

SCOTT POLLOCK
T 613.787.3541
spollock@blg.com

Borden Ladner Gervais LLP
World Exchange Plaza
100 Queen St, Suite 1300
Ottawa, ON, Canada K1P 1J9
T 613.237.5160
F 613.230.8842
blg.com



Our File # 339583-000237

January 30, 2018

By electronic filing

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th floor
Toronto, ON M4P 1E4

Dear Ms. Walli

**Re: Hydro One Networks Inc. ("Hydro One")
Motion to Review and Vary Decision EB-2016-0160
Board File #: EB-2017-0336**

On Monday, January 29, 2018, we filed the Submissions of Canadian Manufacturers & Exporters ("CME") by email to the Board and to all interested parties in the above-noted proceeding.

Upon further review this morning of CME's Submissions, we note that there are typographical errors found in certain footnotes in the document and in the text. These errors have been corrected as follows:

- Footnotes 9, 22, 25, 26 and 30; and
- Paragraph 31.

A corrected version of CME's Submissions is enclosed. Please replace the document circulated yesterday with this corrected version of CME's Submissions.

Yours very truly

Borden Ladner Gervais LLP

A handwritten signature in black ink, appearing to read 'S. Pollock', is written over a horizontal line.

Scott Pollock

enclosure

- c. Erin Henderson and Oded Hubert (Hydro One)
Intervenors EB-2016-0160
Paul Clipsham and Ian Shaw

OTT01: 8735758: v1

IN THE MATTER OF a cost of service application made by Hydro One Networks Inc. pursuant to section 78 of the *Ontario Energy Board Act 1998* seeking approval for changes to its transmission revenue requirement and to the Ontario Uniform Transmission Rates, to be effective January 1, 2017 and January 1, 2018;

AND IN THE MATTER OF a motion by the Hydro One Networks Inc. pursuant to Rule 42 of the Ontario Energy Board's *Rules of Practice and Procedure* for an order or orders to vary the Decision and Order of the Board EB-2016-0160

**CORRECTED SUBMISSIONS OF
CANADIAN MANUFACTURERS & EXPORTERS ("CME")**

January 29, 2018

Emma Blanchard
Scott Pollock
Borden Ladner Gervais LLP
World Exchange Plaza
100 Queen Street, Suite 1300
Ottawa, ON K1P 1J9
Counsel for CME

1. INTRODUCTION

1. On May 31, 2016, Hydro One Networks Inc. ("**HONI**") filed a cost of service application pursuant to section 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15 Schedule B, seeking approval for increases to its transmission revenue requirement and to the Ontario Uniform Transmission Rates, to be effective January 1, 2017. The Ontario Energy Board (the "**Board**") issued its Decision and Order with respect to HONI's application on September 28, 2017 (the "**Decision**").

2. On October 18, 2017, HONI filed notice of its intention to make a motion for an Order to review and vary the Decision in relation to the following determinations:

- (a) That a portion of the \$2,595 in future tax savings resulting from the deemed disposal at fair market value of all of HONI's assets, should be allocated to ratepayers and applied to reduce the revenue requirement;
- (b) That the annual recovery of carrying charges for capital expenditures in respect of the unfinished Niagara Reinforcement Project (the "**NRP**") approved in HONI's EB-2006-0501 transmission rates case should be discontinued in 2018; and,
- (c) That certain compensation costs attributable to the Ombudsman's Office should not be included in rates.

(the "**Motion**")

2. STANDARD OF REVIEW

3. As set out in Procedural Order No. 1 issued December 19, 2017, the Board has determined that HONI's Motion has met the threshold for review as defined in section 43 of the Board's Rules of Practice and Procedure, and will hear the motion on its merits.

4. CME submits that, as is the case with most reviews of decisions engaging the Board's rate setting expertise,¹ the Board's review of the Decision should be afforded deference through the application of the reasonableness standard.

5. The "reasonableness standard" is "a deferential standard animated by the principle that...certain questions that come before administrative tribunals do not lend themselves to one specific, particular result."²

6. The fact that a decision of the Board engages or impacts principles of corporate law, does not create a basis for applying a more stringent standard of review.³

7. The Board confirmed in *Brantford Power Inc. (Re)* that the Board's review of a decision pursuant to Rule 40 of the Board's Rules of Practice and Procedure uses the same standards as the Court.⁴

8. The aspect of the Decision which is the primary focus of the Motion, is concerned with the extent to which HONI should be permitted to recover in rates amounts in respect of taxes that it is not actually paying, an issue which goes to the heart of the Board's regulatory authority to determine the amount which is reasonable for recovery from ratepayers. The Decision is therefore entitled to a deferential standard of review.

