ONTARIO ENERGY BOARD

IN THE MATTER OF a cost of service application made by Hydro One Networks Inc. on May 31, 2016 under section 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B), 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 (EB-2016-0160);

AND IN THE MATTER OF the Decision and Order dated September 28, 2017 in proceeding EB-2016-0160;

AND IN THE MATTER OF the Decision and Order dated November 9, 2017 in proceeding EB-2016-0160;

AND IN THE MATTER OF the Decision and Order dated August 31, 2018 in proceeding EB-2017-0336; and

AND IN THE MATTER OF sections 40 and 42 of the Ontario Energy Board's *Rules of Practice and Procedure.*

WRITTEN ARGUMENT OF HYDRO ONE NETWORKS INC.
(Reconsideration of Future Tax Savings Allocation)

Date: November 20, 2018

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PART I - OVERVIEW

1. On August 31, 2018, the Ontario Energy Board (the "**Board**") released its decision (the "**Review and Variance Decision**") on Hydro One Networks Inc.'s ("**Hydro One**") motion to review and vary the Decision and Order dated November 1, 2017 regarding Hydro One's electricity transmission revenue requirement and charge determinants beginning January 1, 2017 (the "**Original Decision**"). The panel hearing the motion (the "**Review Panel**") determined that the Original Decision's reasons concerning the allocation of the tax savings (the "**Future Tax Savings**"), arising from Hydro One's move from the provincial Payment in Lieu of Taxes ("**PILs**") regime to the Federal Income Tax Act, contained a number of errors.

2. In summary, these were: a) failing to follow the stand-alone utility principle; b) finding that the payment made by Hydro One to exit the PILs regime (the "**PILs Departure Tax**") was "variable"; c) holding that the PILs Departure Tax was not a real cost paid by Hydro One; and d) proposing two allocation methodologies that were, in the facts and circumstances, inappropriate.

3. Pursuant to Procedural Order 1, dated November 6, 2018, Hydro One was directed to answer two questions: a) given the errors identified by the Review Panel, and with due consideration given to the May 2005 Report of the Board on the 2006 Electricity Distribution Rate Handbook (the "**May 2005 Report**") and any other matters argued in the original case, would the Original Decision be reasonable regarding the allocation of future tax savings between shareholders and ratepayers?; b) if not, what is the appropriate outcome?

4. The answer to the first question is no. The Original Decision is unreasonable. The errors identified by the Review Panel were material errors. They identified findings of fact based on no evidence, and errors of fact or misapplication of evidence that go to the very heart of the Original Decision's reasoning concerning the Future Tax Savings. The decision cannot be considered reasonable in light of these errors and the magnitude of the issue. The Original Decision resulted in nearly one billion dollars in Future Tax Savings being allocated to ratepayers based on these on these errors and "inappropriate" allocation methodologies – the result being a clearly material error.

5. Given that the Original Decision is unreasonable based on the findings of the Review Panel, the only appropriate outcome is to confirm the findings of the Review Panel and confirm that: a) the payment of the PILs Departure Tax was a real cost incurred by Hydro One, and b) that benefits follow costs principles should be followed, and since Hydro One paid the cost, the PILs Departure Tax, Hydro One should receive the benefit, the Future Tax Savings.

6. Any findings that do not confirm the above findings of the Review Panel, would result in this panel repeating the errors in the Original Decision, which it cannot do given the binding findings of the Review Panel.

PART II - THE FACTS

7. In 2015, Hydro One paid $2,271 million of PILs Departure Tax. In the original application, Hydro One did not seek recovery of the PILs Departure Tax payment amount in in rates because it was cost caused by the initial public offering ("**IPO**"). The Future Tax Savings were also caused by the IPO. Hydro One took that position that benefits follows costs principles should apply, and since it had paid 100% of the PILs Departure Tax (an upfront payment), it should be entitled to 100% of the benefit of the Future Tax Savings (as realized over time).

