



**EB-2011-0399**

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

**AND IN THE MATTER OF** an application by Hydro One Networks Inc. for an order or orders approving a distribution revenue requirement and rates and other charges for the distribution of electricity;

**AND IN THE MATTER OF** a request by Hydro One Networks Inc. for Approval for the use of the USGAAP accounting standard for Rate Setting, Regulatory Accounting and Regulatory Reporting, as of January 1, 2012, in its Distribution business.

**BEFORE:** Paul Sommerville  
Presiding Member

Ken Quesnelle  
Member

## **DECISION AND ORDER**

### **Background**

Hydro One Networks Inc. ("Hydro One") is a licensed Ontario electricity distributor.

On November 23, 2011, the Ontario Energy Board (the "Board") issued its EB-2011-0268 Decision with Reasons granting approval for Hydro One Networks Inc. Transmission to utilize United States Generally Accepted Accounting Principles ("USGAAP") as the basis for rate application filings, regulatory accounting and regulatory reporting commencing January 1, 2012.

In its findings in the EB-2011-0268 proceeding, the Board noted that "...its policy states that a cost-of-service application is required for approval to transition to USGAAP. However, given the unique circumstances of Hydro One Transmission and Hydro One Distribution, the Board does not believe this applicant should be precluded from applying to extend the use of the USGAAP accounting standard to the Distribution business on appropriate terms and conditions, as a stand-alone application."

On December 1, 2011, Hydro One filed an application requesting approval to utilize USGAAP for rate setting, regulatory accounting and reporting as of January 1, 2012, for its distribution business. The Board assigned file number EB-2011-0399 to the application.

The application included:

- Evidence addressing the justification of the move to USGAAP;
- The decision of the Ontario Securities Commission (OSC) granting Hydro One permission to use USGAAP in its financial statements filed with the OSC for the fiscal year beginning January 1, 2012;
- Hydro One's request to the OSC, incorporating the rationale for its request for permission to use USGAAP in its financial statements filed with the OSC;
- The Board's Decision With Reasons in the EB-2011-0268 proceeding; and,
- A summary of the regulatory asset accounts that would be requested, continued and discontinued if adoption of USGAAP is approved.
- A copy of Ontario Regulation 395/11 under which Hydro One Inc. is required to prepare its financial statements in accordance with USGAAP, beginning January 1, 2012.

In the application, Hydro One estimated that the 2012 notional Hydro One Distribution revenue requirement would be \$166 million higher if Modified International Financial Reporting Standards ("MIFRS") were utilized rather than USGAAP. This would result in an approximate rate increase of 14% in 2012 if MIFRS were used for rate making instead of USGAAP.

With regard to deferral and variance accounts, the Application sought the Board's approval to:

- discontinue the Impact for Changes in IFRS Account,
- continue (with a revised scope) the IFRS Incremental Transition Costs Account, and
- establish a new Impact for US GAAP Account.

As part of the application, Hydro One also informed the Board that it was not requesting any change to its approved 2011 or 2012 distribution rates. Hydro One expects that its currently approved 2011 distribution rates will continue into 2012 and all appropriate costs will continue to be tracked in Board approved deferral and variance accounts, including its Green Energy related expenditures for Smart Grid, Express Feeders and other renewable generation.

### **The Addendum**

The Board's *Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment* (EB-2008-0408) (the "Addendum") issued on June 13, 2011, sets out the Board's expectations regarding proposals to use USGAAP:

"A utility, in its first cost of service application following the adoption of the new accounting standard, must demonstrate the eligibility of the utility under the relevant securities legislation to report financial information using that standard, include a copy of the authorization to use the standard from the appropriate Canadian securities regulator (if applicable) showing any conditions or limitations, and set out the benefits and potential disadvantages to the utility and its ratepayers of using the alternate accounting standard for rate regulation.

The Board cautions utilities that the adoption of USGAAP as a short term solution may be counter-productive. If a utility is required to transition to IFRS for financial reporting purposes a few years after adopting USGAAP, certain transitional issues may not have been avoided, but delayed, and additional costs may be incurred if the utility changes its accounting standard twice. The Board will carefully scrutinize the costs incurred to accomplish two successive transitions if the utility seeks to recover these costs from ratepayers."<sup>1</sup>

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<sup>1</sup> *Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment* (EB-2008-0408) (the "Addendum") June 13, 2011, page 19

As in the transmission USGAAP case, the Board will use the provisions set out in the Addendum to address the USGAAP request from Hydro One Distribution.

### **The Proceeding**

On December 13, 2011, the Board issued its Notice of Hearing and Procedural Order No. 1 regarding this application. The Board granted intervenor status to all intervenors in the previous Hydro One Distribution proceeding (EB-2009-0096) and intervenors in the Hydro One Transmission USGAAP proceeding (EB-2011-0268).

Procedural Order No. 1 provided for interrogatories to be submitted by Board staff and intervenors and for Hydro One's responses. Interrogatories were submitted by the Vulnerable Energy Consumers Coalition (VECC), the Canadian Manufacturers and Exporters (CME), the School Energy Coalition (SEC), and Board staff.

Hydro One provided interrogatory responses on January 16, 2012 and also included Miscellaneous Exhibit K-1-1 which included all interrogatory responses from the EB-2011-0268 (USGAAP for Hydro One Transmission) proceeding.

Provisions for submissions by Board staff and intervenors, and reply submissions by Hydro One, were also made in this procedural order. Submissions were received from VECC, CME, SEC, the Builder Owners and Managers Association Toronto ("BOMA"), the Power Workers Union ("PWU") and Board staff. Hydro One submitted its reply submissions on February 7, 2012.

### **Positions of the Parties**

#### *Adoption of USGAAP for Hydro One Distribution*

Intervenors and Board staff generally supported Hydro One's request to utilize USGAAP as the regulatory accounting and rate setting framework for the company's distribution business. As in the Hydro One Transmission USGAAP case (EB-2011-0268), all parties were satisfied that the transition to USGAAP instead of MIFRS would be of substantial benefit to ratepayers and stakeholders. The parties cited the following benefits from adopting USGAAP:

- Reduced revenue requirement and rate impacts;
- Increased rate stability as USGAAP is very similar to Canadian GAAP; currently being used by Hydro One, and deferral and variance accounts can continue to be used if rate smoothing is needed;

- Reduced regulatory compliance costs since Hydro One will not have to duplicate transactional accounting in two sets of books and reconcile them; and
- Alignment of the accounting frameworks used for external financial reporting and rate making providing a clearer and more understandable relationship between the accounting basis used to set rates and that used to report results.

In general there was agreement that Hydro One had satisfied the Board's criteria of demonstrating the required eligibility under relevant securities legislation, and had filed the required copy of the authorization to use the USGAAP accounting standard from the appropriate securities regulator. In addition, it was noted that Hydro One was also subject to Regulation 395/11, which mandated the preparation of its financial statements using USGAAP.

However, intervenors and Board staff did voice concerns in a number of areas, summarized below:

#### Benchmarking

Several intervenors and Board staff were concerned that Hydro One's transition to USGAAP would not facilitate benchmarking of its results with those of other local (Ontario) electric distribution utilities.

VECC pointed out that this issue is more significant for Hydro One's distribution business than for its transmission business, as Hydro One's transmission business tends to be benchmarked against major US Transmission companies (subject to USGAAP) while its distribution business is generally benchmarked against other Ontario distributors (generally using MIFRS).

VECC submitted that Hydro One was unresponsive, when asked through interrogatories, to address difficulties in benchmarking. Hydro One indicated that it did not have any further insight to offer on the types of "high level adjustments" it anticipates making in order to allow its results to be comparable to those of other Ontario distributors. In addition, Hydro One did not indicate (as requested) what work it was undertaking to address the issue and/or what had been completed to date.

VECC submitted that the Board make clear that it expects a constructive response to be provided in Hydro One's next Distribution Rate Application. VECC also cautioned that adoption of USGAAP (ultimately) should not be used by Hydro One as a rationale/excuse as to why benchmarking does not work for its distribution business.

CME had similar concerns and expressed disappointment, as Hydro One could not provide a date for when it would be making its next Cost of Service Application, and by extension, submitting the required benchmarking evidence.

SEC also expressed disappointment that Hydro One did not have any preliminary information on benchmarking. In addition, SEC submitted that with regard to benchmarking, a significant difference in capitalization policies (among Ontario distributors) may become a problem, since Hydro One's OM&A may be relatively lower, but rate base relatively higher, than its peers due only to a difference in accounting methodology. SEC submitted that it would be useful if Hydro One integrated the study of its capitalization policy with its consideration of the benchmarking/comparative analysis issue, as one may be largely driven by the other.

The PWU submitted that benchmarking studies that are not based on total cost comparison are flawed regardless of similarities in the accounting standard adopted by the utilities. PWU maintained that benchmarking studies that have attempted to compare Hydro One with other utilities in the past have not been based on total cost and have ignored the unique nature of Hydro One's service territory. It is not convincing therefore to assume that a meaningful and objective comparison could be made simply because utilities follow similar accounting standards.

PWU also stated that it could be argued that having Hydro One Distribution report on the basis of USGAAP might improve the ability to benchmark Hydro One against comparable large North American utilities using USGAAP.

Board staff stressed the importance of benchmarking, noting how the Board had, in past cases, relied on benchmarking evidence in its decision making processes.

Board staff submitted that Hydro One Distribution should propose specific solutions in its next rates application for benchmarking to other distributors in Ontario or comparable distributors in Canada that do not adopt USGAAP. Staff indicated that the Board may wish to provide specific direction to Hydro One to provide solutions at the time of its next rebasing application filing to address concerns related to benchmarking.

Board staff submitted that as part of Hydro One Distribution's next cost of service application, Hydro One should include the results of its capitalization review, including information with respect to what other Ontario distributors or comparable distributors to Hydro One in Canada or US typically capitalize. The evidence in the distribution cost of service application should include information regarding the capitalization policies and methodologies used by other Ontario distributors, and comparable Canadian and US distributors, with a view to comparing these to Hydro One's capitalization policies.

In reply, Hydro One indicated that it is cognizant of the benchmarking concerns of the intervenors and that it will respond in its next rates case. Hydro One stated that it believes that it will continue to benchmark with other local utilities and that OM&A cost comparisons can still be made with appropriate top-down adjustments.

Hydro One submitted that total cost benchmarking will be more of a challenge as time passes due to the inclusion of depreciation expenses in total costs. Hydro One stated that it will work toward developing solutions to allow appropriate total cost benchmarking in the short and longer term. However, Hydro One cautioned that, as the Board and its expert has recognized in the past, there is a difficulty in benchmarking Hydro One distribution to other Ontario LDCs due to the fundamental differences in their businesses.

### Capitalization

SEC expressed concern, as it did in the Transmission USGAAP proceeding, regarding the high level of overhead capitalized by Hydro One compared to other utilities. SEC noted that the Board, in the EB-2011-0268 Transmission Decision, directed Hydro One to do a comparative analysis of its capitalization policies and report in its “next rate application”. SEC requested that the Board, in its decision in this proceeding, to specify that the comparative analysis should apply to distribution as well as transmission, and the report should be filed in the rate applications for both transmission and distribution.

Also, as noted above, SEC submitted that Hydro One should integrate the study of its capitalization policy with its benchmarking efforts.

Board staff, as noted above, submitted that as part of Hydro One Distribution’s next cost of service application, it should include the results of its capitalization review, including information with respect to what other Ontario distributors or comparable distributors to Hydro One in Canada or US typically capitalize. The evidence should include information regarding the capitalization policies and methodologies used, with a view to comparing these to Hydro One’s capitalization policies.

In its reply submissions, Hydro One indicated that it will respond as directed in the EB-2011-0268 Decision and notes that it utilizes the same overhead capitalization methodology in both Transmission and Distribution, so that issue will be addressed at that time.

### 2012 Distribution Rate Application

In its submissions, CME also focused on the fact that Hydro One has chosen not to file a distribution rate application for 2012 rates, and that its currently approved 2011

deferral and variance accounts will continue to operate through 2012 in conjunction with the currently approved 2011 distribution rates. CME also noted that Hydro One could not confirm when it plans to submit its next Distribution Cost of Service rate application.

CME submitted that the deferral account continuance is of concern, particularly if there are large debit balances in existing deferral accounts and the likelihood that further significant debits will accrue in those deferral accounts during 2012.

CME noted that it had sought information from Hydro One pertaining to the deferral account balances at the end of 2011 and the likely changes to those deferral account balances during 2012 (assuming operations in 2012 under USGAAP). Hydro One declined to provide the information requested on the basis that it is "out of scope" of the current proceeding. CME maintains that, as a result, there is no information available to enable the Board to determine whether Hydro One's proposal to refrain from clearing 2011 deferral account balances and to continue to accumulate amounts in those deferral accounts throughout 2012 is appropriate.

CME expressed concern that there may be large amounts accumulating in those deferral accounts and it urged the Board to refrain from countenancing Hydro One's refusal to provide current and estimated deferral account balances.

To that end, CME requested that the Board direct Hydro One to provide this information before the Board implicitly authorizes an action plan that would allow large amounts to be accumulated in those accounts to December 31, 2012. In addition, CME submitted that once Hydro One had provided the balances in deferral accounts as of December 31, 2011 and estimated the balances for December 31, 2012, interested parties should be allowed an opportunity to make submissions as to whether existing December 31, 2011 balances in the accounts should be cleared, rather than being allowed to accumulate interest for another twelve months along with additional 2012 charges to these accounts.

SEC noted that the current application is limited to the USGAAP issue, and does not appear to seek approval to continue all 2011 deferral and variance accounts into 2012. SEC submitted that Board approved deferral and variance accounts do not continue beyond their originally intended time period unless the Board so orders, and, as there does not appear to be any evidence in this proceeding on which such an order could be based, requested that the Board make clear in its decision that it is not, either directly or by implication, approving or consenting to Hydro One's proposal to continue all of its 2011 deferral and variance accounts into 2012.

In its reply argument, Hydro One submitted that these accounts will be subject to the Board's normal prudence review prior to the disposition of any balances as part of the next distribution cost of service proceeding.

### **Board Findings**

In its Hydro One Transmission USGAAP decision (EB-2011-0268) the Board approved Hydro One's request that it be authorized to use the USGAAP accounting standard for regulatory purposes associated with its transmission business.

The Board has reviewed its reasoning in that decision and finds that it is substantially applicable and relevant to this application. The Board finds that it is appropriate that Hydro One be permitted to use USGAAP as the accounting standard for regulatory purposes associated with its distribution business as well.

Having adopted the reasoning in the EB-2011-0268 decision, the Board wishes to address a number of circumstances, specific to an Ontario distribution utility, that must be addressed in this decision.

First, as is well known to the electricity distribution industry in Ontario, the Board regards benchmarking to be an important regulatory tool. Over the last number of years the Board has spent considerable effort developing a benchmarking methodology which has had an evolving role in distribution rate approval. The use of USGAAP by Hydro One Distribution could have the effect of making benchmarking between Hydro One and other Ontario distributors more difficult in that it will require a well planned and purposeful analytics application to effectively provide useful knowledge.

The Board considers it important that Hydro One Distribution develop a definitive methodology which will allow its results to be appropriately comparable with the results of other distribution utilities in Ontario. This may mean that Hydro One will have to maintain parallel statistics or develop factors which will enable its financial results to be accurately comparable to the results of other distributors in the province.

The Board notes Hydro One's submission, that because of the unique nature of its operation and its service territory, the comparability of Hydro One Distribution to other Ontario distributors is problematic. The Board recognizes that there are some aspects of Hydro One's distribution system and service territory that complicate benchmarking. Nevertheless, the Board remains convinced that it is important that a methodology be found which advances such benchmarking to the extent possible.

Second, in addition to benchmarking, intervenors and Board staff raised concerns with respect to the capitalization practices of Hydro One. They were concerned that use of USGAAP by Hydro One will result in capitalization practices that are materially different to those utilized by the other distributors in Ontario, and which is substantially more aggressive than may be desirable.

In its EB-2011-0268 decision, the Board directed Hydro One Transmission to conduct a critical review of its current and proposed capitalization practices. The review was not intended to be a benchmarking study per se, but it was intended to provide information with respect to what other US transmitters typically capitalize and the capitalization methodology that is employed by other transmitters. This information would be compared to Hydro One's capitalization policies. That review is to be available in time for Hydro One's next transmission rate application.

The Board notes that Hydro One has indicated that it utilizes the same overhead capitalization methodology in both Transmission and Distribution. It is the Board's view that Hydro One should conduct a similar capitalization review and comparison with respect to its distribution business and other Ontario electricity distributors. Particular consideration should be paid by Hydro One to other Ontario distributor capitalization policies that are generated under MIFRS and Hydro One should identify and justify the incorporation of any distinguishable drivers that may cause its capitalization policy to materially vary from those developed in the MIFRS regime. Results of this study should be available at the time of Hydro One's next distribution cost-of-service rate application.

Third, with regard to specific Deferral and Variance accounts, the Board agrees that the Impact for Changes in IFRS Account should be discontinued. This account has a zero balance and cannot be increased, given this decision to allow Hydro One to use USGAAP for regulatory purposes. The Board therefore finds that this account is no longer required.

Similar to the account approved in the recent Hydro One Transmission USGAAP proceeding (EB-2011-0268), the Board will also approve creation of a new deferral account entitled "USGAAP Incremental Transition Costs." This account can be used to track costs associated with the transition to USGAAP, but shall not include any costs attributable to the previously planned transition from CGAAP to IFRS. The exception would be those costs that were required for the transition to MIFRS and that are still required for the transition to USGAAP.

The Board also approves the establishment of an "Impact for USGAAP Account", which will be a symmetrical variance account to record the 2012 impact of differences

between CGAAP and USGAAP. The account will be limited to potential impacts on the 2012 revenue requirement, and not relate solely to balances incorporated into the audited financial statements. The Board approved the establishment of an Impact for USGAAP Account in the EB-2011-0268 proceeding. The Board is of the view that it is reasonable to extend this regulatory treatment to Hydro One's distribution business as the amounts that would be recorded in the account would likely relate to costs in the same corporate structure.

Upon request for disposition of the Impact for USGAAP Account, the Board will take into account whether Hydro One adequately reviewed in its application all of the impacts of the accounting changes associated with the transition.

Finally, with regard to questions raised about continuation of certain other deferral accounts (as a result of Hydro One's decision to not file a 2012 distribution rate application), these accounts will be subject to the Board's normal prudence review prior to disposition of any balances as part of the next distribution cost of service proceeding. In the event that the balances in these accounts become, in Hydro One's view, material in terms of rate impacts, it should take the steps necessary to address this situation by way of application to the Board. At that time parties can address whether the amounts in the accounts should in fact be recovered from, or returned to, ratepayers.

## IMPLEMENTATION MATTERS AND COST AWARDS

### Implementation

In this decision, in addition to approving Hydro One Distribution's use of USGAAP for regulatory purposes, as of January 1, 2012, the Board has also approved the creation of two new Deferral and Variance accounts: The USGAAP Incremental Transition Costs and the Impact for USGAAP Account.

1. Hydro One shall file with the Board, and shall also forward to intervenors, a draft Accounting Order for each of these new Deferral and Variance Accounts within **10 days** of the date of the issuance of this Decision.
2. Board staff and intervenors shall file any comments on the draft Rate Order with the Board and forward to Hydro One within **7 days** of the date of filing of the draft Rate Order.

3. Hydro One shall file with the Board and forward to intervenors responses to any comments on its draft Rate Order within **7 days** of the date of receipt of Board staff and intervenor comments.

### **Cost Awards**

A number of intervenors were deemed eligible for cost awards in the previous Hydro One Distribution EB-2009-0096 proceeding and the Hydro One Transmission USGAAP proceeding (EB-2011-0268). On December 13, 2011, the Board issued its Notice of Hearing and Procedural Order No. 1 and among other items, granted intervenor status for the Distribution USGAAP proceeding to all intervenors in the EB-2009-0096 and EB-2011-0268 proceedings. Accordingly, the Board will receive cost claims from eligible intervenors for the EB-2011-0399 proceeding and will issue a cost awards decision after the steps set out below are completed.

1. Intervenors eligible for cost awards shall file with the Board and forward to Hydro One their respective cost claims within **35 days** from the date of this Decision.
2. Hydro One may file with the Board and forward to intervenors eligible for cost awards any objections to the claimed costs within **40 days** from the date of this Decision.
3. Intervenors, whose cost claims have been objected to, may file with the Board and forward to Hydro One any responses to any objections for cost claims within **47 days** of the date of this Decision.

Hydro One Networks Inc. shall pay the Board's costs of and incidental to this proceeding upon receipt of the Board's invoice.

All filings to the Board must quote file number **EB-2011-0399**, be made through the Board's web portal at, [www.errr.ontarioenergyboard.ca](http://www.errr.ontarioenergyboard.ca) and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at [www.ontarioenergyboard.ca](http://www.ontarioenergyboard.ca). If the web portal is not available parties may email their document to the address below. Those who do not have internet access are required to

submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

All communications should be directed to the attention of the Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date.

**ADDRESS**

Ontario Energy Board  
P.O. Box 2319  
2300 Yonge Street, 27th Floor  
Toronto ON M4P 1E4  
Attention: Board Secretary

E-mail: [Boardsec@ontarioenergyboard.ca](mailto:Boardsec@ontarioenergyboard.ca)  
Tel: 1-888-632-6273 (toll free)  
Fax: 416-440-7656

**DATED** at Toronto, March 23, 2012

**ONTARIO ENERGY BOARD**

*Original Signed By*

Kirsten Walli  
Board Secretary