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BY COURIER

April 16, 2018

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON M4P 1E4

Dear Ms. Walli:

EB-2017-0338 Hydro One Networks Inc. (Transmission) – Application for an Accounting Order Establishing a Deferral Account

On November 2, 2017, Hydro One Networks Inc. ("Hydro One") submitted an application for an accounting order establishing a deferral account to capture the financial impacts associated with a change to USGAAP accounting standards related to the accounting of pension and other post-employment benefits for Hydro One's transmission business, to be effective January 1, 2018.

Pursuant to the Notice of Application and Hearing and Procedural Order No. 1, Hydro One is filing its written reply submission in this proceeding. The submission is attached to this letter and has also been filed through the Ontario Energy Board's Regulatory Electronic Submission System (RESS).

If further clarification or additional information is needed please feel free to contact us at Regulatory@HydroOne.com.

Sincerely,

ORIGINAL SIGNED BY FRANK D'ANDREA

Frank D'Andrea
Encls.

Hydro One Networks Inc.

EB-2017-0338

Reply Submission

On November 2, 2017, Hydro One Networks Inc. ("Hydro One") filed an Application ("the Application") with the Ontario Energy Board ("OEB") seeking an accounting order to establish a deferral account for its transmission business to capture the financial impacts associated with a change to the Financial Accounting Standards Board's accounting standard (ASU 2017-07) related to the accounting of pensions and other post-employment benefits ("OPEB"), effective January 1, 2018.

This is Hydro One's written reply argument. It responds to the submissions filed by OEB staff, the Society of United Professionals ("the Society") and the London Property Management Association ("LPMA"). For the reasons set out below, the continued capitalization of the affected costs should be approved consistent with Hydro One's existing policy. In the alternative, the requested deferral account should be approved.

Background

In March 2017, the Financial Accounting Standards Board ("FASB") issued an Accounting Standard Update (ASU 2017-07) that affects the accounting for pension and OPEBs. The Update is effective January 1, 2018. As part of ASU 2017-07, Topic 715 – Compensation – Retirement Benefits of the USGAAP Accounting Standards Codification was amended. The amendments allow only the service cost component of the net periodic pension cost and net periodic post-retirement benefit cost to be eligible for capitalization when applicable.

For rate-setting purposes, Hydro One accounts for its pension costs on a cash basis and therefore this amendment is not anticipated to affect the pension related amounts embedded in the OEB-approved revenue requirements for 2017 and 2018. However, Hydro One accounts for OPEBs on an accrual basis. The amendments therefore result in a re-classification of the net periodic post-retirement benefit cost other than service cost to OM&A. This will materially affect Hydro One's 2018 expenses.

Request for Approval of Continued Capitalization

Subsequent to the filing of the Application, Hydro One discussed with its auditor KPMG the requirements surrounding FASB standard ASU 2017-07, including the eligibility of utilities to continue capitalizing OPEB costs, without the requirement of a deferral account, if approved to do so by its regulator. The Federal Energy Regulatory Commission ("FERC") has provided such an approval for regulated entities under its jurisdiction.[1]

Hydro One submits that the OEB should approve the continued capitalization of the affected costs, consistent with the FERC guidance. Such a decision would achieve the same objective as the requested deferral account without the additional regulatory overhead associated with the ongoing tracking and disposition of balances in the account and would avoid material adverse rate impacts to Hydro One's customers.

Hydro One notes that the submissions of the Society and LPMA both support the continued capitalization of the affected costs as proposed by Hydro One. The concerns raised by OEB staff are discussed in a separate section below.

Proposed Deferral Account

In the alternative to continuing with Hydro One's existing policy, Hydro One submits that the deferral account should be approved to track the impact of the accounting change in 2018 and beyond. All parties that filed submissions agree that the account meets the OEB's criteria of need, materiality and prudence, as outlined by Hydro One on pages 4 and 5 of the Application.

OEB staff and LPMA submit, however, that, if approved by the OEB, the scope of the proposed account should be revised to reflect the net revenue requirement impact of the reduction to capitalized costs, not just the increase to OM&A expenses. These parties argue that Hydro One is disaggregating the impact of the accounting policy change and not fully capturing its impact. This is incorrect.

As noted in its response to OEB staff interrogatory #3, the capital-related revenue requirement impact of the accounting change will already be captured in Hydro One's In-service Variance Account. Both LPMA and OEB ignore this in their submissions.

Hydro One's In-service Variance Account, which was approved by the OEB in Hydro One's 2017/2018 transmission rate proceeding[2], tracks the revenue requirement impact of the difference between Hydro One's forecast in-service additions and actual amounts that are placed in-service in 2017 and 2018. The forecast costs that will be used as the comparison for making entries in to this account reflect Hydro One's evidence in that proceeding and thus reflect Hydro

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[1] A copy of the FRC guidance can be found at https://www.ferc.gov/enforcement/acct-matts/docs/AI18-1-000.pdf
[2] EB-2016-0160.

One's historical practice of capitalizing OPEB costs. All other things being equal, Hydro One's actual in-service costs will be lower than those forecast amounts as a result of the accounting change and the associated revenue requirement difference will be captured in the in-service variance account and refunded to customers.

