

EB-2011-0268

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

AND IN THE MATTER OF a hearing initiated by the Board on its own motion under section 78 of the *Ontario Energy Board Act, 1998*, to consider adjustments to Hydro One Networks' 2012 Transmission revenue requirement.

Submissions of AMPCO

October 17, 2011

EB-2011-0268
 Hydro One Networks Inc. (HONI)
 Adjustment to HONI's Approved 2012 Electricity Transmission Revenue Requirement
 to Reflect Adoption of US GAAP
 AMPCO Submission

1. Pursuant to a hearing under section 78 of the Ontario Energy Board Act, 1998, initiated on the Board's own motion, HONI is asking the Board for approval 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, rather than Modified International Financial Reporting Standards (MIFRS).
2. The Canadian Accounting Standards Board (CASB) requires that Canadian Generally Accepted Accounting Principles (CGAAP) will be replaced by IFRS. The required effective date for rate-regulated enterprises is January 1, 2012.¹
3. On December 23, 2010, the Board approved HONI's 2011 and 2012 transmission revenue requirement and rates application which was premised on the assumption that HONI was required to transition from CGAAP to MIFRS for financial and regulatory reporting purposes commencing January 1, 2012. The final rate order for 2011 transmission rates was approved on January 18, 2011. The final rate order for 2012 was to be approved following the Board's release of the Cost of Capital parameters update in the fall of 2011.
4. In this application, HONI is seeking an Order or Orders approving an adjusted revenue requirement and customer rates for 2011 and 2012 to reflect the change in accounting standards from MIFRS to US GAAP. The change in accounting standards results in the following adjustments.²

	Year	Approved EB-2010-0002	Proposed EB-2011-0268	Adjustment
Base Revenue Requirement	2012	\$1,657.6 M	\$1,462.3 M	\$(195.3 M)
Capital	2012	\$781.3 M	\$981.3 M	\$200 M
Rate Base	2012	\$8,726.3 M	\$8,774.4 M	\$48.1 M

5. In May 2011, Hydro One became aware of the Enbridge Income Fund application to its relevant securities regulators for a similar exemption. Enbridge was granted the requested relief on June 3, 2011.³ Based on this precedent case, HONI notified the Board in May that it was evaluating the option of adopting US GAAP in lieu of MIFRS in 2012.

¹ EB-2009-0408 Addendum to the Report, Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment, June 13, 2011, Page 1

² Exhibit A, Tab 2, Schedule 1, Page 2

³ Exhibit B, Tab 1, Schedule 2

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6. The Addendum to the Board's Report, "Implementing International Financial Reporting Standards in an Incentive Rate Mechanism", issued on June 13, 2011 indicates "the Board requires a utility that adopts USGAAP or an alternative accounting standard other than IFRS, in its first cost of service application following the adoption of the new accounting standard, to:
 - demonstrate the eligibility of the utility under the relevant securities legislation to report financial information using the standard;
 - include a copy of the authorization to use the standard from the appropriate securities regulator (if applicable); and
 - set out the benefits and potential disadvantages to the utility and its ratepayers of using the alternative accounting standard for rate regulation."⁴
7. HONI filed an application with the Ontario Securities Commission (OSC) on July 7, 2011 seeking an exemption from the requirement that financial statements be prepared in accordance with CGAAP to permit HONI to prepare its financial statements in accordance with US GAAP for its financial years that begin on or after January 2012 but before January 1, 2015. The OSC granted the exemption on July 21, 2011. The exemption will terminate on or after January 1, 2015.
8. HONI indicates that it has satisfied the first two Board filing requirements specified in the Addendum Report. Its application to the OSC outlines HONI's eligibility requirements for the exemption sought. A copy of the authorization from the OSC was filed with HONI's application. AMPCO agrees that HONI has satisfied the first two Board filing requirements.
9. In order to meet the Board's third filing requirement to set out the benefits and potential disadvantages, HONI provided evidence regarding its view of the value to rate payers and its shareholder.⁵ HONI is 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 all stakeholders.⁶
10. AMPCO submits that HONI did not provide sufficient evidence on the potential disadvantages.

⁴ Addendum to the Report (EB-2009-0408), Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment, June 13, 2011, Page 33

⁵ Exhibit C, Tab 1, Schedule 1, Page 2

⁶ Exhibit A, Tab 3, Schedule 1, Page 4

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11. In response to an AMPCO interrogatory inquiring about the potential disadvantages, HONI indicated it has not identified any significant disadvantages to it or to its primary stakeholders in using US GAAP for rate setting purposes rather than MIFRS.⁷
12. AMPCO disagrees with HONI on this point. AMPCO submits that there are potential disadvantages that should be acknowledged and noted for the Board's consideration in this application.