A. The Board's Decision

8. In the Original Decision, the Board found that that Hydro One should be entitled to only a portion of the Future Tax Savings for 2017 and 2018 (the "T**ax Savings Determination**"). It did so through the finding that Hydro One was entitled to the more favourable[1] of two methodologies:

   (a) a recapture methodology, under which Hydro One (and therefore its shareholders) would receive the Future Tax Savings attributable to the portion of the $2,271 million of PILs Departure Tax paid as a result of recaptured CCA and CEC deductions ("**Recapture Methodology**"); and

   (b) a benefits follow costs methodology, under which Hydro One would receive *partial* credit[2] for the $2,271 million in PILs Departure Tax it had paid according to an allocation factor, based in part on shares of Hydro One Limited sold by the Province of Ontario, which when multiplied against the tax savings

[1] Original Decision, p 103

[2] Original Decision, p 100.

in the year gives the portion of the tax savings which the company is allowed to retain ("**Actual FMV Sales and Payments Methodology**").

B. The Review and Variance Motion

9. On October 18, 2018, Hydro One filed a notice of motion to review and vary the decision of the Board in respect of the Tax Savings Determination (and certain other matters that are irrelevant to these submissions). Hydro One filed a factum and book of authorities on January 15, 2018. Intervenors filed materials between January 22 and 30, 2018. An oral hearing was held on February 12, 2018.

10. Hydro One argued that the Board had erred in making the Tax Savings Determination because:

(a) utility rate-making principles including cost causation, benefits follows costs and the stand-alone utility principle, as well as the fair return standard were not applied;

(b) the statutory framework applicable to Board decisions was not considered; and

(c) the allocation methodologies adopted in the Decision were made without the necessary factual record.

11. On August 31, 2018, the Board released its decision. The Board granted Hydro One's motion for "review and variance" of the Board's Tax Savings Determination, and

returned it to the original panel for further consideration.[3] In particular, the Board agreed with Hydro One that:

(a) the Tax Savings Determination did not follow, and was inconsistent with prior applications of, the stand-alone utility principle;[4]

(b) the original panel erred in holding that the PILs Departure Tax was "variable";[5]

(c) Hydro One paid the tax in substance and that it was a real cost to the utility, and the original panel erred in holding otherwise;[6]

(d) the Recapture Methodology was inappropriate because, among other things, it "did not recognize the real cost of the departure tax liability paid by Hydro One Networks";[7] and

(e) the Actual FMV Sales and Payments Methodology was inappropriate because it treated shares of Hydro One Networks that continue to be owned by the Province differently than those owned by other shareholders.[8]

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3 Review and Variance Decision, p 3.
4 Review and Variance Decision, p 7.
5 Review and Variance Decision, p 8.
6 Review and Variance Decision, p 8.
7 Review and Variance Decision, p 8.
8 Review and Variance Decision, p 9.

PART III - ISSUES AND THE LAW

12. The parties have been directed to not re-argue the issues before the Review Panel. This was a mandatory direction. The findings of the Review Panel are binding on this panel and cannot be varied, reconsidered, or ignored as a matter of law.

13. There are two issues that the parties have been directed to address on this reconsideration of the original decision:

    (a) Given the errors identified by the Review Panel and with due consideration given to the May 2005 Report and any other matters argued in the original case, would the Original Decision be reasonable regarding the allocation of future tax savings between shareholders and ratepayers?

    (b) If not, what is the appropriate outcome?

A. The Original Decision was unreasonable in light of the findings of the Review Panel

14. Procedural Order 1 states that "the threshold test is being applied in two stages with only the first stage having been performed by the Review Panel."[9] The two-steps were described in the Board's Natural Gas Electricity Interface Review Motion decision. The first stage is "whether there is an identifiable error in the decision." The second step relates to materiality:[10]

> The applicant must also be able to demonstrate that the alleged error is material and relevant to the outcome of the decision, and that if the error is corrected, the reviewing panel would change the outcome of the decision.

