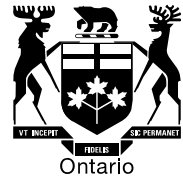


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**BY EMAIL**

January 30, 2015

Ontario Energy Board  
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[Kirsten.Walli@ontarioenergyboard.ca](mailto:Kirsten.Walli@ontarioenergyboard.ca)

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

**Re: Halton Hills Hydro Inc.  
Application for Rates  
Board File Number EB-2014-0079**

In accordance with Procedural Order No.1, please find attached Board Staff's Submission in the above proceeding. This document is being forwarded to Halton Hills Hydro and VECC, as the other registered party to this proceeding.

Halton Hills Hydro is reminded that its Reply Submission, if it intends to file one, is due by February 13, 2015.

Yours truly,

*Original Signed By*

Martha McQuat  
Project Advisor

Encl.



# **ONTARIO ENERGY BOARD**

## **STAFF SUBMISSION**

**2015 ELECTRICITY DISTRIBUTION RATES**

**Halton Hills Hydro Inc.**

**EB-2014-0079**

**January 30, 2015**

**Board Staff Submission  
Halton Hills Hydro Inc.  
2015 Electricity Distribution Rates  
EB-2014-0079**

## **Introduction**

Halton Hills Hydro Inc. (“Halton Hills Hydro”) filed an application (the “Application”) with the Ontario Energy Board (the “Board”) on October 20, 2014, seeking approval for changes to the distribution rates that Halton Hills Hydro charges for electricity distribution, to be effective May 1, 2015. The Application is based on the 2015 Price Cap IR option.

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 Halton Hills Hydro.

In the interrogatory phase, Board staff identified certain small discrepancies in the data entered by Halton Hills Hydro into the IRM Rate Generator Model. Board staff confirms that it will make the necessary corrections to Halton Hills Hydro’s model at the time of the Board’s decision on the Application.

Halton Hills Hydro seeks to dispose of its December 31, 2013 Group 1 deferral and variance account balances, with interest to April 30, 2015. Board staff notes that the pre-set disposition threshold has been exceeded and that the balances as filed reconcile with the balances reported as part of the *Reporting and Record-Keeping Requirements*. Board staff has no issue with Halton Hills Hydro’s request to dispose of the balances over a one year period.

Board staff makes detailed submissions on the following:

- Halton Hills Hydro’s request for adjustment to base rates given its earnings in prior years

## **Halton Hills Hydro’s Earnings**

Halton Hills Hydro’s application is for the fourth and final year of its price cap IR. Halton Hills Hydro has applied for an increase to its base rates of 1.6%, calculated in

accordance with its stretch factor of 0%, productivity of 0% and inflation of 1.6%. Halton Hills Hydro has calculated the amount of this increase to be \$149,884<sup>1</sup>.

Price Cap IR applications for 2015 rates are prepared in accordance with Chapter 3 of the *Filing Requirements for Electricity Distributors Rate Applications for Price Cap Incentive Rate-Setting and Annual Incentive Rate-Setting Index*, dated July 25, 2014. The filing requirement articulates specific Board policy regarding earnings at section 3.2.10 which states:

“For each of the Board’s three rate-setting options, a regulatory review may be triggered if a distributor’s earnings are outside of a dead band of +/- 300 basis points from the Board-approved return on equity. The Board monitors results filed by the distributors as part of their reporting and record-keeping requirements and determines if a regulatory review is warranted. Any such review will be prospective, and could result in modifications, termination or the continuation of the respective Price Cap IR or Annual IR Index plan for that distributor.

The Board reminds distributors that the filing of an application for an increase to base rates during the IR period or under the Annual IR index is the decision of the applicant; it is not a Board requirement. A distributor whose earnings are in excess of the deadband can refrain from seeking an adjustment to its base rates through a Price Cap IR or Annual IR Index plan. If not, the level of earnings may be raised as an issue in the application.”

In the course of the proceeding, both Board staff and VECC filed interrogatories regarding Halton Hills Hydro’s past earnings levels. In response, Halton Hills Hydro provided its achieved return on equity (“ROE”) for 2011, 2012 and 2013 as follows:

<b>Year</b>	<b>Board Approved Return on Equity</b>	<b>Achieved Return on Equity</b>
2011	8.57%	9.14%
2012	9.12%	13.30%
2013	9.12%	14.97%

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<sup>1</sup> EB-2014-0079, Response to Board staff IR 4c)

Although a forecast of its 2014 return on equity was requested<sup>2</sup>, Halton Hills Hydro responded that the information was not available. Halton Hills Hydro provided its forecast 2014 statement of operations<sup>3</sup>, which shows net income for the period of \$2,903,619.

