



ONTARIO ENERGY BOARD

STAFF SUBMISSION

2013 ELECTRICITY DISTRIBUTION RATES

Hydro One Networks Inc. Distribution

EB-2012-0136
Account 1562 PILs Issue

February 13, 2013

**Board Staff Submission
Hydro One Networks Inc. Distribution
2013 IRM Rate Application
EB-2012-0136**

Introduction

Hydro One Networks Inc. ("Hydro One") filed an application with the Ontario Energy Board (the "Board") on June 15, 2012, under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the distribution rates that Hydro One charges for electricity distribution, to be effective January 1, 2013.

On December 14, 2012, the Board issued its Decision and Procedural Order No. 4 and indicated that it accepted the Settlement Agreement. The Board issued an approved 2013 Rate Order on December 20, 2012.

In its December 14, 2012 Decision, the Board also indicated that it would institute a written proceeding within this application, with regard to the issue of Payments In Lieu of Taxes (PILS) Account 1562 (Deferred Payments in Lieu of Taxes), as noted at pages 15 and 16 of the Settlement Agreement.

On January 10, 2013 the Board issued Procedural Order #5, where it asked for submissions on a threshold question:

"Should the principles established in the Combined PILs Proceeding and in subsequent decisions on PILs issues regarding the decline in tax rates and changes in other tax laws be applied to Hydro One during the period covered by Hydro One's first OEB Rate Order (RP-1999-0001) through April 30, 2006 and if not, what approach should be taken to account for these changes in this time period?"

Hydro One provided its submissions on this issue on January 30, 2013. Board staff and Intervenor submissions were to be filed on February 13, 2013.

The purpose of this document is to provide the Board with the submissions of Board staff based on this issue and in response to the Hydro One submissions.

Board staff makes submissions on the following matters:

- Sections 89/90 and Section 93 of the *Electricity Act, 1998*;

- The Canadian Niagara Power Inc. Decision (EB-2012-0112) of November 22, 2012 regarding Account 1562;
- Retroactive Ratemaking;
- Board Guidance on Account 1562, and
- Hydro One MEU Acquisitions.

Hydro One Submission Summary

In its January 30, 2013 submission, Hydro One indicated that the principles established in the Combined PILs Proceeding (EB-2008-0381) regarding the decline in tax rates and changes in other tax laws do not apply to Hydro One for the period 1999 to April 2006.

Hydro One submitted that Account 1562 only applied to those distributors subject to section 93 of the *Electricity Act, 1998* and that the rationale for the variance account does not apply to Hydro One.

Hydro One also pointed out that the Board and other stakeholders were aware that Hydro One was not using Account 1562 and that for the Board to now require Hydro One to do so is retroactive ratemaking, contrary to general ratemaking principles.

- **Sections 89/90 and Section 93 of the Act**

Hydro One submitted that it began making PILs payments to the Ontario Electricity Financial Corporation (“OEFC”) in accordance with sections 89 and 90 of the *Electricity Act*, beginning on April 1, 1999. Hydro One also noted that the Board did not establish a variance account for by Hydro One to track any PILs variances.

Hydro One pointed out that this was not the case with the Municipal Electricity Utilities (“MEUs”) which were not subject to PILs until October 1, 2001 with the proclamation of section 93 of the *Act*. As a result of this legislative change, the Board issued a letter on August 24, 2001 informing these utilities that a new variance account would be established to implement the Board’s approach to recovery of PILs. The account was later identified as Account 1562 – Deferred Payment in Lieu of Taxes in the 2001 version of the Accounting Procedure Handbook (“APH”).

The establishment of this variance account allowed the MEUs to track and record variances that result from the difference between the Board approved PILs forecast amount and the amount of actual billings that relate to the recovery of PILs. The Board further clarified that Account 1562 and the methodology used to determine the PILs

variance tracked in this account was designed to address PILs required under section 93 of the Act. (see Appendix B of the December 21, 2001 Filing Guidelines for March 1, 2002 Distribution Rate Adjustments) The rationale behind the need for the variance account was due to the inherent uncertainty in any PILs forecast that an MEU would make. MEUs had been tax-exempt previously and thus there was no historical information that could be used to reliably forecast its PILs payment or tax liability.

With regard to the Board's Combined PILs proceeding (EB-2008-0381), Hydro One submitted that the documentation issued by the Board at that time, referred only to those distributors subject to section 93 of the Act. Therefore, in Hydro One's view, the intent of the Combined PILs Proceeding was to focus on the disposition of Account 1562 balances for electricity distributors who were subject to section 93 of the Electricity Act. The Board's documents showed no intent that this Combined PILs proceeding would apply to non-section 93 entities. Therefore, Hydro One's position is that the decisions resulting from this proceeding do not apply to non-section 93 entities, including Hydro One.

Board Staff Submission

While Hydro One has claimed that as a distributor subject to only sections 89 and 90 of the Electricity Act, 1998, it was not subject to Account 1562 or the Combined Proceeding, Board staff submits that although two separate sections of the Act differentiate between Municipal Electric Utilities and Hydro One, the intent of the legislation is the same:

Section 89 reads that if Hydro One "...is exempt under subsection 149 (1) of the *Income Tax Act* (Canada) from the payment of tax under that Act, it shall pay to the Financial Corporation in respect of each taxation year an amount equal to the amount of the tax that it would be liable to pay under that Act if it were a corporation to which that subsection did not apply.

Section 93 reads that if a municipal utility "...is exempt under subsection 149 (1) of the *Income Tax Act* (Canada) from the payment of tax under that Act, it shall pay to the Financial Corporation in respect of each taxation year an amount equal to the amount of the tax that it would be liable to pay under that Act if it were not exempt.

Each section refers to exemption from the payment of tax and that both entities, Hydro One and the Municipal Utilities are to pay the amount of tax equal to the amount of tax they would pay if they were not exempt.

Board staff submits that the legislation is effectively holding both Hydro One and the Municipal Utilities to the same standard, even if the standards are found in separate

sections of the Act. Therefore, Board staff sees no effective distinction between the MEUs and Hydro One on these tax matters.

With regard to the reference to only section 93 in the Combined PILs Proceeding, staff submits that these documents are not significant for consideration in Hydro One's applicability to be subject to Account 1562. Documents that indicate the rough scope of a proceeding do not necessarily indicate the Board's overall policy on an issue.

- **The Canadian Niagara Power Inc. Decision (EB-2012-0112) of November 22, 2012 regarding Account 1562;**

The Board's November 22, 2012 Decision in the Canadian Niagara Power Inc. case (EB-2012-0112) ruled that CNPI did not require the 1562 Variance Account. Hydro One submitted that its circumstance is the same as CNPI.

Board Staff Submission

Board staff submit that the CNPI situation, where CNPI is a privately own distributor who paid taxes according to the Income Tax Act is a different circumstance than Hydro One distribution and that this decision is not related to Hydro One's situation. Board staff points out that Hydro One is not privately owned and did not pay taxes according to the Income Tax Act and therefore the CNPI decision does not apply to Hydro One's circumstances.

Board staff also acknowledges the Algoma Power Inc. (EB-2011-0217) decision of February 7, 2012 which reinforced the CNPI decision, however, Algoma is also privately held, unlike Hydro One.

- **Retroactive Ratemaking**

Hydro One indicated that the Board approved the Ontario Hydro Services Company's ("OHSC's") application for 1999 and 2000 distribution revenue requirement (RP-1998-0001), including provisions for income taxes to set distribution rates for 1999 and 2000. Since 2002, Hydro One stated that it has been filing its variance balances quarterly as part of the Board's Reporting and Record-keeping Requirements. Hydro One stated that it has never carried a balance in Account 1562. In addition, Hydro One has come before the Board in many rate proceedings and RRR filings over the years.

