



Ontario Energy Board Commission de l'énergie de l'Ontario

DECISION AND ORDER

EB-2017-0336

HYDRO ONE NETWORKS INC.

Motion to review and vary the Decision and Order dated November 1, 2017 regarding Hydro One Networks Inc.'s electricity transmission revenue requirement and charge determinants beginning January 1, 2017 (EB-2016-0160)

BEFORE: Cathy Spoel
Presiding Member

Allison Duff
Member

Rumina Velshi
Member

August 31, 2018

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1. INTRODUCTION AND SUMMARY

This is a decision on a motion brought by Hydro One Networks Inc. (Hydro One Networks), the applicant in the Ontario Energy Board (OEB) proceeding that considered the Hydro One application for transmission revenue requirements and charge determinants for 2017 and 2018. Hydro One Networks filed a motion seeking a review and variance of the OEB decision issued September 28, 2017 and revised October 11, 2017 and November 1, 2017 (the Decision)¹. The OEB assigned OEB file number EB-2017-0336 to the motion.

Hydro One Networks filed its Notice of Motion on October 18, 2017 and followed with a factum, motion record and book of authorities on January 15, 2018 (Motion).

The Motion was for an order that the OEB review and vary the Decision in respect of the following determinations:

- 1) that a portion of the \$2,595 million in future tax savings resulting from the Government of Ontario's decision to sell its ownership interest in Hydro One Limited by way of an Initial Public Offering on October 28, 2015 and subsequent sale of shares should be applied to reduce Hydro One Networks' revenue requirement for 2017 and 2018² (Future Tax Saving Determination)
- 2) that \$4.600 million in allowance for funds used during construction in respect of the Niagara Reinforcement Project should not be included in the revenue requirement for 2018³ (Niagara Reinforcement Project Determination)
- 3) that \$0.750 million in costs attributable to the Ombudsman Office should not be included in the revenue requirements for 2017 and 2018⁴ (Ombudsman Office Determination).

The OEB grants the Motion with respect to the Future Tax Saving Determination and will return it to the original panel for further consideration. The OEB denies the Motion to vary the Decision with respect to the Niagara Reinforcement Project Determination and the Ombudsman Office Determination.

¹ EB-2016-0160 Decision and Order.

² EB-2016-0160 Decision and Order, Section 15

³ EB-2016-0160 Decision and Order, Section 13

⁴ EB-2016-0160 Decision and Order, paragraphs 7.2.2 and page 47

2. THE PROCESS

Hydro One Networks applied to the OEB on May 31, 2016 for approval of transmission revenue requirements and charge determinants for 2017 and 2018. The OEB issued its Decision on that application on September 28, 2017, which was revised on October 11, 2017 and again on November 1, 2017.⁵

Hydro One Networks filed a Notice of Motion on October 18, 2017. The OEB issued Procedural Order No. 1 on December 19, 2017, in which the OEB provided for intervenor participation in the Motion, accepted that the OEB's threshold test had been met, and directed the filing of submissions on the merits of the Motion.

As directed, Hydro One Networks filed its argument and motion record with the OEB and sent these materials to all intervenors on January 15, 2018. Submissions were filed by OEB staff, the Vulnerable Energy Consumers Coalition (VECC), the School Energy Coalition (SEC), the Power Workers Union (PWU), the Building Owners & Managers Association, Greater Toronto (BOMA), Canadian Manufacturers & Exporters (CME) and the Consumers Council of Canada (CCC). Hydro One Networks filed its submission responding to the staff and intervenor submissions on January 29, 2018.

An oral hearing was held on February 12, 2018 during which the OEB asked questions of parties regarding their written submissions and heard oral reply argument by Hydro One Networks.