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[9] Procedural Order No. 1, p 2.

[10] Procedural Order No. 1, p. 2.

15. The Review Panel's reasons demonstrate that the errors they found were material. It is inconceivable that substituting the Review Panel's findings for the original panel's finding would not change the outcome of the decision as there is nothing left in the original panel's reasons that would support the outcome in the Original Decision's Tax Savings Determination.

16. Consequently, given that the entirety of the Original Decision's reasons on these points were in error, and given that the errors were material, it is impossible to conclude that the Original Decision is reasonable. Indeed, each error, on its own, is sufficient to render the Tax Savings Determination unreasonable. The nature and materiality of each of the errors are discussed below and in context with the stated reasons found in the Original Decision.

i. The Original Decision does not follow the stand-alone utility principle and is inconsistent with prior OEB applications of the stand-alone utility principle

17. The Review Panel held that the Original Decision's Tax Savings Determination failed to follow the stand-alone utility principle.[11] That principle, which was acknowledged in the Original Decision as a "Guiding Principle", "limits the amounts recoverable in utility rates to costs related to the provision of regulated utility services. For ratemaking purposes, costs related to unregulated or non-utility business activities are excluded from the ambit of the "standalone" or "pure" utility activities."[12]

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11 Review and Variance Decision, p 7.

12 Original Decision, p. 10.

18. The Review Panel found that the Original Decision failed to follow this "Guiding Principle" because it treated Hydro One differently because its shareholder was the Province. The Review Panel expressly agreed with Hydro One's submissions on this point.

19. An error made in applying a principle is a well-established criteria for determining that a resulting decision is unreasonable.[13] Errors of principle and unreasonableness are often treated as synonyms by appellate courts.[14] Once an error has been found in applying a principle, it can only follow that the Review Panel's findings are in error. Proper application of the Stand-alone Utility principle would change the Original Decision because it would recognize that the cost, paid by Hydro One, was a true cost, and it would not examine the conduct of Hydro One's ultimate shareholder to determine whether the utility incurred a cost. A focus on the shareholder and its identity, rather than the utility, was a foundation of all of the analysis undertaken in the Original Decision, because of this, it was not reasonable.

ii. The Original Decision erred in finding that the PILs Departure Tax was variable

20. The Review Panel held that the Original Decision's finding that the PILs Departure Tax was "variable" was an error. The Review Panel held that there was "no evidence" that suggested that the PILs Departure Tax should have been treated differently than any other PILs payment, or that the Province ever contemplated waiving the PILs

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13 *Saadilla v. York Condominium Corporation No. 187*, 2017 ONCA 797 at para 9.

14 *Bristol-Myers Squibb Co. v. Canada (Attorney General)*, [2005] 1 SCR 533 at para 92; *Mota v. Regional Municipality of Hamilton-Wentworth police services board*, 2003 CanLII 47526 (ON CA) at para 28; *R. v. Louie*, 2017 BCCA 218 at para 25; *Alberta (Securities Commission) v Chandran*, 2015 ABCA 323 at para 13.

Departure Tax for Hydro One. As a result, the Review Panel found that the Original Decision erred in "speculating or assuming" that the PILs Departure Tax was variable.

21. A finding made in the absence of evidence is another ground on which a decision will routinely found to be unreasonable.[15] The variability of the PILs Departure Tax was one of the findings in the Original Decision[16] on which the allocation methodologies were based. That finding was made in an absence of evidence. This is another material error and demonstrates that the Original Decision was unreasonable.

iii. The Original Decision erred by not accepting that Hydro One paid the departure tax in substance and that it was a real cost to the utility

22. The Review Panel held that the Original Decision's conclusion that the PILs Departure Tax was not a real cost to Hydro One was an error. As a result, the Review Panel concluded, that "since Hydro One Networks paid the PILs Departure Tax, it should benefit from the Future Tax Savings." This correct conclusion is fundamentally at odds with the Board's original reasoning and its conclusions. The Original Decision's finding that the PILs Departure Tax was not a real cost permitted the Board to reject a simple benefits follows costs analysis, which inevitably leads to the conclusion that the benefits, the Future Tax Savings, should follow the costs, the PILs Departure Tax. The Review Panel found that this was an error. The Original Decision should never have gone down the path of the allocation methodologies. It should have followed benefits follows costs principles and allocated the Future Tax Savings to Hydro One.

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15 *Canada (Justice) v. Fischbacher*, [2009] 3 SCR 170 at para 87; *Canadian Union of Postal Workers v. Healy*, 2003 FCA 380 at para 46; *Toronto (City) Board of Education v. O.S.S.T.F., District 15*, [1997] 1 SCR 487 at para 44.

16 Original Decision, 15.8 (f) and November 9, 2017, 5.1(s)

iv. The two allocation methodologies in the original decision were inappropriate

23. The Review Panel concluded that both of the allocation methodologies proposed in the original decision were inappropriate. ***First***, it held that the Recapture Ratio Methodology was inappropriate because it did not recognize the real cost of the departure tax liability paid by Hydro One Networks. This is the same error identified above, and for the same reasons, the Recapture Ratio Methodology is unreasonable as it is based on a material error of fact.

24. ***Second***, it held that the Actual FMV Sales and Payments Methodology was inappropriate because it treated the shares of Hydro One Networks that continue to be owned by the Province differently than those owned by other shareholders, and it was inconsistent with other findings in the Original Decision. This error is, in effect, the culmination of the first three errors found by the Review Panel. Disregarding the stand-alone utility principle, finding that the PILs Departure Tax was variable, and finding that the PILs Departure Tax was not a real cost were all integral rationale supporting the Actual FMV Sales and Payments Methodology. The cumulative impact of these errors makes it impossible to conclude that the Actual FMV Sales and Payments Methodology is reasonable as the entire basis of the methodology has been found to have been in error.

25. Given that neither proposed allocation methodologies are appropriate, neither can be used to allocate the Future Tax Savings. The Future Tax Savings are estimated to be $2,595 million at Hydro One’s present combined federal and provincial rate of tax

(26.5%). At an allocation factor of 62%,[17] Hydro One is being deprived of $986.1M in Future Tax Savings due to an "inappropriate" allocation methodology. A decision that deprives a utility of nearly one billion dollars in tax savings on the basis of an inappropriate allocation methodology, predicated on errors of principle, errors of fact, and "speculation" cannot be reasonable. In other words, the selection of an inappropriate reallocation methodology with such a significant financial impact is a clear material error.

B. Allocating in accordance with Hydro One's request is the only outcome consistent with the Review Panel's findings

26. Hydro One requests that the Board find that:

(a) the payment of the PILs Departure Tax and the benefit of the Future Tax Savings were both caused by a change in statutory tax schemes resulting from the Province's decision to sell its ownership interests in Hydro One Limited by way of IPO, and do not result from any change in the provision of rate-regulated service, and therefore are not applicable to Hydro One's rates-revenue requirement;

(b) the payment of the PILs Departure Tax was a real cost paid by Hydro One that was not recovered through rates; and

(c) stand-alone utility principle and benefits follow costs principles must be followed, and since Hydro One paid the cost, the PILs Departure Tax, Hydro One should receive the benefit, the Future Tax Savings.

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[17] Review and Variance Decision, p 6.

(d) (individually a "**Proposed Finding"** and collectively, the "**Proposed Findings**").