9. In order for HONI to succeed on its Motion, it must demonstrate to the reviewing panel that the outcomes which it seeks to challenge clearly fall outside the range of reasonable outcomes which the evidence before the Board was capable of supporting.

10. CME submits that the Decision, and in particular the Decision as it relates to the allocation of future tax benefits as between shareholders and ratepayers falls within the range of reasonable outcomes in the circumstances and that, as a result, HONI's Motion must fail.

¹ *Ontario (Energy Board) v. Ontario Power Generation Inc.*, 2015 SCC 44 at para 73.

² *Dunsmuir v. New Brunswick*, 2008 SCC 9 at para 47.

³ *Toronto Hydro-Electric System Ltd. v. Ontario (Energy Board)*, (2009), 252 O.A.C. 188 at para 17 (Ont. Div. Ct.).

⁴ *Brantford Power Inc. (Re)*, 2010LNONOEB 269 at paras 34-38.

3. TAX SAVINGS DETERMINATION

11. The potential for amounts recovered in rates in respect of taxes to exceed actual taxes paid by utilities is a longstanding concern for ratepayers.⁵

12. This concern is normally addressed through adherence “to the inclusion of actual tax estimates in rates.”⁶

13. HONI’s 2016-2017 rates application marked a significant departure from both its own historical practice and the normal approach to establishing amounts to be collected in rates in respect of taxes.

14. In rendering its Decision, the Board was required to consider a scenario where HONI would recover in future years through rates “taxes” which the Board estimated will be approximately \$2,595 Million in excess of the taxes which HONI actually expects to pay over the same period.⁷

15. The reason for this disconnect is the existence future tax savings realized as a result of the deemed sale and repurchase of Hydro One Limited’s assets which savings HONI proposed to allocate entirely to its shareholders.

16. In its Decision with respect to the allocation of future tax benefits, the Board applied principles articulated in the report of the Board with respect to the 2006 Distribution Rate Handbook (the “**RP-2004-0188**”), which, *inter alia*, include the following:

Rates must be just and reasonable, and any substantial variation between taxes determined for regulatory purposes and actual taxes paid by the [utility] must be justifiable⁸

17. HONI argues that the stand-alone, benefits follow costs and fair return principles require the Board to allocate 100% of the future tax benefits of the FMV Bump to HONI’s shareholders.

⁵ RP-2005-0188 at page 47.

⁶ Decision at page 84.

⁷ Decision at page 85 (\$1,475 Million allocated to Transmission and \$1,120 Million allocated to Distribution).

⁸ RP-2004-0188 at page 46.

18. The Board disagreed that these principles justify the result advocated by HONI and exercised its jurisdiction to determine a different allocation.

19. CME submits that the Board's decision with respect to the partial allocation to ratepayers of the benefit of future tax savings associated with the FMV Bump is consistent with the Board's direction in RP-2004-0188 and achieves an appropriate balance between the interests of ratepayers and the interests of HONI's shareholders in the particular circumstances present in HONI's application. The Decision is therefore entirely within the range of reasonable outcomes available for consideration by the Board.

20. CME's detailed submissions with respect to this issue follow.

3.2 Summary of Facts

21. The facts underpinning the tax savings determination issue are as follows:

- (a) In November of 2015, the province of Ontario sold more than 10% of the shares in Hydro Ontario Limited (the "**IPO**") and as a result ceased to be exempt from the application of the *Income Tax Act, Canada* (the "**ITA**");
- (b) Pursuant to the ITA, Hydro Ontario Limited was deemed to have disposed of all of its assets and to have reacquired them at fair market value, thereby producing a step-up in the tax basis of the assets (the "**FMV Bump**") which will generate future tax savings of approximately \$2,595;
- (c) On becoming subject to the ITA, Hydro Ontario Limited ceased to be subject to the payments in lieu of taxes ("**PIL**") regime pursuant to regulations under the *Electricity Act* and was required to pay to the Ontario Electricity Financial Corporation (an entity wholly owned by the province of Ontario) a departure tax of \$2,271 Million (the "**Departure Tax**"); and,

- (d) In order to fund the Departure Tax, prior to the IPO, the province of Ontario created a transaction whereby it subscribed for additional shares in Hydro One Limited at a cost equivalent to the Departure Tax.⁹

3.3 The Stand-alone Principle is Not Determinative

22. The stand-alone principle holds that ratepayers should bear only the costs, risks and benefits arising from the provision of regulated services.

23. HONI seeks to rely on the stand-alone principle to support its argument that 100% of the future tax benefits associated with the FMV Bump should be allocated to its shareholders, emphasizing that the deemed disposition was caused by the IPO which was a decision of Hydro Ontario Limited's shareholder, unrelated to the provision of regulated utility services.