Hydro One pointed out that the Board also approved its rate mitigation plan in 2002 (RP-2000-0023/EB-2001-0016) and highlighted that the reduction in distribution revenue requirement was already well above the adjustment that would be made by applying PILs guidelines to reflect timing differences and lower statutory rates. Rate increases were limited in 2001, 2002 and 2003.

Hydro One submitted that the Board has been aware that Hydro One was not using Account 1562, nor any other mechanism to account for changes in rules and policy during that period and to track PILs variances. Hydro One submitted that in consideration of their rate setting history, mandating a review of accounts for tax changes after a decade is retroactive rate making in the extreme.

Board Staff Submission

Board staff submits that the Board's findings in the Combined PILs Proceeding are by no means retroactive rate making. The prudence review and true up of an existing Variance Account (1562) is a common practice of economic regulators and is not equated with retroactive ratemaking. At question is whether it was clear Account 1562 is applicable to Hydro One.

- **Board Guidance on Account 1562**

Hydro One submitted that the guidance documents relating to Account 1562 in 2001 (the APH, the December 21, 2001 Filing Guidelines, and the Rate Adjustment Model (RAM)) did not apply to Hydro One. Hydro One indicated that it contacted the Board on three occasions to obtain guidance from the Board on its situation as a non-section 93 utility, but did not receive a reply.

As such, Hydro One submitted that Account 1562 was never intended to apply to Hydro One.

Board Staff Submission

Hydro One has argued that they sent letters to the Board detailing their approach to PILs and that because no direction to the contrary was received by the Board this meant that Account 1562 did not apply to Hydro One. Board staff submits that while letters to the Board are informative, the lack of response does not mean the Board agrees with that letter. Board staff has determined that the February 25, 2002 letter was not just sent to the Board but was also placed on the record of the RP-2000-0023, EB-2001-0016 rate proceeding, in which PILs was an issue. On that basis, this letter appears to have been evidence in this rate proceeding in which the Board accepted

Hydro One's rate mitigation plan. However, staff can find no reference to Account 1562 in that proceeding, or in the Board's decision, so it is not clear to what extent the Board had considered this letter in the proceeding.

Board staff believes that the Board will now have to determine if it is persuaded that it was understood by the Board at the time that a different approach to PILs was being approved for Hydro One.

- **Hydro One MEU Acquisitions**

In its submission, Hydro One mentions that, "Most of Hydro One's MEU acquisitions were completed prior to October 1, 2001 and the assets were consolidated with those of Hydro One Networks." Hydro One mentions two exceptions, Terrace Bay Superior Wires ("Terrace Bay") in 2007 and Brampton Hydro in 2001.

Board Staff Submission

It was helpful for Hydro One to provide details on the timing of the acquisitions because it allowed for a detailed review of the relevant rate proceedings. Board staff invites Hydro One in its reply submission to confirm that there were no other acquisitions after October 1, 2011 in which the distributor received Board approval for a PILs Proxy. With respect to Terrace Bay, Hydro One mentions that, at the time Terrace Bay was acquired, it had a credit balance of \$2,765 in Account 1562, but submits that this amount is immaterial relative to the Terrace Bay rate base of approximately \$1 million at that time.

Board staff submits that the fact that a relatively small amount was recorded in the Terrace Bay accounts at that time is no basis for judging materiality. As was shown in the Hydro One Brampton case (EB-2011-0174), scrutiny by intervenors and Board staff resulted in a material restatement of Account 1562 amounts. However, Board staff has reviewed the files from Terrace Bay's 2002 rate proceeding. While Terrace Bay did calculate a PILs Proxy, it decided to forgo this adjustment in order to mitigate rate impacts¹. While this was not raised by Hydro One, Board staff submits that because there were no amounts approved in rates for PILs, no entries to Account 1562 are required.

All of which is respectfully submitted.

¹ Manager's Summary, Terrace Bay Superior Wires Inc. RP-1999-0209, EB-2001-0629, page 2.