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

BY EMAIL

May 28, 2020

Christine E. Long
Registrar and Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4

Dear Ms. Long:

Re: Hydro One Inc., Hydro One Networks Inc. and Orillia Power Distribution Inc.

Application for approval to purchase all issued and outstanding shares of Orillia Power Distribution Corporation

Ontario Energy Board File Number: EB-2018-0270

In accordance with the OEB's Decision and Order in the above referenced proceeding, please find attached OEB staff's comments on Hydro One Networks Inc.'s Draft Rate Order and Draft Accounting Orders filed on May 14, 2020.

Hydro One Networks Inc., copied on this filing, is reminded that its responses to OEB staff's comments are due no later than June 11, 2020.

Yours truly,

Original Signed By

Andrew Bishop
Project Advisor – Generation and Transmission

Encl.

ONTARIO ENERGY BOARD

OEB STAFF SUBMISSION ON DRAFT RATE ORDER AND DRAFT ACCOUNTING ORDERS

APPLICATION FOR APPROVAL TO PURCHASE ALL ISSUED AND OUTSTANDING SHARES OF ORILLIA POWER DISTRIBUTION CORPORATION

HYDRO ONE NETWORKS INC.

EB-2018-0270

MAY 28, 2020

INTRODUCTION

On September 26, 2018, Hydro One Networks Inc. (Hydro One) and Orillia Power Distribution Corporation (OPDC) (collectively, the Applicants) filed an application with the OEB (Application). The Application requested approval for Hydro One Inc. (HOI), the parent company of Hydro One, to purchase all of the issued and outstanding shares of OPDC. HOI would then transfer the assets and liabilities of the electricity distribution business from OPDC to Hydro One. The Application also requested various related approvals under several different sections of the *Ontario Energy Board Act, 1998*.

The OEB issued its Decision and Order (Decision) on the Application on April 30, 2020, in which it approved the Application subject to a number of conditions. The OEB's Decision also directed Hydro One to file the following by May 14, 2020:

- A Proposed Tariff of Rates and Charges that reflected the OEB's Decision, including the OEB approved rate rider that provides a 1% reduction in the base distribution delivery rates of specific rate classes.[1]
- A recalculation of the Earnings Sharing Mechanism (ESM) based on a 10% risk premium being applied to the Applicants' forecast operations, maintenance and administrative (OM&A) expenditures.
- A Draft Accounting Order to track the amounts associated with the ESM for disposition following the conclusion of the ten-year deferred rebasing period.
- A Draft Accounting Order to track the impacts of the transition of OPDC financial reporting to United States Generally Accepted Accounting Principles (US GAAP) with respect to how costs are capitalized and depreciated.

Although not ordered by the OEB, Hydro One's May 14, 2020 filing also provided what Hydro One refers to as "a clarification of the calculation for the fully allocated revenue requirement that will be used to determine the customer rates in Year 11 for the former customers of OPDC."

OEB staff's submission is based on the information provided by the Applicants through its May 14, 2020 filing.

[1] The 1% rate rider is shown in Appendix 1 of the Draft Rate Order as a line item entitled "Rate Rider for Hydro One Networks' Acquisition Agreement – effective and implemented September 1, 2020 and in effect until August 31, 2025". This rate rider offsets the base delivery rates of eligible rate classes as described at A-1-1, page 3 of the Application.

1. Draft Rate Order

Paragraph 8 of Section 7 of the Decision required Hydro One to file a Draft Rate Order for the current OPDC service territory that includes a proposed Tariff of Rates and Charges reflecting the OEB's Decision. Consistent with paragraph 8, Hydro One provided its proposed Tariff of Rates and Charges that reflects the following:

- A rate rider applicable to OPDC's residential and general service rate classes that provides a reduction of 1% to these customers' base distribution delivery rates.

OEB staff has reviewed the Tariff of Rates and Charges provided by Hydro One in Attachment 1 of its May 14, 2020 filing. Based on its review, OEB staff submits that Hydro One's proposed Tariff of Rates and Charges is consistent with the Decision in this proceeding.

OEB staff notes that OPDC was granted approval to postpone the implementation of its new rates until November 1, 2020 (Vary Order). In its Draft Rate Order, Hydro One states that the Tariff of Rates and Charges for OPDC to be effective from the time of the closing of the transaction is based on the Tariff approved in the Vary Order. OEB staff seeks clarity from Hydro One, through its reply submission, with respect to when the 1% rate reduction will be implemented. Specifically, how will the 1% rate reduction, and the subsequent rates it will be applied to, be implemented if the transaction is closed before November 1, 2020 (e.g., September 1, 2020)?

