

**Hydro One Networks Inc.**

8<sup>th</sup> Floor, South Tower  
483 Bay Street  
Toronto, Ontario M5G 2P5  
www.HydroOne.com

Tel: (416) 345-5700  
Fax: (416) 345-5870  
Cell: (416) 258-9383  
Susan.E.Frank@HydroOne.com



**Susan Frank**

Vice President and Chief Regulatory Officer  
Regulatory Affairs

BY COURIER

October 25, 2011

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

Dear Ms. Walli

**EB-2011-0268– Adjustment to Hydro One Networks’ Approved 2012 Electricity Transmission Revenue Requirement To Reflect Adoption of US GAAP - Hydro One Reply Argument**

Please find attached Two (2) hard copies of Hydro One Networks Reply Argument.

An electronic copy of the Argument, have been filed using the Board’s Regulatory Electronic Submission System.

Sincerely,

ORIGINAL SIGNED BY SUSAN FRANK

Susan Frank

Attach.

c. EB-2011-0268 - Intervenors (electronic only)

## **Hydro One Reply Argument**

### **Introduction**

Hydro One Networks Inc. (“Hydro One”) is pleased to file its reply argument in relation to the Ontario Energy Board (the “Board”) initiated review of the Company’s 2012 electricity transmission revenue requirement under the Board’s proceeding EB-2011-0268.

Pursuant to the procedural Order issued by the Board, all intervenors in Hydro One’s last transmission rates application EB-2010-0002 were made intervenors in this proceeding which deals with the limited issue of the proposed regulatory accounting change. In accordance with the Board’s procedural Order, Hydro One received argument submissions from Board staff as well as:

- Association of Major Power Consumers of Ontario (“AMPCO”)
- Consumers Council of Canada (“CCC”)
- Canadian Manufacturers & Exporters (“CME”)
- The London Property Management Association (“LPMA”)
- Power Workers Union (“PWU”)
- School Energy Coalition (“SEC”)
- Vulnerable Energy Consumers Coalition (“VECC”)

Hydro One observes that there is broad support for its request to utilize US GAAP as its regulatory accounting and rate setting framework for its Transmission Business as well as its Distribution Business effective January 1, 2012.

Hydro One notes that AMPCO, CCC, CME, LPMA, PWU, SEC, VECC and Board staff all support Hydro One’s request including the proposed adjustments to 2012 transmission revenue requirement and rate base. All of these parties were satisfied, on the evidence

before the Board, that the transition to US GAAP instead of modified IFRS (“MIFRS”) is of substantial benefit to ratepayers and the shareholder. No party raised any challenge to the benefit of the proposed change. The requested change is the same that has been approved by other regulators across Canada as outlined in the PWU argument.

Hydro One therefore asks that its proposal be approved.

Board staff and some intervenors did raise a few concerns to which Hydro One feels it should respond. Each of those will be addressed briefly below.

### **Impact of Hydro One’s Ability for Peer Group Comparisons**

Board staff raised a concern about the ability to benchmark Hydro One against its utility peer group if it adopts US GAAP. This is particularly so for its Distribution Business.

Board staff invited Hydro One to make further comment upon this in this reply submission. In particular, Board staff invited Hydro One to identify any specific accounting standards which should be uniform amongst all Ontario distribution utilities to permit robust benchmarking to occur. In addition, Board staff invited Hydro One to provide an example of how reconciliations could be made to allow comparison between Hydro One using US GAAP with other distribution utilities using MIFRS.

Hydro One does not believe that this is a concern as it relates to its Transmission Business. As the Board staff has noted, benchmarking opportunities will not be greatly reduced, and in fact may be enhanced, through the use of US GAAP. This will allow Hydro One to continue to compare itself with other large US transmission and distribution utilities, as well as with Canadian utilities which have adopted US GAAP.

As it relates to distribution, Hydro One believes that it will continue to be able to benchmark with other local utilities. OM&A cost comparisons can still be made between Hydro One’s Distribution Business, operating under US GAAP, and other Ontario Local

Distribution Companies (“LDCs”) subject to MIFRS. This would be possible following the application of appropriate top-down adjustments to Hydro One’s actual OM&A costs to adjust them to an MIFRS basis. Hydro One has a good understanding of how its OM&A costs would be impacted by a move to MIFRS and which costs disallowable for capitalization under MIFRS would have to be added.

The Company agrees that total cost benchmarking presents more of a challenge as time passes due to the inclusion of depreciation expense in total costs. Calculating a top-down adjustment for depreciation expense would be difficult due to multiple accounting differences affecting property, plant and equipment balances that are subject to different capitalization policies under US GAAP versus MIFRS. Further, benchmarking depreciation for LDCs will present substantial challenges for the Board regardless as all utilities are now free to select their own asset componentization and depreciation rates under MIFRS as long as they are considered reasonable by the Board.

However, no matter what adjustments are made, they would not resolve the historical difficulties inherent in benchmarking Hydro One’s essentially rural Distribution Business with other Ontario LDCs that primarily operate urban systems. The Board’s consultant, Pacific Economics Group, when establishing benchmarking of costs amongst all Ontario power distributors, indicated that unit cost appraisal on Hydro One cannot be done due to the lack of comparably-scaled Ontario peers.<sup>1</sup> Therefore, Hydro One does not believe that there is a need to modify its financial information to allow comparison between Hydro One using US GAAP with other Ontario LDCs using MIFRS.

## **Variance Accounts**

Hydro One proposed discontinuance of the Impact for Changes in IFRS Account, the IFRS – Gains and Losses Account and the IFRS Capitalisation Policy Variance Accounts. Nobody opposed discontinuance of these accounts.

---

<sup>1</sup> “Benchmarking the Costs of Ontario Power Distributors”, Pacific Economics Group, LLC, March 2008, Page vii.

Hydro One proposed to establish a new variance account – the Impact for US GAAP Account. Board staff and SEC questioned Hydro One’s proposal. Board staff invited further clarification about the need for the account, while SEC supported the creation of the account, but in a modified fashion.

Hydro One is proposing a symmetrical variance account to track any yet to be identified differences which could arise from the transition to US GAAP from the current accounting framework. Hydro One continues to assess and analyze the impact of transitioning to a new accounting framework. The requested account is generally consistent with previous analogous IFRS accounts approved by the Board when a rate application was submitted prior to completion of an accounting change project.

### **Overhead Capitalization Practice Concerns**

SEC, supported by CME, has asked that the Board direct Hydro One to include a full review of its overhead capitalization policies when filing its next rates case. SEC has submitted that the review should include a benchmarking study of Hydro One’s peers and their treatment of capitalized overheads.

Hydro One capitalizes overheads based on independent external studies, applying causality and benefit principles, and subject to Board review and approval. In its recent transmission rate case, as well as in prior transmission and distribution rate proceedings, Hydro One has filed studies by an external consultant relating to its cost allocation and capitalization methodology which were used to derive appropriate overhead capitalization rates. Its methodology is supported by these external studies. Hydro One will continue to file such studies as part of its cost of service applications which are available for review.

Hydro One does not believe it is necessary for it to conduct a benchmarking study to support its capitalization policy. The overhead capitalization policy has to be specific to each utility based on how the business carries out its work activities. For example, some

utilities may outsource its major capital programs, while others may complete the work with internal resources. In the first case, capitalization would be expected to be minimal compared to in the latter case. Therefore, Hydro One believes that external benchmarking of overhead capitalization rates is not required and utility specific studies are the most appropriate.

Accordingly, Hydro One respectfully requests that the Board deny SEC's request.

### **Alleged Failure to Satisfy Board Filing Requirements**

AMPCO suggested that there are potential disadvantages to adopting US GAAP, including a transitional issue in 2015 when the OSC permission to use US GAAP expires, an alleged competitive advantage and difficulty comparing Hydro One with other LDCs. It is unclear to Hydro One as to what these disadvantages are. The need to cease the use of US GAAP in 2015 is not a certainty and, in any case, Hydro One always has the option to issue debt in the United States and thus becoming an SEC issuer.

Hydro One submits that it has complied with the Board's filing requirements outlined in its Addendum Report referred to above, contrary to AMPCO's submissions.

### **Use of US GAAP by Hydro One Distribution**

Hydro One notes the broad support for the adoption of US GAAP for Hydro One Distribution, given the same treatment for Transmission.

### **Summary**

Aside from the few concerns raised by Board staff and some intervenors, all interested parties are overwhelmingly in support of Hydro One's proposal to utilize US GAAP as the basis for rate setting and regulatory accounting and reporting commencing January 1, 2012 for both its Transmission and Distribution Businesses. This would reduce the

transmission revenue requirement by \$195.3 million and distribution revenue requirement by \$166.0 million in 2012, resulting in an approximate rate reduction of 15% for transmission and the avoidance of a 14% rate increase for distribution, respectively. The adoption of US GAAP in lieu of MIFRS avoids the significant de-recognition of regulatory assets and liabilities, which would result in a reduction in the retained earnings of the Province of Ontario by approximately \$2 billion.

Hydro One's proposal benefits the ratepayers and the shareholder. Accordingly, Hydro One respectfully submits that its proposal be approved by the Board.

All of which is respectfully submitted.

ORIGINAL SIGNED BY DON H. ROGERS

**D.H. Rogers, Q.C.**  
**Anita M. Varjacic**