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Vice President and Chief Regulatory Officer
Regulatory Affairs

July 15, 2011

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

Dear Ms. Walli:

Hydro One Networks Distribution Business: Utilization of US GAAP as of January 1, 2012

This is further to my letter of May 31, 2011. As the Board is aware, Hydro One Networks Inc. (Hydro One) was evaluating its option of adopting US General Accounting Principals (US GAAP) in lieu of IFRS. I can advise the Board that Hydro One has now opted to proceed in that fashion.

Hydro One requests that the Board make the following orders with regards to its Distribution Business: an order approving the utilization of US GAAP in lieu of modified international financial reporting standards (MIFRS) for regulatory accounting and reporting purposes as of January 1, 2012; and, an order approving Hydro One's use of US GAAP in lieu of MIFRS for its future Distribution Cost of Service Rate Applications. These requests are discussed below.

Adoption of US GAAP

Hydro One filed its official application with the Ontario Securities Commission (OSC) on July 7, 2011, seeking approval to utilize US GAAP as the basis for preparing its periodic public securities filings effective January 1, 2012. Hydro One anticipates receiving formal OSC approval to do so by the end of July 2011 and perhaps sooner.

In anticipation of that approval, Hydro One intends on utilizing US GAAP for regulatory accounting and reporting purposes as of January 1, 2012 and filing any future Distribution Cost of Service Rate Applications on a basis which reflects the adoption of US GAAP for ratemaking and financial reporting purposes beginning in 2012.

In its Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment, EB-2008-0408, the Board indicated that it will require utilities to explain the use of any accounting framework other than modified

international financial reporting standards (MIFRS) for regulatory purposes. In doing so, the Board noted that a utility would need to demonstrate its eligibility under the relevant securities legislation to report external financial information using that framework, would need to include a copy of the authorization to use the alternative framework from the appropriate Canadian Securities Regulator and to set out the benefits and potential disadvantages to the utility and its ratepayers.

As noted, Hydro One filed its application to the OSC on July 7, 2011. That application sets out the requirements under the formal securities legislation and outlines how Hydro One meets those requirements. A copy of this submitted application, subject to any subsequent changes requested by the OSC, is attached as a “Privileged and Confidential” document. Of course, once the formal order is received from the OSC, Hydro One will file that with this Board as well. Provision of these two documents fulfils the first two requirements outlined in the Addendum to Report of the Board.

Hydro One is of the view that there is significant value to both ratepayers and the shareholder in using US GAAP for regulatory purposes. Use of a consistent financial accounting framework for both external/internal financial reporting and regulatory accounting and reporting preserves the existing link between audited financial statements and financial information and documentation utilized in rate applications and regulatory reports. The impacts of Board rate Decisions can be clearly reflected as regulatory assets, liabilities or accounting policy treatments under US GAAP. It is a benefit to the Board, Hydro One, and interested stakeholders to compare financial information provided in the regulatory process to Hydro One’s audited financial statements. This provides all participants with assurance of the integrity of the information.

The use of a consistent accounting framework for financial and regulatory reporting reduces Hydro One’s costs from what they otherwise would be if inconsistent frameworks were used. Amongst other things, the alternative would be to have dual reports and reconciliations, parallel transaction processing, and dual IT systems and ledgers. The cost savings is a direct benefit to ratepayers. The utility also benefits from a consistent accounting methodology by having a better ability to present economic consequences of rate regulation in its audited external financial statements. This provides more meaningful and reliable information regarding the economic substance of Hydro One’s business and operations to its external investors and analysts.

In addition, ratepayers are expected to benefit materially as a result of the retention of two specific accounting policies which cannot be retained under IFRS due to the specific requirements of IAS 16, “Property, Plant and Equipment”. IAS 16 prohibits the capitalization of certain overheads and indirect costs that currently qualify for capitalization under both Canadian and US GAAP. Hydro One capitalizes these expenditures based on causality and benefit based studies performed by an expert external consultant. These studies are filed as part of Hydro One’s cost of service applications. The resulting overhead allocation and capitalization rates support the direct attribution of overheads to capital assets, including self-constructed fixed and intangible assets. Under US GAAP, Hydro One would retain its existing capitalization policies with respect to overheads and indirects.

Retaining existing capitalization policies benefits customers by avoiding a significant rate increase driven by specific rules found in IAS 16. Allowing Hydro One to continue with its

current overhead capitalization accounting treatment will reduce future annual distribution revenue requirement compared to the MIFRS alternative as of January 1, 2012 and beyond. This is particularly salient in a time where ratepayers and the Board are both expressing heightened concerns about the cost of electricity.

In addition, US GAAP allows continued use of group depreciation methods. IAS 16 does not. If US GAAP is approved as Hydro One's regulatory accounting and reporting framework, Hydro One will continue its existing depreciation accounting policies, including the use of group depreciation. This results in depreciation rates and annual depreciation expenses that will be lower than those available under MIFRS. Over the long run these rates will more closely reflect the average service life of all in-service assets. This will avoid future rate increases that would accompany the use of item depreciation, which does not take into consideration the dispersion of asset expected service lives within a group. The use of group depreciation rates also relieves the utility of the risk of not recovering unforecast or unforecastable premature asset retirement losses.

Hydro One is aware that the Board favours consistency in accounting methodology across local utilities. Hydro One acknowledges that its transition to US GAAP will not facilitate comparison with other local distribution companies. However, the adoption of US GAAP will improve Hydro One's ability to benchmark with other large North American utilities and other entities that are retaining or adopting US GAAP. In the future, once appropriate normalization adjustments have been made, local benchmarking can still take place.

Hydro One notes that those who are involved in setting standards for US and international accounting are working closely together, and expect to do so more significantly in the future. As a result of this cooperative effort, US and international accounting frameworks continue to converge. The use of rate-regulated accounting remains as one of the few major differences requiring resolution. As the Board noted in its Addendum Report, "Hydro One pointed out that differences between US GAAP and IFRS are concentrated in specific well-defined areas where the potential impacts can be easily understood." Thus, Hydro One remains of the view that its use of US GAAP will not lead to the confusion or unmanageable complexity that was previously expressed as a concern.

Note that similar adoption of US GAAP in 2012 by the HON Transmission business would also result in a material benefit to ratepayers for all the same reasons and such a request has been submitted recently to the OEB in a Motion To Vary the Board's Decision in the EB-2010-0002 proceeding. Further, this Board's approval of US GAAP for ratemaking and financial reporting purposes beginning in 2012 for both Hydro One's Distribution and Transmission businesses would ensure that cost efficiencies will be maintained through consistency of approach.

For the foregoing reasons, Hydro One remains of the view that its adoption of US GAAP for both financial accounting and regulatory accounting and reporting purposes is in the best interests of the utility and its ratepayers.

Accordingly, Hydro One asks for this Board's approval to utilize US GAAP in lieu of MIFRS for regulatory accounting and reporting purposes as of January 1, 2012 as well as proceed to file its future Distribution Cost of Service Rate Applications utilizing US GAAP.

I trust the foregoing is satisfactory. If the Board has any questions or concerns, please do not hesitate to contact me.

Yours very truly,

ORIGINAL SIGNED BY SUSAN FRANK

Susan Frank

Enc.

Privileged and Confidential

Hydro One Submission to OSC dated July 7, 2011

REDACTED