Ontario Energy Board | Commission de l'énergie de l'Ontario

DECISION AND ORDER

EB-2018-0269

HYDRO ONE NETWORKS INC.

2018 Transmission Revenue Requirement and Charge Determinants, Reconsideration of Future Tax Savings Issue

BEFORE: Cathy Spoel
Presiding Member

Ken Quesnelle
Member

Emad Elsayed
Member

March 7, 2019

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1 INTRODUCTION AND SUMMARY

The Ontario Energy Board (OEB) determined in the Decision and Order[1] (Original Decision), that a portion of the future tax savings resulting from the Government of Ontario's decision to sell its ownership interest in Hydro One Limited by way of an Initial Public Offering on October 28, 2015 and subsequent sale of shares should be applied to reduce Hydro One Networks Inc.'s (Hydro One) revenue requirement for 2017 and 2018 (the Future Tax Savings Determination).

On October 18, 2017, Hydro One filed with the OEB, a Notice of Motion to Review and Vary portions of the Original Decision in accordance with Rules 40 and 42 of the OEB's *Rules of Practice and Procedure.*[2]

On August 31, 2018, the Review Panel issued its Decision and Order finding that the part of the Original Decision dealing with the Future Tax Savings Determination should be returned to the Original Panel to reconsider in light of its review findings and all the evidence and argument the Original Panel and the Review Panel heard on this issue.

On October 3, 2018, the OEB issued a letter regarding the composition of the panel that would re-hear parts of the original proceeding, and the process the OEB would employ in the re-hearing. This was in response to letters that the OEB had received related to these matters from both the School Energy Coalition (SEC), an intervenor in these proceedings, and Hydro One.

The OEB's letter noted that the appointment of a panel is a duty assigned to the Chair of the OEB pursuant to section 4.3 of the *Ontario Energy Board Act, 1998* and that while helpful, recommendations as to subsequent process and panel appointments made by the Review Panel are not binding on the Chair as she considers panel assignments. The letter further stated that in this case, the Chair has appointed a panel composed of Ken Quesnelle, Emad Elsayed from the Original Panel and Cathy Spoel from the Review Panel to undertake this matter, and that this panel would issue a procedural order in due course.

In response to the direction provided by the Review Panel, the OEB has considered the Review Panel's findings of certain errors in the Original Decision in addition to the record of evidence relied on in the Original Decision and has determined that the outcome of the Original Decision is reasonable.

[1] EB-2016-0160
[2] EB-2017-0336

2 THE PROCESS

On November 6, 2018, the OEB issued Procedural Order No. 1 (PO#1) in this proceeding.

In PO#1, the OEB deemed the parties granted intervenor status in the original proceeding as intervenors in this proceeding. In addition, those parties that were granted cost eligibility status in the original case were also determined to be eligible for cost awards in this proceeding.

The OEB also determined a schedule for the filing of written submissions on this matter. Hydro One filed its submission on November 20, 2018. OEB staff as well as intervenors, the Building Owners and Managers Association, Greater Toronto (BOMA), Canadian Manufacturers & Exporters (CME), Power Workers' Union (PWU) and the School Energy Coalition (SEC), all filed submissions on December 4, 2018. Hydro One filed its reply submission on December 18, 2018.

3 DECISION

Background

The Review Panel identified four factors that the Original Panel relied on, "some of which included errors."[3]

1. The Original Decision did not follow the stand-alone utility principle and was inconsistent with prior OEB applications of that principle.

2. The Original Decision found that the Payment in Lieu of Taxes (PILs) departure tax was "variable".

3. The Original Decision did not accept that Hydro One paid the departure tax in substance and that it was a real cost to the utility.

