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January 31, 2012

VIA MAIL and E-MAIL

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

Dear Ms. Walli:

**Re: Vulnerable Energy Consumers Coalition (VECC)
Final Submissions: EB-2011-0399
Hydro One Networks Distribution Request for Approval of USGAAP for
Rate Setting, Regulatory Accounting & Reporting Purposes**

Please find enclosed the submissions of the Vulnerable Energy Consumers Coalition (VECC) in the above noted proceeding.

Thank you.

Yours truly,

Michael Buonaguro
Counsel for VECC

cc: Hydro One Networks Inc.

ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an application by Hydro One
Networks Inc. for an order or orders approving a
distribution revenue requirement and rates and other
charges for the distribution of electricity;

AND IN THE MATTER OF a request by Hydro One
Networks Inc. for Approval for the use of the USGAAP
accounting standard for Rate Setting, Regulatory
Accounting and Regulatory Reporting, as of January 1,
2012, in its Distribution business.

FINAL SUBMISSIONS

On Behalf of The

VULNERABLE ENERGY CONSUMERS COALITION (VECC)

January 31, 2012

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Vulnerable Energy Consumers Coalition (VECC)
Final Argument

1 Introduction

1.1 On December 1, 2011 Hydro One Networks Inc. (HONI) filed an Application with the Ontario Energy Board requesting approval to adopt USGAAP for rate setting, regulatory accounting and regulatory reporting for its Distribution business as of January 1, 2012¹. The Application also sought the Board's approval regarding various Deferral/Variance Accounts.²

1.2 Set out below are VECC's final submissions on these matters.

2 Hydro One Networks' Use of US GAAP for Financial Reporting

2.1 Initially, it was assumed that all of Ontario's electricity transmitters and distributors would be required to adopt MIFRS for financial and regulatory reporting purposes commencing January 1, 2012. However, in May 2011 it became known that there was an option for these rate regulated entities to apply to their securities regulator for an exemption to permit the use of US GAAP for the preparation of financial statements³. Subsequent to this, the Board released its Addendum to Report of the Board – Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment in which the possibility of adopting US GAAP for regulatory purposes was introduced. The Addendum also outlined what information/evidence a utility would need to provide if requesting to adopt US GAAP⁴.

2.2 On July 7, 2011 HONI filed an application⁵ with the Ontario Securities Commission ("OSC") seeking approval to utilize US GAAP as the basis for preparing its periodic public securities filings effective January 1, 2012. Approval to do so was

¹ Exhibit A, Tab 2, Schedule 1, page 1

² Exhibit A, Tab 2, Schedule 1, page 2

³ Exhibit A, Tab 3, Schedule 1, page 1

⁴ Exhibit A, Tab 3, Schedule 1, page 2

⁵ Exhibit B, Tab 1, Schedule 2

granted by the OSC on July 21, 2011⁶. The OSC approval is effective up to the end of 2014.

- 2.3 On August 17, 2011 Ontario Regulation 395/11 was approved requiring Hydro One Inc. (HONI's parent company) to prepare its financial statements in accordance with U.S. generally accepted accounting principles (US GAAP)⁷. However, unlike the OSC approval, there is no time limitation in the Regulation on the use of US GAAP.
- 2.4 VECC submits that the OSC approval and Ontario Regulation 395/11 place Hydro One Networks Inc. in a unique position relative to other electricity distributors in the Province as it has both the necessary OSC approval to adopt US GAAP for reporting purposes and, more importantly, is required by statute to adopt US GAAP for financial reporting purposes.

3 Hydro One Networks' Request with Regard to Regulatory Rate Applications, Accounting and Reporting

- 3.1 The Board's Addendum indicated⁸ that distributors would normally be expected to apply for the use of US GAAP in their first cost of service proceeding. However, in its EB-2011-0268 Decision the Board acknowledged⁹ that a HONI application seeking approval for the use of US GAAP in place of MIFRS could be made as a stand-alone application.
- 3.2 In its Application HONI has specifically requested that the Board issue an Order or Orders "approving the utilization by Hydro One Distribution of US Generally Accepted Accounting Principles ("US GAAP") as its approved framework for rate setting, regulatory accounting and regulatory reporting commencing January 1, 2012¹⁰. The Application also sought¹¹ the Board's approval to:

⁶ Exhibit B, Tab 1, Schedule 1

⁷ OEB Staff Interrogatory #6

⁸ Page 19

⁹ Page 14

¹⁰ Exhibit A, Tab 3, Schedule 1, page 3

¹¹ Exhibit A, Tab 3, Schedule 1, page 3

- Discontinue the Impact for Changes in IFRS Account,
- Continue, with a revised scope, the IFRS Incremental Transition Costs Account, and
- Establish a new Impact for US GAAP Account.

Adoption of US GAAP for Rate Setting, Regulatory Accounting and Regulatory Reporting

3.3 In its June 2011 Addendum Report¹² the Board indicated that if a utility wished to use US GAAP for regulatory purposes it must file the following information in its cost of service application:

- The eligibility of the utility under the relevant securities legislation to report financial information using that standard,
- A copy of the authorization to use the standard from the appropriate Canadian securities regulator (if applicable) showing any conditions or limitations, and
- Set out the benefits and potential disadvantages to the utility and its ratepayers of using the alternate accounting standard for rate regulation.

3.4 As noted in the preceding section of VECC's submissions, Hydro One Inc. has received authorization from the OSC to use US GAAP for preparing its periodic public securities filings effective January 1, 2012. Furthermore, VECC notes that Hydro One Inc. is required, by Ontario Regulations, to prepare its financial statements in accordance with US GAAP. As a result, VECC submits that HONI has met the Board's first two requirements.

3.5 In HONI's view "there is significant value to both ratepayers and its shareholder in using US GAAP for regulatory purposes"¹³. For rate payers, the benefits cited include:

- Continued rate stability, as US GAAP is very similar to CGAAP¹⁴,
- Lower distribution rates in the near term¹⁵ due to the continuance of existing

¹² Page 19

¹³ Exhibit C, Tab 1, Schedule 1, page 2

¹⁴ OEB Staff #7 and #8

capitalization policies¹⁶,

- Lower revenue requirement and rates over the long term due to differences between group accounting under US GAAP and item accounting under IFRS regarding the treatment of gains and losses upon retirement¹⁷, and
- Reduced compliance and reporting costs for HONI as compared to using MFRIS for regulatory purposes for distribution but US GAAP for financial reporting for both transmission and distribution and for regulatory purposes for its transmission business¹⁸, which would otherwise have to be passed on to customers¹⁹,

In its Application, HONI has also set out the ways in which its other major stakeholders (the OEB, the financial community, its shareholder, and the Corporation itself) benefit from the adoption of US GAAP for regulatory purposes²⁰.

3.6 VECC notes that these are generally the same benefits as were cited by HONI in the EB-2011-0268 proceeding and found sufficiently compelling for Board to approve the use of US GAAP in that instance. VECC further notes that the recent approval for HONI's transmission business to use US GAAP for regulatory purposes further accentuates the benefits²¹ (in terms of cost reduction) of using US GAAP for HONI's distribution business. Overall VECC agrees with HONI's evidence in this area and submits that there are significant benefits to be had by all from HONI being permitted to use US GAAP for regulatory purposes.

3.7 The only potential disadvantage is that HONI's transition to US GAAP will not facilitate the benchmarking of its results with those of other local (Ontario) electric distribution utilities. This issue is more significant for HONI's distribution business than for its transmission business. The reason for this is that HONI's transmission

¹⁵ Exhibit C, Tab 1, Schedule 2, page 1

¹⁶ Exhibit C, Tab 1, Schedule 1, page 3

¹⁷ Exhibit C, Tab 1, Schedule 1, page 4 and VECC #5

¹⁸ As approved in EB-2011-0268

¹⁹ VECC #2 b) and Exhibit C, Tab 1, Schedule 1, pages 2-3

²⁰ Exhibit C, Tab 1, Schedule 1, page 2 and VECC #2

²¹ VECC #2 b)

business tends to be benchmarked against major US transmission companies (who will themselves be using US GAAP) while its distribution business is generally benchmarked against other Ontario distributors (who will by and large be adopting MIFRS). This issue was acknowledged by the Board in its EB-2011-0268 Decision and HONI was directed²² to “address the potential disadvantages raised by intervenors and Board Staff of the increased difficulty in benchmarking Hydro One Distribution to other Ontario distributors if Hydro One uses the US GAAP accounting standard” in its next rate application.

3.8 In VECC’s view it would have been preferable if HONI had been directed to address this issue as part of the current Application. This would have allowed the Board to make a fully informed decision regarding the use of US GAAP for HONI’s distribution business. To this end VECC and Board Staff²³ sought preliminary comments from HONI on how the benchmarking issue could/would be addressed.

3.9 In VECC’s view HONI’s answer was non-responsive. The Company did not have any further insight to offer on the types of “high level adjustments” it anticipates making in order to allow its results to be comparable to those of other Ontario distributors. Furthermore, it did not indicate (as requested) what work it was undertaking to address the issue and/or what had been completed to date. However, of even more concern, is that fact that a good part of the response dealt with the “age old argument” as to how HONI was different from other distributors and so could not be “benchmarked”. Similarly, VECC found the discussion regarding the problems on benchmarking depreciation to be somewhat misleading as the Board’s current benchmarking activities focus on OM&A. In VECC’s submission this is not responsive to the Board’s EB-2011-0268 Decision and the Board should make it clear to HONI that it expects a constructive response to be provided in HONI’s next Distribution Rate Application.

3.10 In its June 2011 Addendum Report²⁴ the Board stated that the “adoption of US

²² Pages 13-14

²³ VECC #6 and Board Staff #10

²⁴ Pages 19-20

GAAP as a short term solution may be counter-productive". While Hydro One's request to the OSC regarding the use of US GAAP for filing its financial statements was only for the period before January 1, 2015, the Company has explained the choice of a three year exemption period was based on the Enbridge Income Fund precedent and the fact that such a term was likely to be approved²⁵. However, Hydro One has also indicated that if the issues surrounding rate-regulated accounting under IFRS are not resolved by the time the exemption granted by the OSC expires then it would likely apply for a further extension²⁶ or even a permanent exemption²⁷. As a result, in HONI's case, the use of US GAAP does not represent a short-term delay in the implementation of IFRS (as it is currently formulated).

- 3.11 In its EB-2011-0268 submissions VECC expressed the view that the benefits of HONI adopting US GAAP for regulatory purposes far outweighed any potential disadvantages and the use of US GAAP by HONI should be approved by the Board for both its Transmission and Distribution businesses. However, given the nature of HONI's response to Board Staff #10 VECC is unable to offer unqualified support, at this time, for HONI's request that it be allowed to use US GAAP as the approved framework for rate setting, regulatory accounting and regulatory reporting for its distribution business commencing January 1, 2012. As noted above, the use of US GAAP has material benefits, but VECC does not want to see the adoption of US GAAP (ultimately) being used by HONI as an additional rationale/excuse as to why benchmarking does not work for its distribution business. However, subject to HONI addressing this concern to the Board's satisfaction, VECC submits that the adoption of US GAAP by HONI's distribution business for regulatory purposes should be approved by the OEB.

²⁵ EB-2011-0268, OEB Staff #8

²⁶ VECC #8 and EB-2011-0268, OEB Staff 10 iii)

²⁷ EB-2011-0268, VECC #2

Proposed Changes to Deferral and Variance Accounts

- 3.12 In 2009 the Board established an IFRS – Incremental Transition Costs Account to capture variances between the actual costs incurred by a utility in transitioning to MFRIS and (any) costs included in the utility's approved rates. If its request to adopt US GAAP for regulatory purposes is approved, HONI proposes to continue to track the cost incurred to date related to its original plans to transition to MIFRS and to also track (separately) any costs incurred in transitioning to US GAAP²⁸. HON notes that the IFRS-Incremental Transition Costs Account currently has a net balance of \$309 k²⁹ and that it has incurred \$75 k to date in US GAAP transition costs³⁰. HONI also indicates that it does not expect to incur significant incremental US GAAP transition costs during 2012. VECC submits that, if US GAAP is approved for use by HONI distribution, then HONI's proposals regarding the change in scope for this account are reasonable.
- 3.13 HONI also proposes to discontinue the Impact for Changes to IFRS Account and replace it with an Impact for Changes to US GAAP Account³¹. The purpose of this latter account would be to capture any differences between Canadian and US GAAP that would impact its revenue requirement. To date, HONI has not identified any such differences³² and appears to be requesting the account as a "precautionary" measure. In principle, VECC has no objection to the approval of such an account if HONI's distribution business is granted approval to adopt USGAAP for regulatory purposes. However, VECC would be concerned if ultimately there were material variances recorded in the account since the main justification for adopting US GAAP is its similarity to current Canadian accounting practices.

²⁸ Exhibit D, Tab 1, Schedule 1, page 2

²⁹ Board Staff #5

³⁰ Board Staff #2

³¹ Exhibit D, Tab 1, Schedule 1, pages 1-2

³² Exhibit D, Tab 1, Schedule 1, page 2 and OEB Staff #7 & #8

4 Recovery of Reasonably Incurred Costs

- 4.1 VECC submits that its participation in this proceeding has been focused and responsible. Accordingly, VECC requests an award of costs in the amount of 100% of its reasonably-incurred fees and disbursements.

All of which is respectfully submitted this 31st day of January 2012