27. The Proposed Findings are the only findings that can be made that are consistent with the findings of the Review Panel, the May 2005 Report, and the other matters argued in the original case. Any other result will lead to this Panel repeating the errors found by the Review Panel. In particular:

(a) Proposed Finding (a) reflects the findings of the Review Panel concerning the stand-alone utility principle. Any findings inconsistent with Proposed Finding (a) would, again, be inconsistent with the stand-alone utility principle and would repeat the errors found in the Original Decision by the Review Panel;

(b) Proposed Finding (b) was found to be true by the Review Panel – a finding that cannot be disputed given the direction in the Procedural Order and given that it was made in a decision that is binding on this Panel. To make a finding contrary to Proposed Finding (b) would reintroduce the third error found by the Review Panel – not accepting that Hydro One "paid the departure tax in substance and that it was a real cost to the utility" - into any decision made by this Panel; and

(c) Proposed Finding (c), again, was found to be true by the Review Panel, which held that since Hydro One "paid the PILs departure tax, it should benefit from

the Future Tax Savings."[18] Again, any finding or allocation methodology that does not allocate all of the Future Tax Savings to Hydro One would be contrary to this binding finding of the Review Panel and would be inconsistent with the stand-alone utility principle.

28. These findings are consistent with the principles set out in May 2005 Report. As noted in the Original Decision, that report determined that tax savings attributable to increases in tax value that are "costless" to the utility owner are to be allocated to ratepayers.[19] That was the rationale in the May 2005 Report that led the Board to conclude that the benefits follows costs principle was not applicable.[20]

29. The Review Panel confirmed that the increase in tax value arising in connection with the payment of the PILs Departure Tax by Hydro One was not costless. Therefore, the benefits follows costs principle must apply and must result in the Future Tax Savings being allocated to Hydro One.

30. Further, a tax concern identified in the May 2005 Report is not present. It cannot be said that the Future Tax Savings will cause regulatory taxes to be in excess of the actual taxes payable as Hydro One, in effect, prepaid its taxes through the payment of the PILs Departure Tax.

31. Finally, this is also consistent with the no-harm principle, which was identified in the 2005 decision as a relevant principle (along with the, already addressed, benefits

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18 Review and Variance Decision, p 8.

19 Original Decision, p 84.

20 May 2005 Report, p 56.

follow costs and stand-alone utility principles).[21] There is no harm to ratepayers as they did not pay the PILs Departure Tax through increases rates, and but for the IPO transaction (which caused the PILs Departure Tax) there would have been no Future Tax Savings.

PART IV - CONCLUSION

32. Hydro One requests that the Board find that:

(a) the payment of the PILs Departure Tax and the benefit of the Future Tax Savings were both caused by a change in statutory tax schemes resulting from the Province's decision to sell its ownership interests in Hydro One Limited by way of IPO, and do not result from any change in the provision of rate-regulated service, and therefore are not applicable to Hydro One's rates-revenue requirement;

(b) the payment of the PILs Departure Tax was a real cost paid by Hydro One that was not recovered through rates; and

(c) the stand-alone utility and benefits follow costs principles must be followed, and since Hydro One paid the cost, the PILs Departure Tax, Hydro One should receive the benefit, the Future Tax Savings.

33. Hydro One also asks for such further relief as it may request and that the Board may deem appropriate in these circumstances.

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[21] May 2005 Report, p 51.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 20th day of November, 2018.

Signed in the original
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SCHEDULE “A”
LIST OF AUTHORITIES

1. *Saadilla v. York Condominium Corporation No. 187*, 2017 ONCA 797

2. *Bristol-Myers Squibb Co. v. Canada (Attorney General)*, [2005] 1 SCR 533

3. *Mota v. Regional Municipality of Hamilton-Wentworth police services board*, 2003 CanLII 47526 (ON CA)

4. *R. v. Louie*, 2017 BCCA 218

5. *Alberta (Securities Commission) v Chandran*, 2015 ABCA 323

6. *Canada (Justice) v. Fischbacher*, [2009] 3 SCR 170

7. *Canadian Union of Postal Workers v. Healy*, 2003 FCA 380

8. *Toronto (City) Board of Education v. O.S.S.T.F., District 15*, [1997] 1 SCR 487