board approved the company's CDM plan by order dated November 1, 2005.

It is against this background that the questions posed by the Board in this proceeding must be considered.

Questions

- (i) The Board has asked whether it "should order an LDC to spend money on CDM programs in an amount that is different from the amount proposed by an LDC in a test year and, if so, under what circumstances?"**

The Board has asked whether it should order additional expenditure, not whether it can do so in law. This is a policy question, not a legal question. Accordingly, this argument outline does not address the issue of whether the Board can, in law, order a utility to spend money on CDM beyond the level proposed by the LDC.

It is also assumed that the thrust of the Board's question relates to the transitional CDM program funding contained in the 2006 rate applications and is not designed to consider a permanent policy rule. Otherwise, it is submitted that more than one-half day should be devoted to the assessment.

Furthermore, it is submitted that the legal issue is real and deserves serious consideration if a longstanding rule is being contemplated. As the Board pointed out in its decision EB-2005-0315, the powers of the Board in this area are limited. There the Board stated:

“For present purposes, the key point is that rate setting authority addresses the prudence of expenditures. It does not extend to ordering LDCs to engage in specific demand management activities.”

and

“As a result, like the OPA, LDCs have the ability to provide a number of CDM services at their discretion. Also, like the OPA, LDCs do not require prior Board approval, and the Board does not have the authority to direct them to do so.”

Dealing solely with the policy issue, it is submitted that, in the present circumstances, the Board should not order an LDC to spend money on CDM programs beyond the amount proposed in the present rate applications. There are several reasons for this including the following.

1. The electricity industry Ontario has only recently embarked on CDM programs and experience is lacking. The “third tranche” CDM funding is transitional in nature and was deliberately structured to allow a measured ramp-up with limited risk to LDCs. These plans have only just been approved by the Board after extensive public review. To modify these approved plans now would undermine confidence in the Board’s process, cause confusion in the industry,

and increase risk for the LDCs.

Affidavit of Todd Williams, paragraph 10 (TAB A)

2. As the Board saw in considering the third tranche proposals, ramping-up CDM spending from a zero base gives rise to concerns about the utility's ability to deploy funds prudently and efficiently. Networks' proposed CDM spending, as already approved by the Board through 2007, is comparable to that of Ontario gas utilities which have a well established base of spending and considerably more experience. Simply put, the ability of LDCs to effectively spend more than they have proposed is seriously in question.

Affidavit of Todd Williams, paragraph 15 - 18 (TAB A)

3. Networks' proposed spending for 2006 approximates one percent of distribution revenues, exclusive of commodity costs. It is submitted that basing a distributor's proposed CDM spending levels on revenues which include an unpredictable and fluctuating component such as electricity commodity costs is inappropriate.

Networks interrogatory response to GEC #5 (TAB 1)

4. More information is required through experience before any additional funds should be spent on CDM. Present CDM plans include pilot projects which are designed to provide important information which will assist in the design of more effective CDM programs in the future. Further, the rules governing second generation CDM are not well defined and the role of other authorities such as the Ontario Power Authority is not clear. As the framework for CDM becomes more

clear over time, LDCs will increase CDM funding.

Affidavit of Todd Williams, paragraph 12; paragraph 23 (TAB A)

5. There is understandable uncertainty about the details of the regulatory framework which will govern the ability of the utilities to recover any such expenditures. This very process has created uncertainty as it appears to revisit firm decisions recently released in the form of the Total Resource Cost Guide and the Distribution Rate Handbook.

Affidavit of Michael Brophy, paragraph 23 (TAB B)

RP-2004-0188, "2006 Electricity Distribution Rate Handbook," Report of the Board, May 11, 2005, pages 104 - 105 (TAB E)

6. Overall direction with respect to CDM matters would best come from an agency with broad powers and responsibilities in the area, like the Ontario Power Authority. This agency has the mandate and the authority to implement CDM initiatives which will allow efficient and consistent application on both the supply and distribution sides throughout the province.

Affidavit of Paul Ferguson, paragraphs 17 - 26 (TAB C)

Should the Board consider it advisable as a matter of policy to order additional CDM spending, it is submitted that the LDC should be fully protected. There must be prospective approval of the plan with assurance that the costs will be fully recovered. To compel a utility to increase expense beyond that which it thinks prudent without such protection would amount to confiscation of assets and would contravene well established legal and regulatory principals.

(ii) **“Should the Board require LDCs to demonstrate freeridership levels for all CDM programs on a program by program basis?”**

It is submitted that LDCs should not be required to demonstrate freeridership levels on a program by program basis for the following reasons.

1. The Board has just established applicable freeridership estimates for the purpose of approving CDM plans in the TRC Guide published September 8, 2005. To change the requirements now would cause great confusion and uncertainty, particularly in the early transitional period of CDM activity.

Affidavit of Todd Williams, paragraph 24 – 25 (TAB A)

2. To modify the TRC Guide so soon after its release would undermine confidence in the Board’s process. This very question was considered by the Board in its report and addressed in Appendix A where it stated:

“The Board recognizes that freeridership is a function of program design, *interalia*, and for any individual custom project the issue of freeridership is binary. The participant would either have undertaken the measure without the distributor’s involvement or it would not have. (i.e. either a freerider or not) However, studies commissioned by Enbridge Gas Distribution Inc. and Union Gas Limited indicate on average, the level of freeridership (not including spill-over) was 30 percent or greater. Without better information, the Board will be guided by these values.”

In effect, the Board is being asked to reverse itself a few months after the release

of its report.

3. It is desirable that clear, firm rules apply prospectively for the assessment of CDM programs and that they not be subject to retroactive review. Development of freeridership levels on a program by program basis is estimated to take six months before Board approval could be obtained. Such a requirement would delay implementation of CDM programs and divert funds from the programs themselves.

Affidavit of Todd Williams, paragraph 30 – 31 (TAB A)

Affidavit of Michael Brophy, paragraph 6 – 13 (TAB B)

Affidavit of D. Heeney, page 9 (TAB D)

4. It must be remembered that CDM funding is in a transitional phase. It would be better to wait for information to be developed through presently planned programs and pilot projects before attempting to establish the methodology for calculation of program by program freeridership values. Furthermore, such undertakings should be co-ordinated with other agencies such the OPA which might undertake research to refine the freeridership estimate set out in the guide.

Affidavit of Todd Williams, paragraph 37 (TAB A)

Affidavit of D. Heeney, page 10 (TAB D)

- (iii) **“Should the Board order that an LDC should only be entitled to claim incremental benefits associated with its participation in a CDM program with a non-rate regulated third party?”**

It is submitted that LDCs should not be limited to claim incremental benefits associated with its participation in a CDM program with a non-rate regulated third party for the following reasons.

1. Once again, the Board has already determined the appropriate treatment for such benefits in the TRC Guide recently issued. During that process the issue of freeridership and rules of attribution were examined by the participants and after submissions the Board reached a decision. Specifically, the Board considered and rejected the Pollution Probe proposal at Appendix A, page 5. There is no reason for the Board to reverse itself a few months later and to do so would create unnecessary confusion and undermine confidence in the Board's processes.

The Total Resource Cost Guide, page 16, TAB F

The Total Resource Cost Guide, Appendix A, page 5, TAB F

2. To restrict LDCs to demonstrated incremental benefits only would impose a rigour which would be inconsistent with the Board's findings regarding the transitional nature of the third tranche CDM framework laid out in the TRC Guide and would cause delay and incremental costs.

Affidavit of Todd Williams, paragraph 35 (TAB A)

3. If the Board were to implement such a requirement, it is submitted that the determination should be made prospectively on a Board approved methodology. To develop such a methodology now would delay implementation of CDM

plans already committed and would divert funds from the programs themselves.

Affidavit of Todd Williams, paragraph 36 (TAB A)

4. It is premature to approve a methodology for the attribution of benefits pending development of the information which will be available from the programs already committed.

Affidavit of Todd Williams, paragraph 37 (TAB A)

All of which is respectfully submitted

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