24. In its Decision, the Board observed that "the business activities of [HONI] are, and will continue to be, limited to the provision of OEB regulated electricity and distribution services. [HONI], currently and prospectively, stands alone as a pure utility."¹⁰

25. HONI differs from other utilities, such as gas and power generation utilities, which have significant unregulated components of their businesses. This fact distinguishes this case from others where the stand-alone principle has been applied and supports the proposition that a strict application of the stand-alone principle to HONI may not always be warranted, particularly where its application would interfere with the exercise of the Board's jurisdiction to allocate windfalls associated with changes in tax rules.

26. There is precedent for disregarding the standalone principle in the context allocating tax benefits associated with a deemed disposition of assets producing a fair market value bump.

27. In RP-2005-0188, the Board determined that it was appropriate to disregard the stand-alone principle and allocate the future tax benefit to ratepayers. In reaching this

⁹ Transcript of Oral Hearing, Volume 11, pg. 44, lines 27-28.

¹⁰ Decision at page 86.

determination, the Board considered that the benefits follow costs principle would not apply because the shareholders had not incurred any costs related to the change in value (an issue that we address further in these submissions) but also that the fair market value bump “could be characterized as a change in tax rules and would therefore fall into the category of changes subject to a true-up.”¹¹

28. The second portion of this reasoning reflects the Board’s preference for the inclusion of actual tax estimates in rates.¹²

29. CME therefore submits that the stand-alone principle is not determinative of the issue and that the Board correctly determined that the stand-alone principle would not operate to preclude the allocation of all or part of the benefit of the future tax savings associated with the FMV Bump to ratepayers.

3.4 The Benefits Follow Costs Principle Does Not Justify the Allocation of 100% of the Future Tax Savings to Shareholders

30. Related to the “stand-alone” principle is the “benefits follow costs principle” which holds that that the stakeholder who has borne costs should receive the benefits that those costs have generated.

31. In RP-2004-0188, the Board held that the benefits follow costs principle was not applicable to the allocation of the future tax benefits associated with a step up in the tax basis of assets realized as a result of a deemed sale of distributor assets. The Board found that this was because the shareholder did not incur any costs related to the change in value for tax purposes.

32. HONI argues that it is entitled to receive 100% of the benefit of the future tax savings associated with the FMV Bump as a result of the application of the benefits follow costs principle and in this regard seeks to differentiate the future tax benefits associated with the FMV Bump, from those considered in RP-2004-0188.

¹¹ RP-2004-0188 at page 56.

¹² Decision at page 84.

33. HONI argues that the Departure Tax “gave rise to [the future tax savings] benefits,”¹³ and that because its shareholder paid the departure tax it should therefore be entitled to fully recover the future tax savings associated with the FMV Bump.¹⁴

34. CME submits that the payment of the Departure Tax did not “give rise to” the future tax savings associated with the FMV Bump.

35. While both the Departure Tax and the FMV Bump result from the revaluation of assets triggered by HONI’s departure from the PIL regime, it is not the case that the payment of the Departure Tax created the FMV Bump and associated future tax savings.

36. Absent the Departure Tax the FMV Bump would remain unchanged.

37. CME submits that the FMV Bump was created by the value of HONI’s regulated assets, or, as formulated by the Board the “operation of the utility as a going concern produces the cash flows that give rise to the FMV Bump in the tax values of [HONI’s] utility assets”¹⁵

38. Having determined that the Departure Tax did not create the FMV Bump, and that the FMV Bump was in fact the product of the operation of the regulated utility, the Board reached the logical conclusion that “neither the amount of nor the payment of the provincial departure tax is, in and of itself, determinative of the allocation of future tax savings available under federal tax legislation under the auspices of [the benefits follow costs] principle.”¹⁶

39. Having reached that conclusion, it would not have been reasonable for the Board to simply accept the approach advocated by HONI which, as articulated in its Submissions on the Motion, was to treat the future tax savings arising from the FMV Bump as “a recovery over time of the ...Departure Tax.”¹⁷

¹³ HONI Argument – paragraph 18.

¹⁴ HONI Argument – paragraph 17.

¹⁵ Decision at page 86.

¹⁶ Decision at page 99.

¹⁷ HONI Argument – paragraph 16.

40. Instead, the Board appropriately focused its attention on identifying an equitable allocation of the future tax benefits associated with the FMV Bump as between ratepayers and shareholders.

3.5 The Fair Return Principle Does Not Preclude the Board from Considering the Substance of the Contribution by the Province of Amounts Equivalent to the Departure Tax

41. In reaching a determination with respect to the fair allocation of future tax benefits, the Board took into account the fact that, from the perspective of the Province as the then owner of all of the shares of the Hydro One group of companies, the Departure Tax payment that the Province funded was effectively a payment from itself to itself.¹⁸

42. That the province understood this fundamental characteristic of its decision to fund the Departure Tax through an additional investment in Hydro One is evident from the transcript of from the October 6, 2015 meeting of the Ontario 2015 Estimate Committee¹⁹ which includes the following exchange:

Mr. Peter Tabuns: ... We are spinning off this company, and it doesn't make sense to me that, given that we need cash, we're putting \$2.6 billion more into it so that it will have a higher valuation. We need that \$2.6 billion. Why are we not simply using the proceeds from the sale of Hydro One to pay down the debt that's held by the OEFC and utilize the other funds for infrastructure and debt reduction?

Ms. Sharon Geraghty: I'll only repeat what the minister and the deputy have said: You're not out of pocket \$2.6 billion because the \$2.6 billion you're contributing will come back to you through the departure tax.

43. The contents of this Hansard transcript were referenced in submissions filed by BOMA in the hearing.²⁰ CME submits that the transcribed testimony of members of the provincial legislature is material of which adjudicators are entitled to take judicial notice.²¹

44. HONI contends that taking into consideration the special circumstances under which the province of Ontario, as the sole shareholder of Hydro One Limited, funded the

¹⁸ Decision at page 99.

¹⁹ http://www.ontla.on.ca/web/committee-proceedings/committee_transcripts_details.do?locale=en&Date=2015-10-06&BillID=&DocumentID=29552 –

²⁰ BOMA Argument – page 4.

²¹ *Newfoundland (Treasury Board) v. N.A.P.E.*, 2004 SCC 66 at paragraphs 55 and 56.

Departure Tax offends “fair return principle” because it amounts to a failure to “treat a government-owned utility in the same way as it would a privately-owned utility.”²²

45. CME submits that HONI’s argument with respect to the fair return principle, if accepted, would unfairly preclude consideration of the unique characteristics of the specific payment in issue which is of central importance when applying the costs follow benefits principle in this case.

46. The substance of the funding for the Departure Tax provided by the province is relevant to determining the amount of “notional” taxes are reasonable for recovery from ratepayers.

47. HONI contends that “the result of the Board’s Decision is that the rates paid by Hydro One’s customers are not being determined based on the cost of providing the utility service.”²³

48. CME submits that a revenue requirement which includes amounts in respect of taxes which exceed the actual amount of taxes to be paid by \$2,595 Million²⁴ would be similarly disconnected from the “cost of providing the utility service” if not more so.

3.6 The Allocation Methodology Adopted by the Board is Not Unreasonable

49. Having determined that regulatory principles should not preclude an allocation of the future tax benefits associated with FMV Bump other than the 100% allocation to shareholders advocated by HONI, the Board exercised its jurisdiction to provide for a more equitable distribution of the savings.

50. In order to achieve this result, the Board developed two alternative allocation methodologies, referred to below as the “Recapture Ratio” and the “Actual FMV Sales and Payments Ratio.”

²² HONI Argument – paragraph 45.

²³ HONI Argument – paragraph 37.

²⁴ Calculated by subtracting minimum Ontario income tax amounts (J2.10) from grossed up tax amounts provided in the Oral Hearing and referenced on page 85 of the Decision.

51. In its argument on the Motion, HONI faults the Board for failing to give HONI an opportunity to make submissions with respect to the allocation methodologies developed by the Board.

52. CME submits that HONI had ample opportunity to develop and present for consideration by the Board alternative allocation methodologies which might be applied in the event that the Board determined that some allocation of the future tax savings associated with the FMV Bump to ratepayers was required.

53. On the second day of a hearing that spanned several weeks, the Board asked the HONI to consider a scenario where the Board might determine that the stand-alone and benefits follow costs principles do not support the allocation of 100% of the benefit of future savings benefits associated with the FMV Bump to shareholders and invited HONI to provide input on how an alternative allocation might be implemented:

MR. THOMPSON: Okay. So my last question is this: If the Board were to find that the principles that you rely upon do not apply and that this benefit should be allocated to Transmission, how should it be implemented? Should it be by way of a reduction in the income taxes in cost of service or in some other manner? You want to take that just as a takeaway and get back to me on that, or can you answer it now?

MR. VELS: I am not sure that I can answer it either now or later. I just -- that would be something we would have to think about carefully. I mean, our position would be that we would need to recover the departure tax through rates as well or, alternatively, revalue or change the regulated rate base or increase rate base values in order to fully recapture the cost to the shareholder, so it for sure would be a complex discussion. I am not sure I would want to even start speculating as to how that would occur.²⁵

54. As demonstrated by the above exchange, even when given the express opportunity to take a position on how some of the benefit of the future tax savings associated with the FMV Bump could be allocated to ratepayers, HONI was not prepared

²⁵ Transcript of Oral Hearing, Volume 2, pages 186-187.

to do so, defaulting instead to the position that, in such an event, it would seek to recover the Departure Tax through rates.

55. HONI devotes a significant portion of its submissions to expressing its opposition to the Actual FMV Sales and Payments Ratio methodology adopted by the Board, arguing among other things that the application of this methodology may interfere “with the Province’s exercise of discretion” to sell additional shares in Hydro One Limited.²⁶

56. These submissions will not address all of the arguments advanced by HONI in opposition to the Actual FMV Sales and Payments Ratio. Nevertheless, it is noteworthy that this methodology would only be used to calculate an allocation of the tax savings associated with the FMV Bump to the extent that it produced an allocation more favourable to shareholders than the Recapture Ratio²⁷ and would therefore only operate to increase the allocation of these tax benefits to HONI.²⁸

57. CME has had the benefit of considering the detailed submissions of SEC with respect to this complex allocation issue, both in the main hearing and in this Motion. CME adopts the submissions of SEC with respect to the merits of the Recapture Ratio methodology.

58. As described by SEC, the Recapture Ratio allocation methodology developed by the Board in its Decision addresses an issue identified by the Board in RP-2005-0188²⁹ which is that ratepayers have already received the benefit of tax deductions on the assets of HONI that exceed the proportion of cost they have borne through depreciation. This benefit is measured by the calculation of recapture.

59. Because the FMV Bump produces a step up in the tax value of HONI’s assets, to the extent that ratepayers received all of the benefit of the associated tax savings,

²⁶ HONI Argument – paragraph 62.

²⁷ Decision at page 106.

²⁸ This is in fact what occurred in the calculation of the 2017 and 2018 Revenue Requirement – November 9, 2017 Decision and Order of the Board.

²⁹ RP-2004-0188 at pages 55-56.

customers would be receiving the benefit of using the same deduction twice with respect to the same asset.

60. The Recapture Ratio operates to identify the amount of the tax savings which would produce a duplicative benefit to ratepayers and allocates that portion of the tax savings to shareholders.

61. CME submits that the allocation resulting from the application of the Recapture Methodology, will ensure that HONI's shareholders retain a significant proportion of the benefit of the future tax savings associated with the FMV Bump³⁰ while providing some relief to ratepayers from the inclusion in rates of notional tax amounts significantly in excess of the actual tax amounts payable by HONI and represents a reasonable exercise of the Board's jurisdiction to set just and reasonable rates in the particular circumstances of HONI's application.

4. DISCONTINUATION OF CARRYING COSTS FOR NRP

62. CME submits that it is not reasonable that carrying costs associated with capital costs which have not produced an asset which is used and useful after more than ten years should continue to be borne by ratepayers.

63. To the extent that progress has been made towards the resolution of the issues which have delayed the NRP, the matter should be addressed in HONI's next transmission rates application.

5. DISALLOWANCE OF COSTS ASSOCIATED WITH OMBUDSMAN'S OFFICE

64. HONI is seeking a variance to the Decision to permit the recovery in rates of costs associated with the Office of the Ombudsman being \$1.4 Million, with \$742,000 being allocated to HONI's transmission business.

³⁰ The Decision and Order relating to 2017-2018 Transmission Revenue Requirements allocated 62% of the future tax savings associated with the FMV Bump to shareholders. (November 9, 2017 Decision and Order of the Board at page 14)

65. CME takes no position on this requested variance.

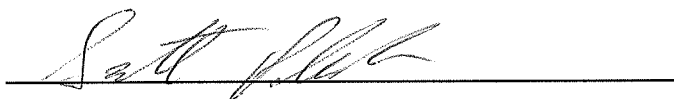
6. CONCLUSION

66. For all of the foregoing reasons, CME submits that HONI's Motion to Vary should be denied with respect to the allocation of the benefit of future tax savings associated with the FMV Bump and the discontinuance of an allowance for carrying costs associated with the NRP for the reasons stated above.

7. COSTS

67. We request that CME be awarded 100% of its reasonably incurred costs in connection with this matter.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 29th day of January, 2018.

A handwritten signature in black ink, appearing to read "Scott Pollock", is written over a horizontal line.

Emma Blanchard
Scott Pollock
Counsel for CME