⁵ EB-2016-0160 Decision and Order

3. DECISION

1) Future Tax Savings Determination

As a consequence of the Province's Initial Public Offering in November 2015 (IPO), Hydro One Limited and its subsidiaries ceased to be taxable under the provincial Payment in Lieu of Taxes (PILs) regime, and instead became subject to the provisions of the Federal Income Tax Act (ITA). Under the terms of the ITA, Hydro One Limited was, at the time of the completion of the IPO, deemed to have sold and reacquired all of its assets at fair market value (FMV) for tax reporting purposes. The increases in the tax values of these assets then became available to provide Hydro One Limited with substantial savings in taxes payable in years beyond November 2015 (future tax savings). The PILs regulation imposes a departure tax liability when a utility leaves the PILs regime. Hydro One Limited incurred a total departure tax liability of \$2,271 million and is entitled to receive future tax savings of \$2,595 million.

In its 2017 and 2018 transmission rates application, Hydro One Networks did not seek to recover the departure tax applicable to its transmission business in rates and sought to allocate 100% of the transmission-related future tax savings to its shareholders.

On September 28th, 2017, the OEB issued its Decision on the application. The Decision addressed the appropriateness of Hydro One Networks' proposal to allocate 100% of the future tax savings from its IPO to its shareholders. The Decision relied on the principles expressed in the May 2005 Report of the Board, which addressed the allocation of similar future tax savings between shareholders and ratepayers.⁶ The Decision found that the application of those principles to the facts established in the Hydro One Networks' proceeding meant that the tax savings should not be allocated 100% to the shareholders of Hydro One Networks as proposed, but should be divided between shareholders and ratepayers.

The Decision considered two separate methodologies under which to allocate these future tax savings between ratepayers and shareholders: the Recapture Ratio and the Actual FMV Sales and Payments Ratio.

⁶ RP-2004-0188 Report of the Board: 2006 Electricity Distribution Rate Handbook, May 11, 2005, which addressed the allocation of tax benefits that had arisen because, in conjunction with the introduction of the PILs regime, all tax-exempt distribution utilities were required to adjust the tax value of their assets to FMV as of October 1, 2001.

The Recapture Ratio recognized that a portion of the future tax savings could be considered recapture of amounts credited to ratepayers in prior rate applications. The Decision calculated that 52.5%⁷ of the transmission-related future tax savings were due to recapture and should accrue to the benefit of the shareholders.

The Actual FMV Sales and Payment Ratio represented the application of the benefits follow costs regulatory principle. The calculation recognized that the payment of the departure tax liability contributed to increasing the FMV of the shares subsequently sold on the IPO (FMV bump). Under this methodology, the Decision calculated that 62% of the transmission-related future tax savings should accrue to the benefit of the shareholders.

The November 9, 2017 decision ordered that 62% be used to determine the regulatory taxes to be included in the revenue requirements because 62% was more favourable to shareholders than 52.5%.

The Decision also addressed the regulatory treatment of the departure tax liability that became payable upon exit from the PILs regime. The Decision found that the liability to pay the departure tax was variable at the Province's discretion, and that it was funded by a payment by the Province to Hydro One Networks for the purchase of additional shares. The Decision found that the payment of departure tax, in and of itself, did not support allocating 100% of the future tax savings to shareholders.

In support of its Motion, Hydro One Networks argued that the Decision was incorrect as in its view, the utility rate-making principles including cost causation, benefits follows costs, the stand-alone utility principle, and the fair return standard, were ignored or misapplied, or both. It further argued that the finding that the departure tax paid by Hydro One Networks was "variable" was not correct, that the statutory framework applicable to the OEB was not properly considered, and the allocation methodologies adopted in the Decision were made without the necessary factual record.

The PWU supported the Motion, arguing that the Decision would have been different if Hydro One Networks had been wholly owned by a non-provincial shareholder, such as a municipality.

⁷ In its original September 28, 2017 Decision and Order (Revised November 1, 2017), the OEB calculated the transmission related Recapture Ratio to be 71%, however it required Hydro One to submit certain additional information during the draft rate order process that separated Exhibit J11.3 between its recapture and gain components. Based on this additional information, the OEB revised its calculation of the Recapture Ratio to 52.5% as part of its November 9, 2017 Decision and Order on the draft rate order.