4. The two allocation methodologies used in the Original Decision appeared to be inappropriate.

The OEB noted in PO#1 that, in a prior OEB decision with respect to the NGEIR Motion,[4] the OEB had first articulated its threshold test for consideration of requests to review and vary a decision. This test has been applied on numerous occasions in OEB proceedings since then. The OEB has also noted that the original decision making panel is entitled to deference, and that the appropriate standard of review is what is known before the courts as "reasonableness".[5]

The OEB further noted in PO#1 that what is unique about the current proceeding is that the review is being conducted in two stages with only the first stage having been performed by the Review Panel. The Review Panel determined that errors were made but did not determine whether these errors, if corrected, would change the outcome of the Original Decision. The reconsideration of the Original Decision by the current panel in view of the identified errors, in the OEB's view, represents the second stage of the review. In PO#1, the OEB found the following determinations of the NGEIR decision to be relevant to this proceeding.[6]

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[3] EB-2017-0336 *Decision and Order* August 31, 2018, pp. 5-7
[4] EB-2006-0322/EB-2006-0338/EB-2006-0340 *Decision With Reasons Motions To Review The Natural Gas Electricity Interface Review Decision,* May 22, 2007 ("NGEIR")
[5] See, for example, EB-2016-0255, Decision and Order (February 22, 2018), and EB-2018-0085, Decision and Order (August 30, 2018)
[6] *NGEIR*, p.18

> With respect to the question of the correctness of the decision, the Board agrees with the parties who argued that there must be an identifiable error in the decision and that a review is not an opportunity for a party to reargue the case.
>
> In demonstrating that there is an error, the applicant must be able to show that the findings are contrary to the evidence that was before the panel, that the panel failed to address a material issue, that the panel made inconsistent findings, or something of a similar nature. It is not enough to argue that conflicting evidence should have been interpreted differently.
>
> 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.
>
> In the Board's view, a motion to review cannot succeed in varying the outcome of the decision if the moving party cannot satisfy these tests, and in that case, there would be no useful purpose in proceeding with the motion to review.

Additionally, the OEB noted that the Original Decision also relied on the principles expressed in the May 2005 *Report of the Board on the 2006 Electricity Distribution Rate Handbook* (2005 Report),[7] which addressed the allocation of future tax savings between shareholders and ratepayers. Although the Review Decision referenced the May 2005 Report, it did not rely on it for its findings.

PO#1 stated that the OEB did not see the need for any additional discovery at this time and would proceed directly to receive submissions on the following.

> In response to the Review Panel's direction and in alignment with the threshold test first articulated in the NGEIR Motion Decision, the OEB decided that it would consider, in addition to all previously filed pertinent evidence and arguments, submissions on the following question:
>
> If the errors identified by the Review Panel are accepted, 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? If not, what is the appropriate outcome?

[7] RP-2004-0188 *2006 Electricity Distribution Rate Handbook Report of the Board,* May 11, 2005.

PO#1 stated that for clarity, the errors identified by the Review Panel are not to be re-argued in these submissions.

Hydro One submitted that the OEB should 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 an 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.

PWU adopted and supported the submissions made by Hydro One.

OEB staff's submission advised the OEB that within the parameters established by PO#1, OEB staff had no further comments to make on these matters beyond those already made in prior related submissions.

BOMA submitted that the issue for the OEB in this case is what is the allocation of a windfall that is fair to both ratepayers and shareholder. BOMA argued that the OEB needed to decide which of the two options, the Original Decision, that the savings should be shared in the manner set out therein, or Hydro One's proposal that all of the windfall should accrue to it, the shareholder, or another allocation between ratepayers and the shareholder that is fair to both, is most reasonable. BOMA submitted that only a fair allocation of the windfall will result in 2017, 2018, and future years' rates being just and reasonable.

BOMA concluded that the Original Decision represented the fairer option. BOMA argued that even if one believed there were errors in either the OEB's application, or failure to apply certain regulatory principles, none of these errors were material enough to justify changing the Original Decision. BOMA submitted that the Original Decision is fair to both ratepayers and Hydro One, while Hydro One's proposal is not.

SEC submitted that the OEB should set transmission rates for Hydro One based on the actual taxes expected to be paid by Hydro One each year, and not by reference to notional taxes payable if the Fair Market Value (FMV) Bump had not occurred. SEC stated that the OEB's order should, consistent with the 2005 Report, expressly reserve for future determination the responsibility of the customers (in rates) for any future recapture arising out of the fact that the FMV increased tax values for Hydro One.

SEC stated that it had interpreted PO#1 differently from Hydro One as Hydro One has argued that the Review Decision is "binding" on the current panel, and as a result only one outcome is possible. SEC argued that that is not the law, and it is contrary to logic. SEC took the viewpoint that the Review Panel has not determined this issue, which is why the case is back with the Original Panel.