2. ESM Recalculation and Draft Accounting Order

Through its Decision, the OEB approved the Applicants' proposal of a guaranteed ESM that calculates excess earnings by way of forecast OM&A and capital expenses through years six to ten of the deferred rebasing period. The OEB also approved that these excess earnings would be shared with current OPDC customers on a 50:50 basis.

The Application proposed that forecast OM&A expenditures would be calculated to reflect a risk premium of 20%. In its Decision, the OEB determined that the OM&A forecast should reflect a 10% risk premium. Accordingly, the Decision required Hydro One to recalculate the excess earnings to be shared with current OPDC customers and file the recalculated amount as part of the Draft Rate Order process.

OEB staff has tested Hydro One's recalculation by independently calculating the revised ESM amount based on a 10% risk factor. OEB staff's calculations are consistent with those prepared by Hydro One. On that basis, OEB staff submits that Hydro One's recalculated ESM, as demonstrated on page 3 of its May 14, 2020 filing, is consistent with the Decision.

Although the recalculated ESM is consistent with the Decision, OEB staff notes that the values presented for “Rate Base” and “Equity Component of Rate Base” by Hydro One (i.e., rows 1 and 2 in Table C on page 3 of the May 14, 2020 filing) vary from those presented by Hydro One in Table 2 found at Exhibit A-3-1 of the Applicants’ April 26, 2019 filing. This apparent inconsistency, specific to years six through ten of the deferred rebasing period, is demonstrated in Tables 1 and 2 below. The updated information shows slightly smaller amounts for both items for every year (Table 1), although not in a material way. For instance, the updated Rate Base information for year 10 (Table 1) states the value of $54,693, which is slightly smaller than the value of 54,722 that was stated in the Application at Exhibit A-3-1 (Table 2). As another example, the Equity Component of Rate Base information for year 10 (Table 1) states the value of 21,877, which is slightly smaller than the value of 21,889 that was stated in the Application (Table 2).

Table 1: Values from May 14, 2020 Filing

Deferral Period Year	6	7	8	9	10
Calendar Year	2025	2026	2027	2028	2029
Rate Base	47,861	49,477	51,210	52,968	54,693
Equity Component of Rate Base	19,145	19,791	20,484	21,187	21,877

Table 2: Values from Table 2 found at Exhibit A-3-1

Deferral Period Year	6	7	8	9	10
Calendar Year	2025	2026	2027	2028	2029
Rate Base	47,887	49,503	51,237	52,996	54,722
Equity Component of Rate Base	19,155	19,801	20,495	21,198	21,889

OEB staff requests that Hydro One clarify this apparent discrepancy in its response to this OEB staff submission.

Hydro One filed a draft ESM accounting order that will be used to record the guaranteed ESM benefits to former OPDC customers during years six to ten of the deferred rebasing period. Based on its review, OEB staff submits that Hydro One’s draft ESM accounting order is consistent with the Decision.

3. Draft Accounting Order: US GAAP

In the Draft Accounting Order for the US GAAP Deferral Account, Hydro One provides the following accounts and descriptions of the entries to be made in the account:

USofA #	*Account Description*
DR/CR: 1576	*Accounting Changes under US GAAP*
CR/DR: 4305	*Regulatory Debits*

Initial entry to record the impact of accounting changes to depreciation expense and capitalization policies on PPE resulting from OPDC's transition from MIFRS to US GAAP.

OEB staff submits that the description of the account does not align with OEB staff's understanding of how it is intended to operate based on the Decision. Specifically, OEB staff does not understand Hydro One's reference to an initial entry, as opposed to an account that captures the ongoing differences between accounting policies.

The OEB stated that the account shall operate in a similar manner to the approach used with Account 1576 when distributors transitioned to Modified International Financial Reporting Standards. The Account 1576 approach determines a principal balance in the deferral account based on the difference between the property, plant and equipment (PPE) of a utility using the previous and new accounting policies.[2] This aligns with the OEB's expressed opinion that a change in accounting policies should not result in a financial benefit for a utility.

In effect, at the end of the deferred rebasing period, the balance in the account shall reflect the cumulative difference between the closing net PPE balance calculated using OPDC's existing accounting policies and the closing net PPE calculated using Hydro One's policies. Hydro One may wish to confirm its understanding of the above mechanics of the account, or provide rationale for any disagreement, in its reply submission.

Consistent with OEB staff's understanding of the intent of the account, OEB staff suggests the following revised account names and descriptions of the example entries:

[2] This approach was most recently adopted by the OEB in the context of merger-related accounting changes in Alectra Utilities' 2020 rate application (Partial Decision and Order, pp.35-36, EB-2019-0018, January 30, 2020)

USofA #	*Account Description*
DR/CR: 1576	*Accounting Policy Changes*
DR/CR: 4305/4310	*Regulatory Debit/Regulatory Credit*

To record the annual difference between the net PPE balances calculated using OPDC's accounting policies and the net PPE balances calculated using Hydro One's accounting policies.

In addition, Hydro One suggests that no interest or carrying charges or a rate of return is permitted in this account, citing the OEB's Accounting Procedures Handbook – Frequently Asked Questions July 2012.[3] OEB staff notes that the guidance relied upon by Hydro One in its proposal to exclude a rate of return component has been superseded by the OEB's subsequent letter to all licensed electricity distributors in 2013, whereby the OEB stated that upon disposition, a rate of return component shall be applied to the balance of Account 1576.[4] Therefore, OEB staff submits that Hydro One's proposal to exclude a rate of return component from Account 1576 is inconsistent with OEB policy and inconsistent with the manner in which all electricity distributors have disposed of Account 1576 balances since the 2014 rate year.[5] OEB staff further submits that since a rate of return component is applied to the account upon disposition, no additional carrying charges should accrue in this account prior to disposition.

4. Clarification of Year 11 Revenue Requirement

As referenced by Hydro One, page 46 of the Decision states:

> If the fully allocated revenue requirement for the new year 11 OPDC rate classes is higher than the year 11 status quo forecast as set out in the evidence and Table 5 of this Decision, these excess costs will be borne by the shareholder and not the ratepayers.

Table 5 as referenced in the above quote has been extracted from the Decision and is shown below.

[3] Hydro One Draft Rate Order / Attachment 2 / p. 1
[4] OEB letter to licensed electricity distributors; Accounting Policy Changes for Accounts 1575 and 1576, issued June 25, 2013
[5] The requirement to apply a rate of return component to an Account 1576 balance upon disposition was recently affirmed by the OEB in Alectra Utilities' 2020 rate application (Partial Decision and Order, pp.37, EB-2019-0018, January 30, 2020)

Table 5: Net savings in year 11 for legacy and acquired customers per Hydro One's proposed cost allocation and rate design

A	B	C	B-A	C-B
Residual Cost to Serve OPDC Customers (lower goalpost)	Forecast Costs to be Collected from OPDC Customers post-rebasing	Status Quo costs that would otherwise be collected from OPDC Customers post- rebasing if Transaction is not approved (upper goalpost)	Net Benefits to Legacy Customers	Net Benefits to OPDC Customers
$7.9 million	$9.6 million	$14.4 million	$1.7 million	$4.8 million

In its May 14, 2020 filing, Hydro One stated that the following parameters used to calculate the year 11 status quo forecast of $14.4 million (as shown on page 7 of the May 14, 2020 filing) would be updated with information current as of the date the calculation is completed:

- Cost of Capital: debt interest and equity return will reflect the cost of capital parameters as issued by the Board for the year-11 rate-setting year
- The corporate tax calculation will reflect the then-current tax rates applicable to utilities and any other tax changes that impact utility customers
- Low Voltage Charges will reflect the rates that OPDC customers would have been charged in year-11 by Hydro One in absence of the transaction.

OEB staff assumes that the calculation will be provided as part of Hydro One's cost of service proceeding that proposes to rebase the OPDC rate zone following the deferred rebasing period. OEB staff requests that Hydro One confirm the expected timing of the calculation in its reply submission.

While Hydro One proposes to update the parameters above, Hydro One states that it will continue to use the OM&A, Depreciation and Rate Base amounts as contained in its Application, and shown on page 7 of the May 14, 2020 filing, in the calculation of the year-11 status quo cost to serve the former customers of OPDC.

OEB staff acknowledges that it is reasonable for Hydro One to update its year-11 status quo forecast as proposed. As Hydro One correctly states, in the absence of the transaction, customers of OPDC would have had their distribution rates calculated using these updated parameters. OEB staff also notes that, unlike OM&A, Depreciation and Rate Base (which will not be updated with then-current information), cost of capital and tax rates are outside of the Applicants' direct control and Low Voltage Charges are outside of OPDC's control.

OEB staff recognizes that there may be some conflict between Hydro One's proposal and the OEB's Decision which established a $14.4 million upper limit to the status quo revenue requirement that is recoverable from ratepayers. In OEB staff's view, Hydro One would continue to be held to an upper limit if it were permitted to update certain information as proposed, even though the specific value of that upper limit might be different (higher or lower) than the $14.4 million value referenced in the Decision.

Allowing the update as proposed would continue to represent a safeguard to consumers by holding the Applicants to no higher than their projected OM&A, Depreciation and Rate Base as contained in the Application and by ensuring OPDC and Hydro One customers will not pay more than would have otherwise been the case in absence of the transaction, including for cost of capital, tax rates and Low Voltage Charges.

All of which is respectfully submitted