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Susan Frank

Vice President and Chief Regulatory Officer
Regulatory Affairs

BY MAIL

July 15, 2011

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-2010-0002 – Hydro One Networks 2011-2012 Electricity Transmission Revenue Requirement – US GAAP Considerations

This is further to my letter of May 31, 2011. In that correspondence, Hydro One Networks Inc. (Hydro One) advised the Board that Hydro One was considering the adoption of US Generally Accepted Accounting Principles (US GAAP) in lieu of International Financial Reporting Standards (IFRS) effective January 1, 2012.

I can advise the Board that Hydro One has now opted to proceed in that fashion. 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. A copy of this submitted application, subject to any subsequent changes requested by the OSC, is attached as a “Privileged and Confidential” document. We anticipate receiving formal OSC approval to do so by the end of July 2011 and perhaps sooner.

Accordingly, Hydro One is now formally proceeding with a motion to vary this Board’s decision on Hydro One’s last transmission rates application (EB-2010-0002) to determine its 2012 revenue requirement and electricity transmission rates effective January 1, 2012 as well as approval of the utilization of US GAAP for regulatory accounting and reporting purposes as of January 1, 2012. Hydro One’s motion seeks Board approval to use US GAAP as its framework for determination of rates and regulatory reporting and accounting in place of modified IFRS in anticipation that the OSC will approve the application.

Attached, you will find Hydro One's Notice of Motion. In addition, attached as Appendix "A" is a summary of the information that the Board indicated it would require from utilities adopting US GAAP as outlined in EB-2008-0408 – Addendum to the Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment. A copy of the OSC's approval to adopt US GAAP for securities filing purposes will be provided to the OEB once Hydro One receives it.

Hydro One's preference is to deal with this motion by way of written Affidavit evidence and written submissions. However, we look forward to hearing from the Board regarding the intended process to be followed to deal with this motion.

The Board should be aware that Hydro One will shortly file a similar request to the OEB on behalf of its Networks Distribution Business, citing the same facts, seeking the Board's approval to use US GAAP as its framework for determination of rates and regulatory reporting and accounting in place of modified IFRS effective January 1, 2012.

Yours very truly,

ORIGINAL SIGNED BY SUSAN FRANK

Susan Frank

Attach.

c. EB-2010-0002 Intervenors

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

AND IN THE MATTER OF a review of an application filed by Hydro One Networks Inc. under section 78 of the *Ontario Energy Board Act, 1998* seeking changes to the uniform provincial transmission rates;

AND IN THE MATTER OF a request for a review by Hydro One Networks Inc. pursuant to Rule 42 of the Rule of Practice and Procedure of the Ontario Energy Board.

NOTICE OF MOTION

Hydro One Networks Inc. (“HON”) will make a motion to the Ontario Energy Board (“the Board”) at its offices at 2300 Yonge Street, Toronto, on a date and time to be fixed by the Board.

The Motion is for:

1. A review and variance of the Board’s decision of December 23, 2010 in EB-2010-0002 (“the decision”) which ordered use of Modified International Financial Reporting Standards (“MIFRS”) for 2012;
2. An order varying the decision and allowing HON to utilize US Generally Accepted Accounting Principles (“US GAAP”) as its approved framework for rate setting, regulatory accounting and regulatory reporting commencing January 1, 2012, in a manner appropriate for a rate regulated entity including the

following resulting adjustments to 2012 levels (reversing the changes as provided in Exhibit 1.9 of “EB-2010-0002 – Hydro One Networks’ 2011-2012 Electricity Transmission Revenue Requirement – Final Revenue Requirements & Charge Determinants in Accordance with Decision”, dated January 5, 2011) :

- a) A reduction in the 2012 revenue requirement from \$1657.6 Million to \$1426.3Million;
 - b) An increase in the 2012 capital expenditures from \$781.3 Million to \$981.3Million;
 - c) An increase in the 2012 rate base from \$8726.3 Million to \$8774.4 Million;
3. An order requiring HON to file a draft 2012 rate order for review and approval which includes all impacts of adopting US GAAP in place of MIFRS. This 2012 rate order would be subject to any changes required by the Board’s subsequent issuance later this fall of its approved cost of capital parameters effective January 1, 2012;
 4. An order requiring establishment of necessary US GAAP variance accounts in place of or in addition to the IFRS variance accounts which the OEB has ordered be established in its past Decisions; and
 5. Such further and other relief as counsel may advise and this Board may permit.