SEC further stated that the second phase of the threshold test has not yet been answered and it still remains to be determined what is the appropriate outcome of the Hydro One Transmission case – i.e. the just and reasonable rates – once the Review Panel findings are taken into account.

SEC argued that the panel in this proceeding is exercising the OEB's jurisdiction to set rates and there are multiple principles and rules that have to be balanced or reconciled. SEC submitted that the Review Panel did not carry out that balancing/reconciliation process, but sent the case back to this panel to do that.

SEC concluded that it would answer the two questions posed by the OEB as follows:

1) Accepting the findings of the Review Panel, the analysis by the Original Panel is not reasonable, and the second of the two allocation methods (based on the ownership of shares) is not reasonable. However, the first of the two allocation methods is still reasonable once the errors are corrected, and the outcome of the Original Decision – sharing of the Future Tax Savings based on recapture percentage - is one of the reasonable outcomes the Original Panel could have reached based on the evidence.

2) The division of the Future Tax Savings between shareholders and ratepayers based on recapture vs. capital gain is one appropriate outcome consistent with the findings of the Review Panel. A more appropriate outcome, SEC submitted, would be allocation of all of the Future Tax Savings to ratepayers. That would still be consistent with the findings of the Review Panel, but is a more just and reasonable result.

CME stated that it had had the benefit of reviewing the SEC submission and agreed with SEC that the text of the Review Panel's decision, as well as the Review Panel's determination that the matter be remitted to the Original Panel for re-determination meant that while the allocation methodologies were found to be inappropriate, the final outcome of the Future Tax Savings issue is not a foregone conclusion.

CME submitted that the OEB has a range of reasonable outcomes and methodologies that it could select that would minimize the disconnect between the amount of taxes that are deemed for regulatory purposes and actual taxes paid by the utility, including the methodology submitted by SEC.

CME argued that in determining the issue, the OEB should endeavor to adopt a methodology that not only avoids the errors articulated by the OEB in the Review Decision[8], but also ensures an equitable and fair outcome for ratepayers in allocating the approximately $2 billion deferred tax asset.

Hydro One responded to the submissions of SEC, CME and BOMA. Hydro One noted that these were the only intervenors that opposed its requested relief as OEB staff and all other intervenors had not opposed it, while PWU had supported it. Hydro One stated that it did not have any reply to PWU's submissions.

Hydro One submitted that the fundamental problem with SEC's submission is that SEC had ignored the findings of the Review Panel, specifically: (1) that Hydro One had paid the Departure Tax; and (2) that the Departure Tax and Future Tax Savings were related. Hydro One argued that the reason SEC had done this was clear, which was because the finding that Hydro One paid the Departure Tax results in the reasoning in the May 2005 Report being inapplicable. Hydro One further argued that SEC had already admitted that the 2005 Report is not applicable in the event Hydro One paid the Departure Tax, noting that SEC had stated in its final argument before the Original Decision that[9] "if Hydro One actually paid the Departure Tax, then OEB staff may be correct that [the May 2005 report] is not applicable here."

Hydro One took a similar view of CME's argument, stating that it had also ignored the cost that had been paid by Hydro One. Where BOMA's submission was concerned, Hydro One argued that BOMA was also re-arguing issues that had already been determined by the Review Panel.

[8] EB-2017-0336
[9] SEC Final Argument, EB-2016-0160 at 5.3.4.

Findings

In consideration of the Review Panel's determinations and the entire record, in particular the Original Panel's consideration of the 2005 Report, the OEB considers the Original Decision to be reasonable.

The review of the Original Decision by the Review Panel did not include submissions on, or analysis of, the Original Panel's reliance on the OEB's principles contained in the 2005 Report.

The 2005 Report contained a determination that future treatment of tax savings would be made by the OEB in response to future proposals and in consideration of the details of the transactions that had triggered the creation of tax savings. The Original Panel determined that the treatment of the tax saving was a matter of ratemaking and that it had the full discretion to make whatever determination it considered to be reasonable. The current panel has retained the determination by the Original Panel with respect to the level of discretion available to the OEB in making its determination with respect to the treatment of the Future Tax Savings. This current panel has considered whether or not the Review Panel's determinations unseat the reasonableness of the Original Decision by analyzing the effect of correcting the errors determined by the Review Panel.

Consideration of the Errors

The Review Panel found that the Decision of the Original Panel did not follow the stand-alone principle and was inconsistent with prior OEB applications of the stand-alone principle. The stand-alone principle findings of the Review Panel distinguish the scenario of regulated versus non-regulated activities where the stand-alone principle is most often applied from this scenario where stand-alone in this context pertains to treating Hydro One differently because its shareholder is the Province.

This finding of error in treating Hydro One differently because its shareholder is the Province is intrinsically related to the determination that the Original Panel erred in finding that the payment was from itself to itself. The two errors, if corrected, would have the payment be recognized as a true cost to Hydro One.

The correction of the error that the departure tax was variable and that the Province could have or should have changed the PILs legislation also results in the payment being recognized as a real cost to Hydro One.

In consideration of the correction of these errors identified by the Review Panel and the 2005 Report, the OEB must balance the impacts of the application of two competing principles.

As submitted by SEC, the 2005 Report observed that in that instance the shareholder had not incurred any cost related to the change in value for tax purposes so the benefits follow costs principle was not applicable. The 2005 Report also recognized that the FMV Bump could be characterized as a change in the tax rules and therefore be subject to true up. The 2005 Report also determined that its approach to incorporate the impact of the FMV Bump into the 2006 tax calculation would reduce the variance between actual taxes and the tax provision in rates.

The Original Decision was based on certain premises that the Review Panel determined were incorrect. With the correction of those errors, the OEB is still faced with a requirement to balance the interests of customers and shareholders. The Original Decision resulted in a proportioning of the Future Tax Savings between shareholders and customers.

Hydro One has argued that 100% of the Future Tax Savings should be allocated to shareholders. The OEB sees merit in this argument based on Hydro One's assertions that it should get the benefit of the Future Tax Savings resulting from the IPO transaction because it paid for it through the Departure Tax.

SEC has argued that based on the just and reasonable principle, 100% of the Future Tax Savings should be allocated to customers. The OEB sees merit in this argument based on SEC's assertions that costs caused by non-regulated activities (i.e. Departure Tax resulting from the IPO) are not recoverable from customers in regulated rates. Although SEC submits that the Review Panel did not discuss how this rule should be applied, SEC argues that this outcome would still be consistent with the findings of the Review Panel.

As stated earlier, the current panel has retained the determination made by the Original Panel with respect to the wide level of discretion available to the OEB in making its determination with respect to the treatment of the Future Tax Savings. In consideration of all the above, the OEB finds that the Original Decision results in an allocation of the Future Tax Savings (62% to shareholders and 38% to the ratepayers)[10] that is within the realm of reasonable outcomes.

[10] EB-2016-0160, p. 103, Table 15-3, 51% Shares Sold Scenario.

The Review Panel had determined that both allocation methodologies used by the Original Panel "appeared to be inappropriate" for reasons related to errors that had been identified. SEC submitted that one of the methods (the Recapture Ratio method) would still be reasonable once the errors identified by the Review Panel are corrected and that the outcome of the Original Decision - sharing of the Future Tax Savings based on recapture percentage – is one of the reasonable outcomes the Original Panel could have reached based on the evidence. The OEB has determined that, given its balance of interest approach and the range of reasonableness of outcomes that stems from the application of the principles contained in 2005 Report, it need not pursue the identification of a more appropriate allocation methodology. Further, the consideration of the appropriateness of one method over the other is not required if both would result in a reasonable outcome. The purpose of this exercise is as stated earlier, to consider the reasonableness of the outcome of the Original Decision in view of the Review Panel's determinations. The OEB considers the outcome of the Original Decision to be reasonable. The motion is dismissed and the original decision upheld.

4 ORDER

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. The EB-2016-0160 Decision and Order findings related to the Future Tax Savings Determination are upheld as they are within the realm of reasonable outcomes.

2. BOMA, CME and SEC shall submit their cost claims no later than March 14, 2019.

3. Hydro One Networks shall file with the OEB and forward to BOMA, CME and SEC any objections to the claimed costs no later than March 21, 2019.

4. BOMA, CME and SEC shall file with the OEB and forward to Hydro One Networks any reply to any objections to the cost claims no later than March 28, 2019.

5. Hydro One Networks shall pay the OEB's cost incidental to this proceeding upon receipt of the OEB's invoice.

DATED at Toronto March 7, 2019

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary