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BY COURIER

May 26, 2008

Ms. Kirsten Walli
Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON.
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Dear Ms. Walli:

EB-2008-0003 – OEB Review of Cost Responsibility Policies for Connection to Electricity Transmission Systems – Hydro One Networks' Additional Comments

On February 14, 2008, Hydro One Networks Inc. ("Hydro One") participated in an initial meeting with stakeholders, arranged by the Board to solicit input on the issues to be addressed in this policy review. We found the meeting most informative, as it allowed stakeholders to offer various viewpoints for discussion, and exposed areas where there is an opportunity for further exploration, clarifications, and convergence.

Hydro One recognizes that the Board seeks to issue a discussion paper in the coming weeks. We are offering these comments in addition to Hydro One's previous submissions of February 11, 2008, and to the oral comments we provided at the meeting. They reflect additional considerations and observations made by Hydro One since the February 14 sessions, and focus on five specific areas. We hope that this input will assist the Board by highlighting areas where there are opportunities for more discussion and for finding common solutions.

Hydro One encourages the Board to engage stakeholders in further dialogue, through written submissions and also oral consultations.

We look forward to the Board Staff discussion paper and the next stage in the consultation.

Sincerely,

ORIGINAL SIGNED BY SUSAN FRANK

Susan Frank

Attach.

Hydro One Additional Comments
Transmission Connection Cost Policy Review

On February 14, 2008, Hydro One Networks Inc. ("Hydro One") participated in the Ontario Energy Board's stakeholder consultation in support of the Board's Transmission Connection Cost Responsibility (TCCR) policy review. In addition to making presentations in that forum, Hydro One also submitted written comments on the subject on February 11, 2008. Hydro One's written comments, presentation material and oral comments addressed cost responsibility for both Generation and Load Connections, as both areas are of significance to Hydro One and its customers.

Hydro One found the stakeholder consultation on February 14 especially informative. The format and agenda of the sessions allowed various stakeholder viewpoints to surface and be discussed, and highlighted not only areas where parties hold opposing views, but also those areas where there is room for further exploration, clarifications, and convergence. Hydro One recognizes that the Board seeks to issue a discussion paper in the coming weeks. We offer the following additional comments and observations in the hope that they will assist the Board by highlighting areas where there are opportunities for finding common solutions.

It is also Hydro One's hope that the Board will engage stakeholders in further dialogue, not only through written submissions, but also by using oral consultations which offer additional opportunities for dialogue and exchange of ideas.

Our comments address five areas where we offer new or changed observations from our previous submissions:

1. Terminology
2. Enabling facilities -- the transmitter's role
3. The "who builds" issue
4. Funding of modifications to customer-owned facilities
5. Addressing transmission impacts of distribution-connected generation:

1. Terminology: While this may seem like a minor issue of "semantics", during the February 14 session it became apparent to Hydro One that stakeholders do not necessarily share a common language in their discussions of transmission connection cost responsibility. It is possible that, through the adoption of common terminology and definitions, positions that previously seemed to diverge may be found to actually be in agreement. Some prominent examples follow:

i *What are Enabler Lines?* The OPA and its IPSP do not explicitly define this important term; yet, the cost responsibility for enabler lines is a key issue in setting generation connections policy. We encourage this review to confirm whether enabler lines are those lines that serve "clusters" of generation, and if so, what constitutes a cluster? Must clusters comprise only wind, only renewables, or any source of generation? Are all enabler lines radial, or can they be looped/networked? Where is the boundary between an enabler and a generation connection? And should the term "enabler lines" be replaced with the more general and inclusive term "*enabler facilities"*, as suggested by both the OPA and Hydro One?

ii *Is Socialization a regulatory mechanism?* Hydro One has been careful to use the term "pooling" when referring to the mechanism whereby costs are to be borne by the broader customer base. If any aspect of Transmission Connection Cost Responsibility is to be shifted from one group to another, larger group, it is important to define the nature of this transfer. It would be helpful to replace "socialization" by a more precise and meaningful term, whether it refers to a transfer of costs:

- from connecting customers to the overall connection pool;
- from connecting customers to the network pool; or
- from connecting customers to a new rate pool.

We suggest that policy changes that would result in a shifting of costs from connecting customers to all consumers through a "social" subsidy are outside the scope of this proceeding, as they extend beyond regulatory policies into the realm of government policy.

iii *How are system reliability and integrity defined?* These terms appear in the Transmission System Code (s. 6.3.6) and currently play a role in the determination of

cost responsibility for connection facilities. Hydro One would welcome clear definitions of these terms, and, as noted in our submissions, suggests that these be tied to documented standards. However, we note that even with better definitions of these terms, it is still not possible to clearly delineate transmission plans that are driven by system reliability and integrity from those driven by load growth. Cost responsibility for load connections should not hinge on such determinations.

2. Enabling facilities and the Transmitter's role: Our observation is that there is near consensus among stakeholders that the cost of enabler lines should be pooled, but the definitions and mechanisms for doing so are still unclear. In its February submissions, Hydro One articulated several options for the pooling of enabling facilities, and we were further informed by the research brought forward by Brookfield and others. Indeed, a number of options exist. From a transmitter's perspective, the key consideration is that any upfront development costs and the cost of construction must be fully recovered without delay, so that undue risk is not shifted to the transmitter. From whom these costs are recovered, and by what mechanism, are issues that remain to be determined in this proceeding, but if the intent is that transmitters take the risk of "build it and they will come", this would have to be accompanied by a corresponding adjustment to the return on equity that transmitters are allowed. North American experience has been that little transmission is built without assurance of cost recovery that includes appropriate returns.

Lead times in planning: The OPA's planning processes should recognize the long lead times required for transmission build. When coupled with the gradual infill of generation, this means that development and construction activities need to start many years before the facilities are fully used and useful. In light of the consultations to date, Hydro One believes even more firmly that there is a need for the OPA, not only through its IPSP, but also through an ongoing planning process ("between" IPSPs), to determine and declare the need for new facilities as early as possible.

Development work: The discussion on February 14, 2008, brought forward differing views on whether development costs are simply "the cost of doing business" or should be

subject to Board oversight and recovery. The outcome of this debate will dictate whether duplicate development costs are allowed. Hydro One's view is that the duplication of effort for development work is not cost-effective, especially in an environment of constrained resources. Development cost has value in itself, even if the facilities are never built, because it may very well be the development work that determines that a certain option is not economic or worth pursuing further. Transmitters must be allowed to recover the cost of this work, whether or not the project proceeds. Hydro One would like to see this policy review determine the points at which development costs can be recovered, and suggests that two stages of development can be identified for this purpose. Stage I of development would be complete when the OPA selects a preferred option based on the transmitter's work, and Stage II when EA and Section 92 approvals are at hand. Transmitters should be allowed to accumulate costs in a deferral account and to recognize and/or recover these costs at the completion of each of the two stages.

Cost Recovery for assets that may not yet be "used and useful. The requirement for assets to be "used and useful", which until now has been a basic tenet of regulation, is no longer applicable when dealing with enabler facilities. By definition, enabler facilities are not necessarily used and useful when they come into service. This reality requires a paradigm shift by regulators, so that transmitters can earn a fair return on facilities that they must construct but that are not yet necessarily used and useful. This is especially the case for facilities that are constructed to meet a need identified by the OPA. With a large "transmission build" looming in Ontario and a significant capital outlay by transmitters for long lead-time projects, Hydro One encourages the Board to consider mechanisms that will allow transmitters to recover their costs sooner. Hydro One's previous proposal (in EB-2006-0501) to allow the early recovery of capital may have merit here. Simply put, Ontario, like other jurisdictions, should consider the need or incentives to build adequate transmission, just as it views the need for CDM to enable the conservation culture with costs recovered as spent and the need for renewable generation to enable the government's supply mix directive. Both CDM and renewable generation are supported by incentive-based programs, and Ontario may benefit from providing incentives for transmitters to put in place the needed infrastructure. Transmitters should be allowed to

recover the costs on an as-spent basis as part of the annual rate-setting and similar in concept to the "capital module" being discussed in the Board's 3rd Generation IRM initiative.