If the OEB approves the change in scope of the proposed deferral account without adjusting Hydro One's In-Service Variance account, as proposed by LPMA and OEB staff, it would amount to the double counting of the capital-related revenue requirement impact of the accounting policy change. Hydro One submits that this outcome is neither just nor reasonable and should not be approved by the OEB.

As noted above, the proposed deferral account will track the impact of the ASU 2017-07 accounting policy going forward. OEB staff submits that the OEB should only allow the proposed deferral account to track the net revenue requirement impact of the accounting policy change in 2018 and that a decision on the regulatory treatment of the impacted costs for 2019 and beyond can be addressed in Hydro One's upcoming transmission rate application.

OEB staff's rationale in its submission is reproduced below:

> In EB-2011-0188, Hydro One Networks Inc. received OEB approval to use US GAAP as the basis of its rate application filings, regulatory accounting and regulatory reporting requirements, instead of the OEB mandated Modified IFRS (MIFRS) framework that most utilities across Ontario follow. OEB staff notes that US GAAP allows for a more broad interpretation of what types of costs may be capitalized to assets, and therefore Hydro One Networks is already able to capitalize significantly more than they otherwise would be permitted to had they been following the OEB's MIFRS framework. For example, as part of the 2017 and 2018 transmission rates proceeding, the applicant indicated that on a consolidated basis, they would be able to capitalize approximately $310 million less over the test period had they been required to follow MIFRS. On this basis, OEB staff submits that only the net revenue requirement impact of the accounting change on the 2018 approved transmission revenue requirement should be tracked in the proposed variance account. A decision on the regulatory treatment of the impacted costs for 2019 and beyond can be addressed in the applicant's upcoming transmission rates application.

In essence, OEB staff submits that the OEB should only approve the tracking of the impact of the accounting policy change in 2018 because USGAAP allows Hydro One to capitalize more costs than would be allowed if Hydro One were required to follow MIFRS. OEB staff makes this submission after noting that the OEB itself has already determined Hydro One does not need to follow the MIFRS framework.

OEB staff made similar submissions in Hydro One's 2017/2018 transmission rate application. These were rejected by the OEB who approved the continued use of USGAAP, including the capitalization of overheads.

Hydro One submits that OEB staff has not provided any true rationale to justify limiting recovery of amounts in the proposed deferral account to 2018. Additionally, OEB staff has not provided any rationale that would justify a deviation from the findings made by the OEB in Hydro One's 2017/2018 transmission rate proceeding, as well as, prior proceedings where the OEB has approved the use of USGAAP by Hydro One. Hydro One submits that there is no reason to revisit the continued capitalization of these costs in Hydro One's upcoming transmission proceeding. Hydro One agrees with the submissions of the Society that any changes to current accounting practices should be considered broadly for all Ontario utilities under USGAAP as part of a broad policy consultation.

OEB staff further claims in its submission that Hydro One's capitalization policies are more "aggressive" than other OEB regulated utilities that follow USGAAP. The sole basis provided for this claim appears to be the fact that no other Ontario utility has yet filed any similar request to Hydro One's. OEB staff says:

> as part the EB-2017-0307 proceeding (Union/Enbridge MADDs Application), OEB staff asked an interrogatory about the impact that ASU 2017-07 has on the 2019 revenue requirement. In the response, the applicants indicated that ASU 2017-07 is not expected to have a significant impact since Enbridge Gas does not currently capitalize pension and OPEB related costs, while Union Gas estimated its impact to be less than $1 million.

Hydro One strongly questions OEB staff's comparison which solely considers the quantum of the impact of the accounting policy change and does not consider any relevant factors and differences between the comparators that would reasonably lead to such differences.

For example, OEB staff's analysis ignores the fact that some utilities, such as Enbridge Gas and Union Gas, outsource labour for capital work (e.g. construction projects, customer installs) rather than utilizing internal resources similar to Hydro One. Rather than capitalizing the pension and OPEB costs of their own internal employees, such utilities would capitalize the construction charge from their contractors who would embed the pension and OPEB costs of their employees in the rate that they charge to the utility. Logically, a utility that places a higher reliance on outsourced labor would have a lesser financial impact due to the ASU 2017-07 standard.

OEB staff also ignore the differences in the size of the work force for each utility. A utility with a larger workforce will typically have higher OPEB costs on an overall basis. It stands to reason that the overall quantum of the impact of the accounting policy change would be higher for such a utility.

Hydro One submits that OEB staff has not provided any true evidentiary basis for its submission that Hydro One capitalizes more "aggressively" than any other OEB-regulated utility under USGAAP and that those unsubstantiated claims should not deter the OEB from approving the continued capitalization of the effected costs consistent with Hydro One's past practice and with the FERC guidance.

Conclusion

In conclusion, Hydro One submits that the OEB should approve the continued capitalization of the effected costs consistent with its past practices. Such an approval would avoid an adverse rate impact to customers and is appropriate as capitalization matches the recovery of these costs over the life of the assets which matches the period over which customers benefit from these assets.

Should the OEB not wish to approve the continued capitalization of the affected costs, consistent with the FERC guidance, Hydro One submits that the deferral account should be approved as proposed.