OEB staff did not support the Motion, arguing that the OEB was well within its mandate to carefully consider all elements of Hydro One Networks' proposed revenue requirement, including the amount for taxes that should be paid by ratepayers. OEB staff submitted that the taxes at issue are Hydro One Networks' taxes, and not taxes applicable to an unregulated business or affiliate, and that the Actual FMV Sales and Payments Ratio properly represented the application of the benefits follows cost regulatory principle.

The other intervenors did not support the Motion. SEC, supported by BOMA, VECC, and CCC, argued that there was no causal relationship between the payment of the departure tax and the FMV bump. These intervenors submitted that the payment of the departure tax did not represent a real cost due to the manner in which it was funded by Hydro One Networks' shareholder. These intervenors submitted that ratepayers should receive a benefit consistent with the application of the stand-alone and the benefits follows costs principles as articulated in the Decision.

Findings on the Future Tax Saving Determination

The OEB finds that in coming to its conclusion on the Future Tax Saving, the Decision relied on a number of factors, some of which included errors:

1. The Decision does not follow the stand-alone utility principle and is inconsistent with prior OEB applications of the stand-alone utility principle.

In EB-2007-0905, a decision regarding Ontario Power Generation Inc. (OPG), in determining the appropriate rate of return, the OEB found that a utility would have no greater or lesser rights and obligations simply because it is government owned.

The Decision treated Hydro One Networks differently because its shareholder is the Province. The OEB agrees with Hydro One Networks submission at the Motion hearing that:

If the shareholder, who had provided the equity and [in]fusion for shares, had been anybody other than the province, it could have been any third-party, then...you can infer from the decision that the cost would not have been treated as variable or anything less than the full true cost...The determination of a cost should not turn on who provides the equity, or who provides the loan. It doesn't matter whether the loan comes from a particular financial institution or it comes from a shareholder.⁸

⁸ EB-2017-0336 Transcript Vol. 1, p. 30, February 12, 2018

This finding in the Decision, which considered the PILs departure tax from the Province's perspective and not from the utility's stand-alone perspective, led to an inappropriate allocation of the future tax savings, as described below.

2. The Decision found that the PILs departure tax was "variable".

The Decision indicated that the PILs departure tax was variable, discretionary and that the Province, as the taxing authority, could have waived the departure tax payment.

The PILs departure tax and the PILs payments paid by Hydro One Networks were established by the PILs legislation. All municipally and provincially owned regulated utilities (including Hydro One Networks and OPG) pay PILs on the same basis and recover those payments from ratepayers.

There has never been any question on whether Hydro One Networks should be allowed to recover its ongoing PILs payments from ratepayers, even though its shareholder and taxing authority, the Province, has the power to amend the PILs legislation to allow it to waive the PILs payments.

There was no evidence presented to the OEB that suggested that the PILs departure tax should be treated any differently than PILs payments and that the Province ever contemplated amending the PILs legislation to waive the departure tax for Hydro One Networks, which it did not do.

The Decision erred in speculating or assuming that the Province could have or should have made changes to the PILs legislation. The evidence should have been considered only in the context of the legislation that was and is in effect.

3. The Decision did not accept that Hydro One Networks paid the departure tax in substance and that it was a real cost to the utility.

The Decision finding that the departure tax was a "payment from itself to itself" by the Province is inconsistent with the evidence on the record. The testimony in evidence as well as Exhibit J11.2 include excerpts from relevant public documents that show how the departure tax liability and the future tax savings, which has been dedicated to the Trillium Trust, have been recorded.

The Decision considered the payment of the departure tax from the perspective of the Province, not the utility's stand-alone perspective. The Decision inappropriately considered potential transactions involving the shareholder, beyond the regulated business.

4. The two allocation methodologies used in the Decision appear to be inappropriate. In particular:

- a. Recapture Ratio methodology – did not recognize the real cost of the departure tax liability paid by Hydro One Networks.
- b. Actual FMV Sales and Payment methodology – treats shares of Hydro One Networks that continue to be owned by the Province differently than those owned by other shareholders, even though Hydro One Networks has only one class of shares. This methodology is also inconsistent with other findings in the Decision (e.g. making allowance for departure tax payment by the Province even though the Decision found that this departure tax was not a real cost to the utility).
- c. None of the parties, including Hydro One Networks, had the opportunity to consider the applicability of these methodologies, review the calculations or make submissions on whether or how they should be applied.

The OEB does not accept the argument by some of the intervenors that the departure tax payment and the future tax savings are unrelated. They both arise as a result of the same transaction. PILs are payable because the ITA does not apply to municipally and provincially owned entities. It is only because of the change in Hydro One Network's tax status as a result of shares being sold that any of these payments and savings occur.

The OEB finds that this part of the Decision should be returned to the original panel to reconsider in light of these findings and all the evidence and argument the original panel and the reviewing panel heard on this issue.

2) Niagara Reinforcement Project Determination

Hydro One Networks had asked the OEB to continue to allow it to recover an allowance for funds used during construction (AFUDC) for the Niagara Reinforcement Project. The OEB had previously ruled⁹ that although the transmission line was not yet in service, Hydro One Networks could continue to recover AFUDC while it attempted to resolve a land claim dispute that was delaying the in-service date.

In its Decision, the OEB indicated that it was not convinced that Hydro One Networks had made sufficient effort over the last ten years to resolve issues associated with the Niagara Reinforcement Project and to place the asset into service. While the OEB acknowledged that some aspects of the land claim dispute were beyond Hydro One Networks' control, it found that Hydro One Networks could have taken a more active role in supporting the resolution of these issues. The OEB added that it expects Hydro

⁹ EB-2006-0501 OEB Decision with Reasons, August 16, 2007 pp. 63-64

One Networks to work diligently to assess and implement alternate means of resolving this dispute in the longer term.

The Decision found that although the OEB's previous decision¹⁰ did not put a time limit on the recovery of carrying charges for this unfinished project, it did not mean that the financial relief provided by the OEB was endless. The Decision found that it was not appropriate for the ratepayers to continue to be burdened with carrying charges for capital expenditures that have yet to result in a used or useful asset. The Decision allowed for an AFUDC to be recovered in 2017, but disallowed the recovery of \$4.6 million in AFUDC in 2018.

Hydro One Networks submitted that the finding that Hydro One Networks should be permitted to recover an AFUDC for 2017, but not for 2018, was unreasonable. Hydro One Networks argued that there was no evidence before the OEB that would allow it to conclude that the situation had changed between 2017 and 2018. In addition, Hydro One Networks submitted that there was no evidence that its negotiation efforts were insufficient, that it was in a position to find "alternate solutions", or that any alternate solutions exist.

Hydro One Networks also argued that new facts have arisen since the ruling in the Decision, and filed as part of its Motion record news releases describing a tentative agreement in the dispute.

OEB staff and intervenors did not support the Motion, arguing that Hydro One Networks should have been aware that recovery of costs for assets that are not used and useful would be an issue in any cost of service case, particularly where the situation has persisted for ten years. The absence of evidence demonstrating any material progress over that time period justified the Decision, in their submissions.

Findings on the Niagara River Project Determination

The OEB finds that the Decision did not err in denying the recovery of the AFUDC of \$4.6 million in 2018. The OEB finds that the Decision is reasonable. The Decision provided the explanation that to allow recovery of a particular cost in one proceeding does not guarantee recovery of that cost in all future proceedings. The Decision considered it the OEB's role to determine an appropriate balance between the interests of the regulated utility and its customers. The OEB finds that reasonable judgement was

¹⁰ EB-2006-0501 OEB Decision with Reasons, August 16, 2007

applied in determining the appropriate balance in 2018 and the discontinuance of the special treatment approved since May 1, 2007.

The OEB acknowledges Hydro One Networks' submission with respect to a tentative agreement reached between the utility, the Ministry of Energy and First Nations. While the status update is encouraging, the agreement is not yet certain. Hydro One Networks can raise the issue again in its next transmission revenue requirement application.

As there is no error, the OEB will not vary the Decision to exclude an AFUDC of \$4.6 million in the 2018 revenue requirement. In addition, the OEB notes that \$4.6 million is below the materiality threshold for the transmission utility.

3) Ombudsman's Office Determination

The September 28, 2017 Decision, at page 48, stated:

The budgeted annual compensation cost of the new Chair is about \$1.7 million and \$1.8 million in 2017 and 2018, respectively, with about 53% of those amounts being allocable to transmission. The 2014 cost of the Chair that was replaced was about \$300,000.

On October 10, 2017, Hydro One Networks filed its draft Revenue Requirement and Charge Determinant Order as required by the OEB. In that filing, Hydro One Networks advised that the statement in the Decision regarding the compensation of the new Chair of Hydro One Networks, did not reflect the evidence in the proceeding, in particular Undertaking J12.5.

On October 11, 2017, the OEB issued a letter agreeing that the statement in the Decision referred to by Hydro One Networks required clarification. As a result, the OEB issued the October 11, 2017 Decision adding the clarifying sentence, "*Of those amounts, \$1.4 million is attributable to the Ombudsman's Office.*" before the last sentence in the original paragraph.

Hydro One Networks argued that the October 11, 2017 Decision did not fully correct the September 28, 2017 Decision. Hydro One Networks submitted that there is still the incorrect statement that "[T]he budgeted annual compensation cost of the new Chair is about \$1.7 million and \$1.8 million in 2017 and 2018...", while this cost relates to the Office of the Chair and not the compensation cost of the new Chair. Hydro One Networks was concerned that retaining the comparison of these amounts to the

\$300,000 cost of the Chair in 2014 incorrectly suggests that the compensation cost of the Chair has materially changed, and that there is a material reputational impact of these misstatements to Hydro One Networks and its Chair.

Hydro One Networks also asked that the Decision be varied to allow inclusion of \$750,000 in Hydro One Networks' revenue requirement for each of 2017 and 2018, being the portion of the cost of the Ombudsman's Office allocated to the transmission business.

OEB staff, SEC and VECC argued that the Decision should not be varied, as each sentence in the relevant paragraph is accurate. OEB staff submitted that the Decision did not specifically deny the costs of the Ombudsman's office, as the Decision approved an envelope reduction to the Hydro One Network's total proposed operations, maintenance and administration (OM&A) budget.

In addition, OEB staff submitted that the Decision had resulted in reasonable levels of revenue requirement. SEC and VECC argued that no increase to the revenue requirements should be made for a function, which, while required by legislation, was fundamentally related to the transformation of Hydro One Networks and did not provide an incremental benefit to ratepayers from the pre-existing Ontario Ombudsman.

Findings on the Ombudsman's Office Determination

The OEB finds that the Decision did not contain an error regarding the Ombudsman Office and should not be varied. The OEB finds that the paragraph from the September 28, 2017 Decision and the clarification issued on October 11, 2017 are accurate. Further, the OEB finds that no adjustment to 2017 or 2018 revenue requirements are needed, as nowhere in the Decision is the cost of the Ombudsman's office specifically denied. The Decision approved an OM&A budget envelope for 2017 and 2018.

The OEB notes that the \$750,000 that Hydro One Networks seeks to have included in the 2017 and 2018 revenue requirements is below the materiality threshold for the transmission utility.

Cost Awards

The OEB finds that cost eligible intervenors in the original transmission revenue requirement and rates proceeding who participated in this Motion proceeding, may apply to recover their reasonable costs of participation in the Motion.

4. ORDER

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. The Decision shall be returned to the original panel to reconsider the Future Tax Savings Determination in light of the findings in this Decision and Order.
2. VECC, SEC, BOMA, CME and CCC shall submit their cost claims no later than 7 days from the date of issuance of this Decision and Order.
3. Hydro One Networks shall file with the OEB and forward to VECC, SEC, BOMA, CME and CCC any objections to the claimed costs within 14 days from the date of issuance of this Decision and Order.
4. VECC, SEC, BOMA, CME and CCC shall file with the OEB and forward to Hydro One Networks any reply to any objections to the cost claims within 21 days from the date of issuance of this Decision and Order.
5. Hydro One Networks shall pay the OEB's costs incidental to this proceeding upon receipt of the OEB's invoice.

DATED at Toronto August 31, 2018

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary