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BY EMAIL AND RESS

June 11, 2020

Ms. Christine E. Long
Board Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON M4P 1E4

Dear Ms. Long:

EB-2018-0270: Hydro One Networks Inc. MAAD s.86 Share Purchase Application for Orillia Power Distribution Corporation – Draft Rate Order Reply Submission

In accordance with the Ontario Energy Board's (OEB) Decision and Order, dated April 30, 2020, regarding Hydro One's purchase of all issued and outstanding shares of Orillia Power Distribution Corporation, Hydro One is filing a Reply Submission to comments received from OEB Staff and the School Energy Coalition ("SEC") in respect of Hydro One's Draft Rate Order and Draft Accounting Order Submission.

Please see the attached files.

An electronic copy of this has been filed through the Ontario Energy Board's Regulatory Electronic Submission System (RESS).

Sincerely,

Joanne Richardson

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an application by Hydro One Networks Inc. for approval to purchase all issued and outstanding shares of Orilla Power Distribution Corporation.

HYDRO ONE NETWORKS INC.

DRAFT RATE ORDER and DRAFT ACCOUNTING ORDER REPLY SUBMISSION

OEB File No. EB-2018-0270

June 11, 2020

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1 INTRODUCTION

This is Hydro One Networks Inc.'s ("Hydro One") reply submission to those received from OEB Staff and the School Energy Coalition ("SEC") in respect of Hydro One's Draft Rate Order and Draft Accounting Order Submission. These submissions are organized to address the following topics raised by OEB Staff and SEC:

i. Implementation of the 1% reduction to base distribution delivery rates;
ii. ESM calculation clarification;
iii. Draft Accounting Order USGAAP; and
iv. Year 11 Upper Goal Post

2 IMPLEMENTATION OF 1% RATE REDUCTION

OEB Staff and SEC both submitted that Hydro One's proposed Tariff of Rates and Charges filed in its DRO was consistent with the Decision in this proceeding.

OEB Staff and SEC both sought clarification from Hydro One as to when the 1% rate reduction would be implemented, asking specifically how will the 1% rate reduction and the subsequent rates be applied and implemented if the transaction is closed before November 1, 2020 given that OPDC was granted approval to postpone the implementation of its 2020 rates until November 1, 2020.

Hydro One confirms its intent that the 1% rate reduction applicable to the base distribution delivery rates of the residential and general service rate classes would be *implemented and effective* for a period of 5 years from the time of closing the transaction, which is planned for September 1, 2020.

The above intent is reflected in the addition of a rate rider to the tariff schedules of the residential and general service rate classes which is clearly labeled as "**Rate Rider for**

Hydro One Networks' Acquisition Agreement - effective and implemented September 1, 2020 and in effect until August 31, 2025."

While OPDC was granted approval to postpone the implementation of its "2020 rates" until November 1, 2020, that statement is only relevant to the application of Retail Transmission Service Rates since OPDC did not request approval to increase its 2019 base distribution delivery rates for 2020. Accordingly, the 1% rider is calculated on the base distribution delivery rates shown in the currently approved 2020 Tariff of Rates and Charges, which are the same as shown in the proposed Tariff of Rates and Charges provided as Attachment 1 to the DRO.

3 ESM CALCULATION

OEB Staff submitted that Hydro One's re-calculated ESM, as demonstrated on page 3 of its DRO is consistent with the Decision. However, OEB Staff also noted that the values presented for Rate Base and Equity Components of Rate Base in the DRO[1] vary slightly from those filed in Table 2 at Exhibit A, Tab 3, Schedule 1 of the Application. OEB Staff requested that Hydro One clarify this discrepancy in this submission.

The reason for small rate base related changes to those filed in the Application, as highlighted by OEB Staff, relate to an ESM modeling oversight where the OM&A risk factor impact was included in the calculation of working capital that was subsequently used to determine the OPDC rate base throughout the rebasing deferral period. The OM&A risk factor increase should not have been included. Hydro One has corrected the calculation and has provided the ESM results in Table 1 below. As shown, the impact of

[1] DRO - Table C, Rows 1 and 2 – page 3 [2] Hydro One notes that the ESM excel model that underpins the PDI related ESM (EB-2018-0242) does not include this modeling oversight and that ESM is accurate as provided in Hydro One's DRO.

the oversight is small, resulting in an additional $7,000 refund to customers of OPDC over the ESM period (Years 6 through 10).[2]

Table 1 provides the revised guaranteed ESM using a 10% OM&A risk factor which results in a $3.7 million guaranteed refund to the former customers of OPDC.

Table 1

Earning Sharing Mechanism Sharing - Years 6 to 10 ($000's)

	Deferral Period Year	**6**	**7**	**8**	**9**	**10**
	Calendar Year	2025	2026	2027	2028	2029
1	Rate Base	47,836	49,477	51,210	52,968	54,693
2	Equity Component of Rate Base	19,134	19,791	20,484	21,187	21,877
3	Revenue	9,310	9,515	9,725	9,946	10,158
4	OM&A[3]	1,902	1,943	1,985	2,028	2,072
5	Depreciation	1,442	1,211	1,274	1,340	1,408
6	Interest	1,700	1,757	1,819	1,881	1,942
7	Tax	841	861	881	902	921
8	Net Profit After Tax	3,425	3,743	3,767	3,794	3,814
9	Achieved ROE (%) (Line 8 ÷ Line 2)	17.90%	18.92%	18.40%	17.92%	17.44%
10	Less: Approved ROE% for OPDC	(9.85%)	(9.85%)	(9.85%)	(9.85%)	(9.85%)
11	ROE% above Approved ROE%	8.05%	9.07%	8.55%	8.07%	7.59%
12	Less: 300 Basis Points Threshold	(3.00%)	(3.00%)	(3.00%)	(3.00%)	(3.00%)
13	Total Over-Earnings (%)	5.05%	6.07%	5.55%	5.07%	4.59%
14	Total Over-Earnings (Line 13 x Line 2)	$967	$1,201	$1,136	$1,073	$1,005
15	50% of Overearnings Shared with to OPDC customers	$483	$601	$568	$537	$502
16	Tax Effected Earnings Sharing (26.5%)	$658	$817	$773	$730	$683
17	Cumulative Tax Effected Earnings Sharing (Years 6 to 10)					$3,661

[2] Hydro One notes that the ESM excel model that underpins the PDI related ESM (EB-2018-0242) does not include this modeling oversight and that ESM is accurate as provided in Hydro One's DRO.
[3] Includes 10% risk factor adjustment

4 DRAFT ACCOUNTING ORDER USGAAP

OEB Staff submitted on page 4 of their submission of the DRO that the description of the account provided by Hydro One does not align with OEB Staff's understanding of how it is intended to operate based on the Decision. OEB Staff requested Hydro One to confirm that at the end of the deferred rebasing period, the balance in the account will reflect the cumulative difference between the closing net PPE calculated using OPDC's existing accounting policies and the closing net PPE calculated using Hydro One's policies. OEB Staff suggested revised accounting names and descriptors be used in the Draft Accounting Order. SEC wrote that their understanding was that Hydro One should record each year the difference in depreciation and capitalization and therefore the difference in closing rate base for PPE, between the depreciation rates and capitalization policies used by OPDC prior to the transaction (which should be the same as those at the time of the Decision), and the depreciation rates and capitalization policies used by Hydro One after the transaction. SEC illustrated this by commenting if "the IFRS-based rate of depreciation for a particular asset was 20% per year, and the USGAAP-based rate of depreciation for the same asset is 10% per year, the difference of 10% of the cost of the asset is recorded in the account each year, because it represents higher rate base that the OPDC accounting policies would have caused."

Hydro One has clarified the mechanics of the account in the revised draft accounting order.

OEB Staff also commented on Hydro One's interpretation of the OEB's *Accounting Procedure Handbook – Frequently Asked Questions July 2012* where Hydro One suggested no interest or carrying charges or a rate of return was permitted in this account. OEB Staff informed Hydro One that this guidance was superseded by a subsequent letter in 2013, whereby the OEB stated that upon disposition a rate of return component shall be applied to the balance of Account 1576.

Hydro One has referenced the appropriate guidance with respect to carrying charges on Account 1576 in the revised draft accounting order.

5 YEAR 11 UPPER GOAL POST

Hydro One in its DRO sought clarification on certain parameters that would be used to calculate the Year 11 status quo forecast. Hydro One stated that it would update the following parameters in setting Year 11 rates with then-current information: cost of capital, corporate tax and low voltage charges. OEB Staff acknowledged that it is reasonable for Hydro One to update its Year 11 status quo forecast as proposed, as in the absence of the transaction customers of OPDC would have had their distribution rates calculated using these updated parameters. OEB Staff also noted that cost of capital and tax rates are outside Hydro One's direct control and that Low Voltage charges are outside the control of OPDC. Therefore, OEB Staff supported allowing the parameter updates as proposed by Hydro One and provided expectation that any calculations would be provided in Hydro One's rate application to rebase the OPDC rate zone. SEC also agreed with Hydro One's proposal but with two exceptions. First, SEC said that the tax rates to be applied should be those applicable to a utility like OPDC, not those applicable to Hydro One (e.g. the rates should reflect the size and nature of OPDC). Second, SEC had concerns over Hydro One's reference to "any other tax changes that impact utility customers", saying that that definition was to nebulous to be included in the DRO.

Hydro One agrees that in its application to set Year 11 rates for OPDC customers, that it will provide all calculations used to determine the upper goal post revenue requirement. On SEC's second point, Hydro One's clarifies that its proposal it to update the Year 11 upper goal post tax calculation to incorporate any new tax law, regulations or administrative practice changes that were implemented during the 10-year deferral period, by any government body. These are changes that would have been applicable to OPDC in absence of the transaction.

Hydro One Networks Inc. Distribution
Draft Accounting Order

<u>Accounting Entries</u>

Accounting Changes under US GAAP Deferral Account

Hydro One proposes the establishment of a new “Accounting Policy Changes” Deferral Account to record the impact of any applicable accounting changes to depreciation expense and capitalization policies on property, plant, and equipment (“**PPE**”) resulting from Orillia Power Distribution Corporation’s (“**OPDC**”) transition from modified International Financial Reporting Standards (“**MIFRS**”) to US GAAP for financial and regulatory accounting purposes. The deferral account will track impacts (both debits and credits) of the transition to US GAAP with respect to how costs are capitalized and depreciated. 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. The deferral account balance will be reviewed at the next rebasing rate application to determine the appropriate approach for disposition.

The account will be established as Account 1576[1] Accounting Policy Changes effective the date of transaction close. As per the Board issued “Accounting Policy Changes for Accounts 1575 and 1576”, a rate of return component will be applied to the balance in Account 1576 upon its disposition in rates and will require the use of separate rate riders for the disposition of the balance in Account 1576. No additional carrying charges shall accrue in this account prior to disposition.

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[1] Note that Account 1576, Accounting Changes under CGAAP was opened to record changes to depreciation expense and capitalization policies as required by the Board in 2013. The nature of this account is similar to the Accounting Changes under US GAAP deferral account being proposed; therefore, Hydro One requests to apply for this USofA account updated for the accounting policy that is being used.

The following outlines the proposed accounting entries for this deferral account.

USofA #	**Account Description**
DR/CR: 1576	*Accounting Policy Changes*
CR/DR: 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.