Potential Disadvantages

Potential Transitional Issue in 2015

13. The issue of what happens when the OSC approval expires on December 31, 2014 is an important issue for the Board to consider in this application.
14. HONI has OSC approval to prepare its financial statements in accordance with US GAAP for three years ending December 31, 2014. HONI chose to request a three-year exemption request based on the term of the Enbridge Income Fund precedent and advice from advisors that this was the term that was likely to receive regulatory approval.⁸ What happens after that in 2015 in terms of financial reporting is an unknown for HONI and its' stakeholders.
15. In response to VECC interrogatory #2, HONI indicated that it cannot at this time determine what will happen after 2014. "The possibilities are numerous and include, but are not limited to, retention of US GAAP through an extended or even permanent OSC exception, retention of US GAAP through the vehicle of Hydro One becoming an SEC registrant as it was previously, or an adoption of IFRS in 2015."⁹
16. In response to Board Staff interrogatories, HONI indicated "There is currently no formal or approved schedule for the United States to adopt IFRS. If the US determines not to adopt IFRS but continues to use US GAAP, Hydro One would intend to seek a further exemption from the OSC for reporting years subsequent to 2014."¹⁰
17. In response to an AMPCO interrogatory, HONI further indicated that it does not expect to change its accounting standard again in 2015. If a change to IFRS becomes necessary, this should not present a significant issue in the market place as analysts and other stakeholder

⁷ Exhibit I, Tab 3, Schedule 2

⁸ Exhibit I, Tab 1, Schedule 8

⁹ Exhibit I, Tab 4, Schedule 2

¹⁰ Exhibit I, Tab 1, Schedule 9

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are well versed in understanding the issues in converting from CGAAP to IFRS. Given the similarities between US GAAP and CGAAP, this knowledge should still be applicable.”

18. In the Addendum to the Board's report, the Board cautions utilities that the adoption of US GAAP as a short-term solution may be counter-productive. If a utility is required to transition to IFRS for financial reporting a few years after adopting US GAAP, 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.”¹¹
19. Hydro One's IFRS conversion effort was substantially completed in 2011. The amount of IFRS Transition Costs that were embedded in the 2011 and 2012 revenue requirement approved in EB 2010-0002 were \$210,420 and \$NIL for 2011 and 2012, respectively. The June 30, 2011 balance in the Transmission IFRS – Incremental Transition Costs Account is a debit balance of \$256,392 (inclusive of interest improvement at the Board's prescribed rate).¹²
20. In response to Board Staff Interrogatories, HONI Indicated it does not have detailed estimates of the future costs of transitioning to US GAAP but does not expect that incremental costs will be significant. In addition, HONI stated that it cannot forecast the future costs to transition to IFRS for January 1, 2015 should that occur given uncertainty regarding IFRS and US GAAP developments occurring over the future period.¹³
21. AMPCO submits that the Board needs to consider that the possibility exists for HONI to be required to switch to IFRS for financial reporting in 2015, and that there may be cost issues. The resulting transitional issues represent a potential disadvantage that needs to be evaluated.

¹¹ Addendum to the Report (EB-2009-0408), Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment, June 13, 2011, Page 33

¹² Exhibit I, Tab 1, Schedule 20

¹³ Exhibit I, Tab 1, Schedule 13

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Consistency in Utility Regulation

22. The Board has acknowledges that it must consider the general public interest in ensuring efficiency and consistency in utility regulation in Ontario.¹⁴
23. HONI indicated in its application that it is aware that consistency in accounting methodology across local utilities is desirable. HONI further acknowledged that its transition to US GAAP will not facilitate this comparison with other local utilities.¹⁵
24. AMPCO submits that allowing HONI to use a different standard than the other utilities in Ontario adds a new layer of complexity to regulation that is not desirable and may not allow for a meaningful comparison with other local utilities.

Potential Competitive Advantage

25. Under US GAAP, HONI is able to accumulate assets and grow at a faster pace than other utilities under MIFRS due to the change in capitalization policies.

HONI's projected impact on rate base over 5 years is reproduced in the table below.¹⁶

Rate Base	2012	2013	2014	2015	2016
\$ M	48	175	290	402	511

One outcome is that HONI will be more sensitive to interest rate fluctuations and their affect on the cost of borrowing and return on equity. As such, HONI's revenue requirement and rates will be more sensitive to increases in interest rates under US GAAP than other utilities in the province under MIFRS. Under this scenario, HONI could potentially have an unfair advantage over other utilities. The Board should consider whether this represents equitable treatment for all utilities or unduly favours HONI.

US GAAP for HONI Distribution

26. HONI seeks acknowledgement and approval that f US GAAP is adopted to establish the revenue requirement and rates for HONI Transmission, it is appropriate for HONI to do so

¹⁴ Addendum to the Report (EB-2009-0408), Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment, June 13, 2011, Page 19

¹⁵ Exhibit C, Tab 1, Schedule 1

¹⁶ Exhibit I, Tab 3, Schedule 5

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for HONI Distribution.

- 27.** AMPCO agrees that if the Board approves US GAAP for HONI Transmission, it should also approve US GAAP for HONI Distribution.

Summary

- 28.** AMPCO submits that HONI's application provides evidence on the benefits of adopting US GAAP in lieu of MIFRS but potential disadvantages have not been sufficiently discussed.
- 29.** AMPCO submits that the Board needs to consider the potential disadvantages discussed above as well as the benefits, in reviewing this application.

All of which is respectfully submitted this 17th Day of October.