The Grounds for the motion are:

1. There has been a material change in circumstances as new facts have arisen.
2. Since HON initially filed its Application for approval of 2011 and 2012 transmission rates and OEB rendered its decision, HON applied for approval by the Ontario Securities Commission (OSC) to adopt US GAAP for external financial reporting and securities filing purposes instead of IFRS effective January 1, 2012.
3. HON anticipates that the OSC will make an order in the near future allowing it to adopt US GAAP instead of IFRS for external financial reporting and securities filing purposes in keeping with similar decisions that the OSC or other Canadian securities commissions have made applicable to the Ontario jurisdiction relating to other utilities (e.g. Enbridge Income Fund).
4. This is a new fact and a material change in circumstance which was not available to HON or the Board at the time of hearing or prior to the Board decision.
5. HON, by letter dated May 31, 2011, notified the Board of this potential change.
6. HON now applies to the Board to adopt US GAAP as the framework for rate setting and for regulatory accounting and reporting purposes commencing January 1, 2012.
7. Consistency in the accounting framework used for both internal/external financial accounting and regulatory accounting provides a significant benefit to both ratepayers and HON as it allows for ease of comparison of financial reports. The impacts of Board rate Decisions can be clearly reflected as regulatory assets,

- liabilities or accounting policy treatments under US GAAP. Cost duplication is avoided.
8. More importantly, adoption of US GAAP as appropriate for a rate regulated utility would allow HON to maintain the regulatory accounting framework and policies currently used under Canadian Generally Accepted Accounting Principles (“CGAAP”). Maintaining the status quo would require HON to continue to capitalize overheads and indirect costs consistent with existing accounting policies and practices. This will result in a material benefit to ratepayers as it will reduce the currently Board approved transmission revenue requirement under MIFRS as the accounting framework by \$200M. This is particularly salient in a time of elevated and ongoing concerns about rising energy rates by interested stakeholder groups and ratepayers. Note that similar adoption of US GAAP in 2012 by the HON Distribution business would also result in a material benefit to ratepayers for all the same reasons.
 9. In addition, US GAAP allows for the retention of group depreciation by HON (whereas group depreciation is not permitted under IFRS). The result is the use of depreciation rates which more closely reflect the economic service life of all in-service assets. A future transmission rate increase will be avoided as IFRS depreciation rates will tend to be higher over time than US GAAP group depreciation rates. Maintaining the current methodology is also of benefit to HON as it relieves it from the risk of premature asset retirement losses. These are currently tracked in a Board approved variance account. The variance account will not be required if US GAAP is adopted as the framework for rate setting and for regulatory accounting and reporting purposes.
 10. In light of this change in circumstances and new facts, the Board’s decision ought to be reviewed and varied.

11. HON requests that the Board allow its request, vary its decision, and allow HON to adopt US GAAP for ratemaking, regulatory reporting and regulatory accounting commencing January 1, 2012.
12. Rules 1.03, 2.01, 8, 42, 43, 44 and 45 of the Board's Rules of Practice and Procedure.
13. The Board's powers, under Rule 43 of the Board's Rules of Practice and Procedure, to review all or part of any order or decision and to vary, cancel or suspend that order.
14. Such further and other grounds as counsel may advise and this Board may permit.

The Documentary Support for this motion is:

1. The decision of the Board in EB-2010-0002, dated December 23, 2010.
2. The evidence adduced in EB-2010-0002.
3. The letter from Susan Frank to the Board, dated May 31, 2011.
4. The Board Report – Transition to International Financial Reporting Standards (IFRS): *Addendum to Report of the Board: Implementing International financial Reporting Standards in an Incentive Rate Mechanism Environment*, EB-2008-0408, dated June 13, 2011.

EB-2010-0002

5. The (pending) Decision of the Ontario Securities Commission granting Hydro One the ability to use US GAAP effective January 1, 2012 and Hydro One's submitted application to the OSC.

6. Such further and other documentary support as may be advised.

July 15, 2011

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Appendix A

Hydro One has now formally applied to the Ontario Securities Commission (OSC) for an order allowing it to utilize US Generally Accepted Accounting Principles (US GAAP) for external financial reporting and securities filing purposes instead of International Financial Reporting Standards (“IFRS”) effective January 1, 2012. Hydro One has now formally filed with the Board, a motion to vary the Board’s decision in Hydro One’s recent transmission revenue rates application, EB-2010-0002 in order to vary the Board’s decision and allow Hydro One to determine its 2012 transmission revenue requirement and rates using US GAAP as its approved framework for rate setting, regulatory accounting and regulatory reporting commencing January 1, 2012, in a manner appropriate for a rate regulated entity.

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 an 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 standard from the appropriate Canadian securities regulator and 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. This fulfills 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.

In addition, the use of a consistent accounting framework for financial and regulatory reporting reduces Hydro One's costs from what they otherwise would be if they were inconsistent. 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. Hydro One has therefore brought a formal motion before the Board, requesting that its decision in EB-2010-0002 be varied. Varying the Board decision and allowing Hydro One to continue with its current overhead capitalization

accounting treatment will reduce the 2012 transmission revenue requirement by \$200 Million. This would also obviate the need of the variance account approved in EB-2010-0002 to track differences between the forecasted \$200 Million impact of overheads not capitalized and actual overheads.

Continuing the use of current overhead capitalization methodology and accounting treatment is significant for ratepayers and removes a significant increase in the revenue requirement solely due to the accounting change of adopting MIFRS. 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. The Board approved a variance account in EB-2010-0002 to track these amounts. Transition to US GAAP and continued use of group depreciation policies would also obviate the need for this variance account.

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 utilities. 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.

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.

Privileged and Confidential

Hydro One Submission to OSC dated July 7, 2011

REDACTED