Halton Hills Hydro stated that variances between actual and achieved ROE can result from many factors that are not necessarily permanent. In this case, the 2013 excess ROE over the amount approved by the Board was the result of a one-time tax refund of \$977,797 resulting from accelerating expenses deducted for income tax purposes and from refiling prior income tax returns. Halton Hills Hydro explained that the tax refund is not a permanent tax saving, as it will result in increased taxes payable in later years. Halton Hills Hydro also indicated that its increased revenues in 2012 were the result of the Board's Decision in EB-2011-0271, approving recovery of lost revenues from CDM activities from 2006 to 2010. Halton Hills Hydro stated that, given the non-permanent nature of the factors underlying its over-earnings, it was reasonable to submit an application for approval of rates under the 2015 Incentive Regulation Mechanism.

## Submission

Board staff submits that the level of earnings in 2012 and 2013 and the expected level of earning in 2014 by Halton Hills Hydro warrants evaluation of whether the Price Cap IR plan for Halton Hills Hydro properly balances the interests of customers in paying reasonable rates and the interests of the utility in earning a financial reward commensurate with its business risks. Board staff submits that the evidence suggests that Halton Hills Hydro's rates have consistently recovered revenues that lead to excessive earnings and that it would be fair to both the utility and its customers to refrain from approving any upward adjustments to its rates until they are reset through a cost of service proceeding.

### *2013 Tax Refund*

The Board's *Supplemental Report of the Board on 3<sup>rd</sup> Generation Incentive Regulation for Ontario's Electricity Distributors* prescribes a 50/50 sharing of the impacts of legislated tax changes from tax rates embedded in Board-approved rates. Halton Hills

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<sup>2</sup> EB-2014-0079, VECC IR #1a)

<sup>3</sup> EB-2014-0079, Board staff interrogatory 4g)

Hydro's base rates have been established on the basis of tax costs of \$28,979<sup>4</sup>. In addition to this amount, which was received from customers in 2013, Halton Hills Hydro subsequently received a tax refund of \$977,797. Board staff submits that this resulted in total tax-related revenues for Halton Hills Hydro of \$1,006,776. Board staff recognizes that the tax changes in this case do not arise from legislated changes in tax rates; Board staff submits nevertheless that the impact of the tax refund in question is significant and has the same overall consequence in 2013 as a change in tax rates would – namely, a significant difference between the expected tax costs embedded in rates and the actual tax cost.

Halton Hills Hydro states that the tax refund is a one-time event that will result in tax increases in future years. However, Halton Hills Hydro confirmed that the future tax increases will be recognized in its 2016 cost of service rate application<sup>5</sup>, so there would appear to be no future negative impact to the company once the company rebases either in 2016, nor, in Board staff's submission, in future cost of service applications. Board staff submits that Halton Hills Hydro has received a windfall through this tax refund, for which its customers have received no benefit. Further, ratepayers will bear the future cost of this windfall through increased rates for the foreseeable future, since a utility's revenue requirement includes taxes. Halton Hills Hydro was unable to provide an estimate of the impact of the tax increase to be included in its 2016 cost of service application, however it stated that:

In general, income for tax purposes for 2014 and subsequent years will be increased since amortization for the amounts capitalized for accounting will be added back to income with no corresponding tax deduction as the costs were not capitalized for income tax purposes<sup>6</sup>.

Board staff notes that while distributors are expected to conduct efficient tax planning, it would be inappropriate for such tax planning to enrich the distributor at the expense of its ratepayers. Consequently, Board staff submits that the Board should consider the appropriateness of sharing a 50% portion of the refund with ratepayers, despite the fact that it does not result from a legislated tax change.

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<sup>4</sup> EB-2011-0171 Revenue Requirement Workform

<sup>5</sup> EB-2014-0079, Response to Board staff interrogatory 4e)

<sup>6</sup> EB-2014-0079, Response to Board staff interrogatory #4e)

Board staff is aware that such an adjustment to a prior year could raise retroactivity concerns. Halton Hills Hydro itself has described this windfall as a timing difference with long term implications in the form of tax increases. Board staff submits that under these circumstances, it may be appropriate to consider the one-time tax effects for 2013 in the context of the total changes to the long-term tax forecast for the utility. Halton Hills Hydro's 2013 taxes were markedly lower, and the shareholder has so far retained the benefit. Future taxes will rise and ratepayers will bear this cost as soon as the utility rebases its rates. Accordingly, Board staff submits it may be fair and consistent with the principles in tax-sharing policy to permit Halton Hills Hydro's customers to share in the tax refund for which they will be expected to pay over time. Board staff submits that the timing of such an adjustment may trigger concerns about retroactive ratemaking, but in this case, it is arguable that fair treatment for ratepayers may be of greater priority. Alternatively, the Board could consider adjusting the tax allowance at the time of the next rebasing to take this credit into account .

In the event that the Board should choose not to allow ratepayers to share in the tax refund, Board staff submits that the 2013 earnings should still be considered by the Board as contributing to a pattern of over-earning in determining the appropriate treatment for Halton Hills Hydro's 2015 rates, as discussed below.

### *2012 LRAM Revenues*

Halton Hills Hydro has explained its over-earning in 2012 as the result of its recovery of LRAM in accordance with the Board's Decision in EB-2011-0271, which approved recovery of LRAM and SSM revenues of \$384,800<sup>7</sup>. Board staff notes that the Decision approved recovery of this amount over a 2-year period, which means that the excess revenues received in 2012 would have been half that amount, or \$192,400. Board staff estimates that these excess revenues result in an increase in Halton Hills Hydro's ROE for that year of 1.13%. Deducting this amount from Halton Hills Hydro's reported ROE of 13.30% results in a ROE of 12.17%.

Board staff submits that the ROE after LRAM still exceeds the 300 basis point deadband from Halton Hills Hydro's approved ROE of 9.12%. While earnings levels of this amount, viewed in isolation, may not be sufficient cause for concern, Board staff

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<sup>7</sup> EB-2011-0271, Partial Settlement Agreement, February 28, 2012, p. 22

submits that these results are consistent with an overall pattern of over-earnings and are therefore noteworthy.

### *2014 Net Income*

Halton Hills Hydro did not provide an estimate of its 2014 return on equity in response to interrogatories. Instead, it provided its Forecast Statement of Operations for 2014<sup>8</sup>. Halton Hills Hydro has forecast net income after taxes for 2014 of \$2,903,619. Based on the Board's RRR filings, Board staff notes that Halton Hills Hydro has reported net income of \$2,705,310 and \$2,930,822 for 2012 and 2013 respectively. Under these circumstances, Board staff submits that expected earnings for 2014 appear to be in the same range as 2012 and 2013. Halton Hills Hydro has not provided a projected rate base calculation for 2014 on which to calculate the ROE forecast.

### *Should the Board allow a base rate increase for 2015 rates?*

Board staff submits that the return on equity reported for Halton Hills Hydro has been above the 300 basis point deadband from its approved return of 9.12% in each of 2012, 2013 and possibly 2014. For the years 2012 and 2014, Halton Hills Hydro has not provided sufficient evidence of cost drivers that would indicate that its earnings level is due to transient or one-time factors. Furthermore, although the 2013 earnings can be largely explained by the one-time tax refund discussed above, Board staff submits that the adjustment will have long-term consequences to ratepayers. While it is true that Halton Hills Hydro is bearing higher tax costs in 2014 and 2015 as a result of the tax changes in 2013, customers would be paying this higher tax cost in 2016 once Halton Hills Hydro rebases.

Accordingly, Board staff submits that the Board should consider whether Halton Hills Hydro's 2015 rates would lead to earnings levels that justly compensate the utility for the actual business risks it faces, or whether there is sufficient indication to suggest that the utility's overearnings are representative of a pattern that is likely to repeat in 2015. If, in the Board's view, the pattern is likely to repeat, then the Board should question whether an increase in the utility's base rates is warranted. Board staff submits that a denial of the base rate increase for 2015 would be an appropriate modification of Halton Hills Hydro's Price Cap IR plan that is consistent with Board policy expressed in the filing requirements.

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<sup>8</sup> EB-2014-0079, Board staff interrogatory 4g)

Board staff further notes that under similar overearning circumstances, the Board has previously ordered distributors to file for early rebasing<sup>9</sup>. Halton Hills Hydro is already scheduled to file a 2016 cost of service application by August 28, 2015<sup>10</sup>. Board staff submits that the Board could consider a declaration of interim rates should Halton Hills Hydro seek to defer its cost of service application or report delays in meeting the Board's deadlines.

*All of which is respectfully submitted*

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<sup>9</sup> Wasaga Distribution Inc., 2012 Cost of Service Application, EB-2011-0103

<sup>10</sup> <http://www.ontarioenergyboard.ca/OEB/Industry/Regulatory+Proceedings/Applications+Before+the+Board/Electricity+Distribution+Rates/2016+Electricity+Distribution+Rate+Applications>