Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2012 ELECTRICITY DISTRIBUTION RATES

Hydro One Brampton Networks Inc.

EB-2011-0174

November 17, 2011

Board Staff Submission
Hydro One Brampton Networks Inc.
2012 IRM3 Rate Application
EB-2011-0174

Introduction

Hydro One Brampton Networks Inc. ("HOBNI") filed an application (the "Application") with the Ontario Energy Board (the "Board") on Sept 16, 2011, under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the distribution rates that HOBNI charges for electricity distribution, to be effective January 1, 2012. The Application is based on the 2012 3rd Generation Incentive Regulation Mechanism.

The purpose of this document is to provide the Board with the submissions of Board staff based on its review of the evidence submitted by HOBNI.

In the interrogatory phase, Board staff identified certain discrepancies in the data entered in the application model by HOBNI. In response to Board staff interrogatories which requested either a confirmation that these discrepancies were errors or an explanation supporting the validity of the original data filed with the application, HOBNI confirmed certain errors as described below and provided the necessary corrections to the IRM 3 Rate Generator Model.

HOBNI provided an appropriate reconciliation of amounts shown for Accounts 1595 and 1592 with Board Decisions in EB-2009-0199 and EB-2010-0132 respectively. HOBNI has updated the model for Account 1595. Board staff notes that some corrections to the model are still required for Account 1592, which can be completed by Board staff at the time of the Board's Decision on the application. HOBNI has identified an error in the calculation of interest for Account 1592 and has committed to prepare adjustments to its General Ledger and its December 31, 2010 RRR filing to correct this error by December 31, 2011.

HOBNI also provided a reconciliation of Account 1521 as requested and the necessary update to the model. An error was identified in the carrying charges for this account, which HOBNI has agreed to correct in its December 31, 2010 RRR filing. Based on

HOBNI's reconciliation, Board staff supports HOBNI's request to dispose of the updated balance in this account of ($116,935.00).

HOBNI's initial application did not include Transformer Allowances in its Revenue/Cost Ratio Model. In response to interrogatories from VECC and Board staff, HOBNI has made the necessary corrections to the model.

HOBNI's completed Tax Savings Workform was based on calculations using a 2012 tax rate that differed from that provided in the model. Board staff is satisfied with the explanation provided by HOBNI for the use of this tax rate, and supports HOBNI's proposal to record the balance of this account in Account 1595 for future disposal.

Board staff makes submissions on the following matters:

- LRAM; and
- PILs

LRAM

Background

Hydro One Brampton originally sought a total amount for LRAM recovery of $597,745, related to CDM activities undertaken in 2009 and 2010 supported through OPA funding. The lost revenues cover the period 2009 to 2011 inclusive. Hydro One Brampton updated its LRAM claim to $609,077 due to the original LRAM claim being based on preliminary 2010 OPA program results. The adjusted LRAM claim of $609,077 is based on final 2010 OPA program results and removes a portion of energy savings associated with 2009 programs that were accounted for in Hydro One Brampton's 2011 load forecast. The impact of this latter adjustment was to reduce the claim while overall, the claim increased slightly from the original filing due to the inclusion of final 2010 program results from the OPA.

Submission

The Board's Guidelines for Electricity Distributor Conservation and Demand Management (the "Guidelines") issued on March 28, 2008 outlines the information that is required when filing an application for LRAM.

Board staff submits that Hydro One Brampton's application for LRAM recovery is consistent with the Board's Guidelines and the Board's Decision on Horizon's application (EB-2009-0192) for LRAM recovery, to the extent that the Board noted that distributors should use the most current input assumptions available at the time of the third party review when calculating LRAM.

LRAM Recovery for 2011

Board staff does not support that portion of the LRAM claim associated with the 2011 year. Staff notes that Hydro One Brampton rebased with an updated load forecast effective January 1, 2011. The intent of the LRAM in the electricity sector is to keep distributors revenue neutral for CDM activities implemented during the IRM term since their rates do not reflect incremental CDM activities. Unlike the gas sector, it is Board staff's submission that the expectation in electricity has been that future LRAM claims pertaining to the test year (including true-ups to previous rebasing forecasts) would be unnecessary once a distributor rebases and accordingly updates its load forecast. This approach results in rate certainty for base rates.

In its 2011 test year application, Hydro One Brampton had the opportunity to reflect CDM savings on a forecast basis for the programs deployed in 2009 and 2010. To the extent that actual savings (and the associated incremental lost revenues) were not reflected in the final approved forecast should be, in Board staff's view, absorbed by the applicant.

In Board staff's view, it does not matter whether a distributor is requesting a true-up of savings already forecasted in a rebasing year (as is the case for Hydro One Brampton's 2009 programs) or whether it is requesting all lost revenues associated with savings that it appears to have failed to forecast at all for a particular year (as is the case with its 2010 programs). The principle that underpins the current CDM guidelines is that a rebased load forecast is final in all respects. The same would hold true in Board staff's view if the forecast was not achieved in either or both of those years.

Board staff notes that the current CDM Guidelines state the following with respect to LRAM claims.

> Lost revenues are only accruable until new rates (based on a new revenue requirement and load forecast) are set by the Board, as the savings would be assumed to be incorporated in the load forecast at that time[1].

Staff notes that the amount in Hydro One Brampton's LRAM claim associated with the 2011 year is $180,220, as shown in the updated response to Board staff interrogatory 7.

Updated LRAM Amount

Board staff notes that the updated LRAM claim of $609,077 includes the final OPA verified results of the 2010 OPA programs. To the extent that it impacts the 2009 and 2010 years, Board staff submits that using the updated 2010 verified results is appropriate and consistent with the method accepted by the Board in past applications. On that basis, Board staff submits that the appropriate LRAM for the Board to approve is $428,857 ($609,077 - $180,200).

Board staff would make the same observations for the 2011 year in the event the Board is inclined to approve the inclusion of the 2011 year. First, Board staff notes that the current CDM Guidelines state as follows:

> LRAM is a retrospective adjustment, which is designed to recover revenues lost from distributor supported CDM activities in a prior year[2].

In this case, Hydro One Brampton has filed a claim for a year that has not yet ended although Board staff acknowledges that the rate year for this application is 2012 and that the claim is not for new programs in 2011 but previous years' programs that persist into 2011. Nevertheless, Board staff submits that Board practice has been only to approve an LRAM for years that have ended. In this scenario, Board staff would also make the following observations:

1 Section 5.2: Calculation of LRAM, Guidelines for Electricity Distributor Conservation and Demand Management (EB-2008-0037)
2 Section 5.0: Lost Revenue Adjustment Mechanism (LRAM), Guidelines for Electricity Distributor Conservation and Demand Management (EB-2008-0037)

Board staff notes that there were some substantial differences between the original filing and the updated LRAM amount, particularly in regards to the GS < 50 kW rate class which went from $204,850 in the original filing to $338,936 in the updated LRAM claim. Board staff would find it helpful in future proceedings if Hydro One Brampton could provide a more thorough update that included an explanation for significant updates to its original filing.

In the event that the Board approves the inclusion of the lost revenue associated with the 2011 year, Board staff makes the following submission with respect to the 2011 amount.

Hydro One Brampton has used the input assumptions that were in place prior to the end of the 2011 program year to calculate its LRAM claim. Board staff submits that these may not be found to be the best assumptions to determine Hydro One Brampton's actual losses. Board staff submits that Hydro One Brampton should be required to track any differences between the 2011 lost revenues it has included in this application ($180,200) and the input assumptions in place at the time it files its next rate application. If there are no changes to the OPA's Measures and Assumptions list, there will be no difference between what Hydro One Brampton has recovered and its actual losses. However, if there is a change to the OPA's Measures and Assumptions list, there will be a difference in actual losses and what Hydro One Brampton has recovered. This amount should be presented to the Board for review by parties and a decision by the Board regarding the difference in order to keep Hydro One Brampton whole for only the actual losses it has incurred because of delivering CDM programs.

Board staff also makes the following submission with respect to the adjustment for the 2009 programs noted above.

Hydro One Brampton adjusted its LRAM claim in its interrogatory responses by removing a portion of energy savings associated with 2009 programs that were accounted for in Hydro One Brampton's 2011 load forecast. Hydro One Brampton provided additional evidence in relation to this adjustment in its updated interrogatory response filed on November 15, 2011. In reviewing the updated evidence, Board staff submits that Hydro One Brampton has provided an adequate description of this adjustment and its rationale for why it is necessary and appropriate.

Disposition of the Balance in Account 1562 Deferred PILs

Interest Expense True-up Variance

Background

In 2001, the Board approved a regulatory PILs tax proxy approach for rate applications coupled with a true-up mechanism filed under the Reporting and Record-keeping Requirements ("RRR") to account for changes in tax legislation and rules and to true-up between certain proxy amounts used to set rates and the actual amounts. The variances resulting from the true-up were tracked in account 1562 for the period 2001 through April 30, 2006.

On December 18, 2009 the Board issued a decision in the Combined Proceeding and provided its views on how it will review the evidence related to account 1562 deferred PILs.

> The parties may well differ in their interpretations of the methodology but the Board will decide those questions on the basis of the facts and the underlying documents. The Board will not enter into an enquiry as to what the methodology should have been but rather, will determine, where necessary, what the methodology was and what the appropriate application of the methodology should have been.[3]

The Board identified components of interest expense in the instructions for filing the RRR SIMPIL models[4]. In the combined proceeding, staff filed some of these instructions as exhibits.[5] The Notes to the Proxy Model ("SIMPIL") Excel Worksheets issued by the Board on December 21, 2001 (as revised January 18, 2002) indicated that for determination of the true up for excess interest distributors should: "Enter actual

3 EB-2008-0381Combined Proceeding, Account 1562 Deferred Payments in Lieu of Taxes (PILs), pg. 7.
4 Spreadsheet implementation model for payments in lieu of taxes.
5 http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/193868/view/
http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/193878/view/
http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/193877/view/
http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/193884/view/
http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/193883/view/

amount of interest expensed in MoF filing "[6]. There is no discussion in these notes of adjustments that could or should be made to this actual interest expense. Furthermore, the excerpt below is taken from the 2005 instructions (and was intended as an instruction of what to enter for interest expense) but also existed in previous years' guidance as well.

> Actual interest expense, including the amount capitalized for accounting but deducted for tax, that exceeds the full amount of deemed interest. Please note the interest true up is calculated in Part V, Interest Portion of True-up.

The Accounting Procedures Handbook ("APH") interest income is recorded in account 4405[7] and various types of interest expense are recorded in accounts 6005 through 6045.[8] In audited financial statements the groupings of these accounts are determined by the utility.

Issues

Hydro One Brampton defines interest expense for the purpose of the interest claw-back penalty as the interest reported in its financial statements.[9] As shown in the table below, Hydro One Brampton grouped several types of interest income, expense and amortization of deferred debt costs in determining its financial statement disclosure.

6 http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/198685/view

7 APH, Uniform System of Accounts, Article 210, pg 13.
8 APH, Uniform System of Accounts, Article 210, pg 20.
9 EB-2011-0174/Response to Staff IRs/Tab11/Sch2/IR#11/pg20 ln13-25/pg21ln 1-4.

Table 11: Interest Expense Components Used in SIMPIL Models for Interest Portion of True-up [10]

Component Description	2001	2002	2003	2004	2005
Long-Term Debt	1,291,099.00	9,954,381.78	9,938,499.99	9,938,500.00	9,938,500.24
Interest Related to Regulatory Assets & Liabilities	-	(192,784.69)	(8,608.68)	(49,278.46)	(457,834.75)
Amortization of Deferred Debt Costs	-	25,920.00	25,920.00	25,920.00	25,920.00
Interest Expense	5,356.64	(52,020.32)	18,401.13	70,112.24	124,007.05
Allowance Other Funds During Construction	(229,306.00)	(410,765.00)	-	-	-
Interest Expense on Customer Deposits	81,049.36	116,003.05	57,145.43	75,641.78	102,531.67
Foreign Exchange	-	-	-	-	2,713.50
Interest and Dividend Income	-		(384,369.21)	(152,786.79)	(196,079.85)
1. Financial Statement amounts used in TAXREC sheet, Section B of SIMPIL Models	**1,148,199.00**	**9,440,734.82**	**9,646,988.66**	**9,908,108.77**	**9,539,757.86**
Add Back Allowance Other Funds During Construction	229,306.00	410,765.00	-	-	-
2. Interest Expense used for Interest Portion of True-up in SIMPIL Models	**1,377,505.00**	**9,851,499.82**	**9,646,988.66**	**9,908,108.77**	**9,539,757.86**

Hydro One Brampton complied with the requirement to add back capitalized interest (allowance for funds used during construction) in 2001 and 2002. However, it did not adjust the other items such as interest income on regulatory assets, on customer deposits and other interest and dividend income.

Interest Income used as an offset to Interest Expense

Should interest income be deducted in determining interest expense for purposes of the interest claw-back? The Board has not addressed this question to the knowledge of staff. In application filing instructions, applicants were instructed to disclose interest income as an offset to gross revenue requirement in determining the amount of revenue to be recovered through distribution rates.

Hydro One Brampton's treatment of interest income as an offset to interest expense for the claw-back calculations, while unique, does not appear to violate any previous Board instruction or policy. Board staff therefore does not oppose this treatment.

10 EB-2011-0174/Response to Staff IRs/Tab11/Sch2/IR#11/pg20.

Interest on Customer Deposits and Prudential Costs

Several distributors have submitted evidence in the 2012 IRM process to reduce total interest expense for items like interest expense on customer deposits. Others have deducted interest related to letters of credit for the IESO prudentials. Hydro One Brampton has included these types of interest expense in its determination of total interest expense.

Staff submits that these types of downward adjustments are not supported by prior Board guidance and should not be made in the determination of interest expense. Staff agrees therefore with Hydro One Brampton's treatment of these items in the SIMPIL interest true-up calculations.

Interest Income and Interest Expense on Regulatory Asset and Liability Balances

In the combined proceeding, the parties completely settled Issue #4 with respect to the treatment of regulatory assets in the determination of the balance in account 1562 deferred PILs. In its EB-2010-0132 Decision, the Board agreed that this approach should apply to HOBNI:

> In the Combined Proceeding, the settlement agreement approved by the Board excluded both recoveries and deductions from the determination of the balance in PILs account 1562. The Board approves the same approach for HOBNI.

As can be seen in Table 11 above, Hydro One Brampton has deducted interest income on regulatory assets in calculating the net interest to be used in the interest claw-back calculations.

The debit side of the interest income entry is recorded as part of the debit balance of the regulatory assets. Since the assets and liabilities are excluded from the PILs 1562 balance calculations, so too should the related interest income be excluded to provide symmetrical treatment.

Staff submits that this treatment of interest on regulatory assets by Hydro One Brampton is inconsistent with the combined decision and the Board's Decision in EB-2010-0132. Board staff therefore submits that the interest income should be removed in the calculation of actual interest.

Tax Basis of Amortization of Deferred Debt Issue Costs

In the tax return, the determination of tax starts with the calculation of taxable income. The tax form schedule 1 is used to reconcile net income as reported on the financial statements with net income for tax purposes by adding and deducting items based on complex rules. There are tax rules with respect to capitalization of interest, amortization of debt issue costs, discounts and premiums. Additional items, such as charitable donations and loss carry-forwards, are then deducted to calculate taxable income.

Other examples of differences between accounting and tax treatments where the accounting number is added back and the tax number is deducted are:

- Accounting depreciation and tax capital cost allowance.
- Accounting accrual costs for post-employment benefits and the tax deductible amounts which are the cash payments.
- Bad debts expense and the receivable amounts actually written off.

In Table 11, Hydro One Brampton shows that the amortization of deferred debt costs is correctly shown as a component of interest expense. In the tax returns from 2001 to 2005 on schedule 1, Hydro One Brampton has correctly added back the accounting amortization of these debt costs and deducted the amount that was allowable for tax purposes. In the SIMPIL models, Hydro One Brampton disclosed these items on sheet TAXREC3 which in Board staff's view correctly avoids true-up to ratepayers.

However, since the net tax deductible amount is interest in nature, it should be part of the actual interest for the true-up calculations. From Hydro One Brampton's evidence, Board staff has prepared the following table showing the addition of the accounting number and the deduction of the allowable tax amount:

Year	Additions: Accounting	Deductions: Tax	Net Increase in Interest Expense Deduction
2001		64,807	64,807
2002	25,920	154,670	128,750
2003	25,920	154,606	128,686
2004	25,920	154,606	128,686
2005	25,920	154,606	128,686
Total			579,615

Staff submits that the difference between the accounting additions and tax deductible amounts of amortization of deferred debt costs for each tax year should be added to the actual interest expense when computing the interest true-up variance.

All of which is respectfully submitted.