Treatment of capital contributions from connecting customers: Hydro One recognizes that as part of this proceeding, the OPA and/or OEB may need to define a settlement process where the costs of the enabling facilities can eventually be recovered from generators (to the extent that they are to be charged to generators) and returned to transmission ratepayers (to the extent that ratepayers may have pre-funded these facilities). It is Hydro One's view that these settlement activities are more efficiently carried out by the IESO using its existing processes, and that this would reduce costs for ratepayers. Transmitters should be at arm's length from any such settlement activities. Any capital contributions or rates payable by generators or loads would be credited to ratepayers via the IESO, as part of the existing processes that the IESO uses to settle transmission revenues. As these costs are collected and returned to transmitters, they could be used to reduce rates to customers and/or used to reduce the asset base.

The concept of involving the IESO in this settlement process may at first seem curious, especially in light of transmitter's historical role in collecting capital contributions from connecting customers. However, the difference here is that the enabling assets would have already been paid for and included by the transmitter in its rates. The mechanism that the OPA uses to collect the "fair share" from connecting parties and the basis for these contributions need not be of significance to the transmitter and is closely related to the OPA's contractual relationship with these parties. Once collected, these contributions should be viewed by the IESO as just another source of revenue to be disbursed among transmitters, in accordance with Board-approved principles.

Under this arrangement, during the procurement and connection phases, transmitters would not have a commercial relationship with customers who connect to enabling facilities

By asserting the OPA's role in the planning, and the OPA's and IESO's roles in the settlement of these "fair share" obligations, the OEB would provide ratepayers and itself with the necessary assurance that transmitters are at arm's length from the any investment decision for facilities that are not immediately used and useful.

In Summary, Hydro One recommends the following process, in chronological order:

- NEED DEFINITION: OPA identifies and defines the need, with adequate lead times
- DEVELOPMENT WORK by the transmitter, with cost recovery
- EARLY EQUIPMENT ORDERS by the transmitter as required to meet in-service dates, with recovery
- OPA/ OEB APPROVAL OF PREFERRED OPTION based on development work and other considerations (e.g. procurement)
- In the event that the OPA decides at any stage that the option should not be pursued, transmitters should be reimbursed for any wind-up or decommissioning costs
- CONSTRUCTION AND RECOVERY of costs incurred to date, through the annual rate-setting process.

3. Who builds: The question of "who builds" is not one of outsourcing the construction of transmission facilities (which is a current practice of transmitters), but more accurately "who is accountable for building?" and maybe even "who owns and operates?" the transmission.

Hydro One continues to maintain that this issue is not appropriate in this policy review, but we were informed by the consultation that other parties may wish to have this question addressed sooner, rather than later. Hydro One's view is that a multiple transmitter model that extends beyond the existing situation in Ontario would introduce added complexity at all stages --from development through operations. It is for this reason that the norm in North America is that incumbent transmitters build, own and operate transmission in their respective service territories.

Hydro One proposes that, should the Board elect to pursue this discussion, the following constraints should be imposed up from the outset:

- The discussion of "who builds" should be undertaken only if it is needed to facilitate policy on "who pays" for construction of enabling facilities;
- Any discussion of "who builds" should be limited to the construction of radial enabling facilities;
- Operation of radial enabling lines, if constructed by others, be coordinated (through agreements) with the transmitter to whose assets these facilities are connected;
- As a principle, any processes (e.g. selection and approvals) that allow construction of transmission facilities by multiple entities would need to ensure that they do not compromise critical lead times, do not increase the overall cost of developing and constructing infrastructure, and do not lead to duplicate or suboptimal facilities being put in place.

Given the interest of some stakeholders in exploring the construction and ownership of assets by multiple parties, and in taking guidance from other jurisdictions, Hydro One continues to monitor experiences of others, paying with attention to

- inter-jurisdictional differences in government policy, regulation, and the overall electricity industry structure,
- the analysis that such jurisdictions may have conducted in taking their decisions, and
- the actual experience to date with the model in question.

4. Funding of modifications to customer-owned facilities: An area of cost responsibility that has not yet been discussed in this proceeding has recently come to Hydro One's attention. Certain transmission enhancement projects, initiated by the transmitter, can require investment in connection facilities. Such investments can fall into two categories:

- Transmitter-owned assets: Hydro One's understanding is that investment in transmission assets should be viewed as facilities that were "otherwise planned" by

the transmitter, and not customer-driven. As such, these should qualify for the exemption in Section 6.3.6 of the Code and would not attract a customer contribution. Such investments would be funded from the rate pool.

- Customer-owned assets: Certain projects (e.g. voltage conversions) could result in changes that must be made to customer-owned facilities. According to the Board's rulings, transmitters cannot execute this work, which is the customer's responsibility. However, the funding mechanism for such investment (whether from the pools or from the customer) needs to be clarified. It could be argued that the customer should pay for such work and that this is a natural consequence of the decision of the customer to own connection facilities. Conversely, it could be argued that these costs are the direct result of changes to the transmitter's system that are for the benefit of all customers and hence should be funded by a contribution from the transmitter (the rate pool) to the customer.

Hydro One would appreciate the inclusion of this issue in this policy review.

5. Inclusion of the impacts of Distribution Connected generation: In the initial scoping of the TCCR, there was an expectation that, while distribution-connected generation has an impact on Transmission and raises issues of cost responsibility, these issues are best dealt with in the Distribution Connection Cost Responsibility Review. In its earlier submissions, Hydro One encouraged the Board to include these issues in the current proceeding. Discussion with Board staff and other stakeholders suggest that it would be helpful if Hydro One elaborated on the rationale and especially on the mechanism for doing so. Understandably, there was a concern that inclusion of this aspect in the current review would expand it to the point of supplanting the Distribution Cost Responsibility proceeding.

Hydro One believes that this need not be the case. The issue of cost responsibility associated with distribution connecting generators can, and in our view should, be viewed in two parts. First, there is the cost responsibility between the generator and the distributor for (i) the actual connection, (ii) any system expansion, and (iii) upgrade,

reinforcement or other enhancements to the distributor's system. These issues are rightly dealt with in the Distribution Connection Cost Review (DCCR) and are mostly covered in the DSC. They need not be introduced into the TCCR, and Board Staff is correct in its view that doing so would significantly expand the scope of the discussion.

Secondly, though, there is the issue of cost responsibility for transmission investments that are required to accommodate the distribution-connected generator. Such investments could include upgrades to address system limits (e.g. reverse flow limits) or to address issues identified in the IESO's System Impact Assessment. Cost responsibility in these scenarios is usually an issue between the transmitter and the distributor who is hosting the generator and who will have a connection agreement with the generator. The expectation in this case is that any costs that must be borne by the customer would be recovered by the transmitter from the distributor, and it is assumed that the distributor would in turn collect the costs from the generator or perhaps from all other sources. The cost responsibility split between the transmitter and the distributor needs to be determined in the TCCR and is a TSC consideration. The vehicle for any recovery of the costs by the distributor -- and whether the costs are recovered from the generator, all generators on an average cost basis, or from load customers through rates -- are issues for the DCCR.

Our view is that approaching this issue in this managed, two-stage manner would ensure that transmission issues are addressed in the TCCR, and distribution issues in the DCCR, each with the right group of stakeholders involved.

Secondly, the inclusion of distribution-connected generator considerations in this policy review would guarantee that accountability for costs incurred to incorporate generation on the transmission system is treated in a consistent matter, whether the connecting generator is on the transmission or the distribution system. This would avoid discrimination that is based on the connection voltage and would also minimize the risk of inadvertently introducing uneconomic behavioural drivers causing generators to connect to one system or the other solely because of cost responsibility differences.

It would also ensure that the TSC, should it need to be amended, would be amended only once, through the TCCR, because even distribution-connected generator impacts on transmission would have already been dealt with by the time the DCCR is underway.

Hydro One appreciates the Board's consideration of these comments and looks forward to Board Staff's discussion paper on the Transmission Connection Cost Review.

Prepared and submitted by
Hydro One Networks
May 26, 2008