Ontario Energy Board
P.O. Box 2319
27th. Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

Commission de l'Énergie de l'Ontario
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone; 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273

Ontario

BY E-MAIL

February 22, 2021

Attention: Ms. Christine Long, Registrar

Dear Ms. Long:

Re: Hydro One Networks Inc.
Remittal of Future Tax Savings Issue
Ontario Energy Board File Number: EB-2020-0194

Please find attached OEB staff's submission on the future tax savings evidence pertaining to this proceeding filed by Hydro One Networks Inc. on October 28, 2020.

Martin Davies
Project Advisor, Rates
Electricity Distribution: Major Rate Applications & Consolidations

Hydro One Networks Inc.

EB-2020-0194

ONTARIO ENERGY BOARD

STAFF SUBMISSION ON HYDRO ONE'S FUTURE TAX SAVINGS EVIDENCE

February 22, 2021

INTRODUCTION

The Ontario Energy Board (OEB) determined in the EB-2016-0160 Decision and Order (Original Decision), that a portion of the future tax savings (Future Tax Savings) resulting from the Government of Ontario's decision to sell a portion of 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) transmission revenue requirement for 2017 and 2018.

The Original Decision was ultimately overturned by a decision of the Divisional Court of Ontario (Divisional Court or Court) dated July 16, 2020. The Divisional Court remitted the matter back to the OEB with instructions that "no portion of the Future Tax Savings should be allocated to ratepayers when the evidence is clear that [Hydro One] paid all of its costs under the stand-alone utility principle", and that "no part of the benefit of the Future Tax Savings is allocable to ratepayers and should instead be paid to the shareholders in its entirety." The OEB commenced the current proceeding to give effect to the Divisional Court's findings.

On October 2, 2020, the OEB issued Notice and Procedural Order No. 1 (PO#1) in the current proceeding which stated that this proceeding was being established to implement the clear direction of the Court that all of the Future Tax Savings should be allocated to Hydro One's shareholders.

In PO#1, the OEB determined that as a first step it would require Hydro One to file evidence on matters related to implementing the Court's decision. The OEB also made provision for interrogatories on Hydro One's evidence and implementation proposals from OEB staff and intervenors, and for submissions from OEB staff and intervenors and reply submissions from Hydro One.

On December 4, 2020, Hydro One filed its responses to the interrogatories which it received from OEB staff and intervenors.

On December 9, 2020, the School Energy Coalition (SEC), an intervenor in this proceeding, filed a motion requesting an order requiring Hydro One to provide full and adequate responses to certain interrogatories.[1]

[1] Interrogatories SEC-2 through 6, Interrogatory OEB Staff-2(a) (5) and Interrogatory CCC-1

On December 11, 2020, the OEB issued Notice of Motion and Procedural Order No. 2 (PO#2), in which it determined that it would hear the motion and established a schedule for the filing of submissions on it.

On February 8, 2021, the OEB issued its Decision on Motion and Procedural Order No.3 (PO#3), which denied the SEC motion and established dates for the filing of final submissions in this proceeding.

Hydro One observed that the purpose of this proceeding is to implement the direction of the Court that all of the tax savings be allocated to its shareholders.

Hydro One's evidence stated that to achieve this result, it was proposing two main amendments to its approved rates revenue requirements: (1) the methodology used to calculate regulatory income taxes in rate periods in 2022 and after; and (2) implementation of temporary rate adjustments commencing in 2021 that are designed to recover disputed tax savings amounts allocated to ratepayers during the Appeal Period.

The following is OEB staff's submission on these matters, which have been organized in accordance with the applicable sections used by Hydro One in its application evidence.

OEB STAFF SUBMISSION

3.1 Calculation of Misallocated Tax Savings Amounts

3.2 Adjustment to Future Regulatory Income Tax Calculations

Background

In section 3.1 of its evidence, Hydro One noted that since January 1, 2017, it had applied the OEB-prescribed allocation percentage from the Original Decision to share the Future Tax Savings with ratepayers. Hydro One also noted that throughout the appeal process, its approach had been to report the Future Tax Savings allocated to ratepayers as a single line item deduction to the calculation of regulatory income taxes.

Hydro One stated that in each of the relevant rate orders for: the 2017-2018 Transmission Revenue Requirement,[2] the 2019 Transmission Revenue Requirement,[3] the 2018-2022 Distribution Revenue Requirement,[4] and the 2020-2022 Transmission Revenue Requirement,[5] Future Tax Savings Amounts that were allocated to ratepayers were reported as in the table below:[6]

MISALLOCATED TAX SAVINGS AMOUNTS DEDUCTED FROM REGULATORY INCOME TAX ($M)

Year	Transmission	Proceeding	Distribution	Proceeding	Total
2017	31.2	EB-2016-0160	N/A		31.2
2018	35.1	EB-2016-0160	19.3	EB-2017-0049	54.4
2019	35.4	EB-2018-0130	26.3	EB-2017-0049	61.7
2020	32.8	EB-2019-0082	24.2	EB-2017-0049	57.0
2021	30.5	EB-2019-0082	22.5	EB-2017-0049	53.0
Total	165.0		92.4		257.4

Hydro One stated that the amounts shown in the above table were reported and used in the annual regulatory income tax calculations included in the rate orders for the applicable proceedings, as approved by the OEB.

In section 3.2, Hydro One stated that starting in 2022, it proposed to amend its method of calculating regulatory income taxes included in its base revenue requirement by removing the following line item deductions attributable to the Future Tax Savings Amounts:[7]

HYDRO ONE 2022 REGULATORY INCOME TAXES ADJUSTMENT ($M)

BUSINESS	AMOUNT	CASE NUMBER
Transmission	$28.4	EB-2019-0082
Distribution	$21.0	EB-2017-0049

---

[2] EB-2016-0160
[3] EB-2018-0130
[4] EB-2017-0049
[5] EB-2019-0082
[6] EB-2020-0194, *Hydro One Networks Inc. Transmission Revenue Requirement and Distribution Revenue Requirement and Tax Issue – Future Tax Savings Evidence*, October 28, 2020. (Hydro One Evidence), Exh A/Tab 1/Sch 1/Table 1, p.7.
[7] Hydro One Evidence, Exh A/Tab 1/Sch 1/Table 8, p.14.

OEB Staff Submission

OEB staff submits that Hydro One has provided the information that the OEB required in PO#1, as outlined in sections 3.1 and 3.2 of its evidence, and as summarized above, for the reasons which OEB staff provided in its submission on the SEC motion.[8]

The relevant section of this submission is reproduced below:[9]

> OEB staff notes that in PO#1, the OEB had stated the purpose of Hydro One's evidence in this proceeding as follows:
>
> > The findings in the Original Decision with respect to the tax savings allocations for the 2017-2018 period have subsequently been incorporated by the OEB into transmission revenue requirements and charge determinants for the years 2019 to 2022 as well as into distribution revenue requirements and rates for the 2018 to 2022 period.
> >
> > The OEB has determined that as a first step it will require Hydro One to file evidence on such matters as the total amount that Hydro One is entitled to recover for the 2017 to 2022 period as a result of the Court's decision. The information should be divided between the transmission business and the distribution business, along with detailed supporting calculations and potential customer bill impacts. Hydro One should also file one or more proposed implementation options for the recovery of the amounts owed through rates, and the annual forecast of rate impacts for these various options. Hydro One may also include any other information related to this matter that it believes would be useful.
>
> OEB staff submits that Hydro One has provided the information that the OEB required in PO#1. The purpose of the current proceeding is to ensure that the amounts associated with Future Tax Savings that were allocated to ratepayers through the decisions covering the period 2017-2022 are returned to Hydro One. OEB staff submits that Hydro One has provided this information and divided it between the transmission and distribution

[8] Ontario Energy Board, *Staff Submission on SEC Notice of Motion December 9, 2020,* December 22, 2020
[9] *Ibid, pp. 3-4.*

segments of the business as required, along with the inclusion of other required information such as bill impacts and implementation options.

OEB staff further submits that additional information, for example relating to the total quantum of the Future Tax Savings beyond 2022 and the allocation of those Future Tax Savings, is not necessary to determine how much was allocated to ratepayers for the period 2017-2022. Presumably Hydro One's applications for rates beyond 2022 will be consistent with the Court Decision and will not allocate any Future Tax Savings to ratepayers (irrespective of what the total quantum of the Future Tax Savings is); regardless, that is not a matter that is currently before the OEB.

OEB staff's view is that the purpose of the current proceeding is to essentially reverse the effects of the OEB's finding in the Original Decision (and carried over to subsequent cases decisions) which established the allocations to ratepayers relating to the Future Tax Savings. Hydro One's evidence has focused on calculating the amounts related to the Future Tax Savings that were allocated to ratepayers in these decisions (i.e. from 2017-2022) and proposing a methodology to return these amounts to Hydro One. In OEB's staff's view, this is the most effective way to achieve the stated purpose of this proceeding and is also consistent with the Court Decision.

Escalation of Future Tax Saving Amounts

Background

In one of OEB staff's interrogatory questions,[10] OEB staff noted that Hydro One did not escalate the Future Tax Savings that were applied to the 2021 Transmission amounts, or 2020 to 2021 Distribution amounts, even though the OEB accepted Hydro One's incentive rate-setting approach to use a Revenue Cap Index (RCI)[11] to adjust its 2021 and 2022 Transmission revenue requirement, as well as its 2020 to 2022 Distribution revenue requirement. Instead, Hydro One used the Future Tax Savings as included in its 2020 Transmission draft rate order for the 2021 Transmission Future Tax Savings amount and its 2018 Distribution draft rate order for the 2020 and 2021

---

[10] OEB IRR #1

[11] RCI is equal to Inflation factor – Productivity factor + Capital factor per the Decision and Order for Hydro One's Transmission rates for 2021, dated December 17, 2020 (EB-2020-0202) and per the Decision and Rate Order for Hydro One's 2020 Distribution rates, dated December 17, 2019 (EB-2019-0043)

Distribution Future Tax Savings amounts. In response to OEB staff's interrogatory, Hydro One calculated the total Future Tax Savings for the period of 2017 to 2021 to be $279.9 million, had it escalated these amounts for 2021 Transmission and 2019 to 2021 Distribution. Hydro One noted that the escalation of the Future Tax Savings for the years noted above would result in greater recovery of tax amounts from ratepayers. Hydro One proposes not to escalate the Future Tax Savings by the RCI.

OEB Staff Submission

OEB staff does not object to Hydro One's proposed approach to determining the Future Tax Savings, without escalating these amounts for the years noted above. OEB staff notes that the proposed approach would benefit Hydro One's ratepayers.

The above position notwithstanding, OEB staff calculates the Future Tax Savings using the escalation approach to be $269.1million, rather than the $279.9 million calculated by Hydro One. In its calculation of the Future Tax Savings for Distribution, Hydro One escalated the 2019 to 2021 Future Tax Savings. In OEB staff's view, if an escalation approach were to be approved by the OEB, the 2019 Future Tax Savings should not be escalated, as the OEB approved Hydro One's 2019 revenue requirement by each component, including the amount of the 2019 Future Tax Savings as shown in the rate order. Therefore, the 2019 Future Tax Savings, as approved in Hydro One's 2019 rate order, should be used as the 2019 Future Tax Savings amount, rather than escalating the approved 2018 Future Tax Savings. This will also impact Future Tax Savings calculated for 2020 and 2021 as the calculation escalates prior years' Future Tax Savings.

OEB staff accordingly submits that Hydro One has provided the information that the OEB required in PO#1, as outlined in sections 3.1 and 3.2 of its evidence, and as summarized above, for the reasons which OEB staff provided in its submission on the SEC motion.[12] OEB staff will however make separate submissions on the following sub sections of Hydro One's evidence, as part of this submission.

3.1.1 Recovery of Carrying Costs During the Appeal Period

3.1.2 Carrying Costs Incurred During the Recovery Period

[12] Ontario Energy Board, *Staff Submission on SEC Notice of Motion December 9, 2020,* December 22, 2020

3.1.3 Start Date for Recovery Period

3.1.4 Options For Recovering Misallocated Tax Savings Amounts

3.4 Implementation of Recovery of Misallocated Tax Savings Amounts

3.1.1 Recovery of Carrying Costs During the Appeal Period

Background

Hydro One proposes to recover carrying charges on the Future Tax Savings at its weighted average cost of debt (WACD). Hydro One stated that it is well-accepted that awarding interest is the fairest and most effective way of compensating for the lost time value of money.[13] Hydro One stated that it is appropriate to apply the approved WACD to the Future Tax Savings amounts that have been allocated to ratepayers, as that is more reflective of the cost Hydro One has notionally incurred from 2017 to 2021, as well as the period in which the Future Tax Savings shall be recovered.[14]

Through the course of this proceeding, various carrying charge rates have been brought forth for consideration. A summary of the carrying charge rates and the amounts as applied to the Future Tax Savings for the 2017 to 2021 period is shown in the table below. In this table, OEB staff included the OEB's prescribed Construction Work in Progress (CWIP) rate for the OEB's consideration.

Regarding the Bank of Canada rate plus 150 basis points (BoC + 150 bp), OEB staff notes that the Alberta Utilities Commission (AUC) decided that this interest rate was to be applied to charges payable or compensation receivable in a proceeding related to line losses that, in part, resulted from the direction of the Alberta Court of Appeal.[15]

[13] Exhibit A Tab 1 Schedule 1 Page 7
[14] IRR CCC #4
[15] Alberta Utilities Commission Decision 790-D04-2016, September 28, 2016

Carrying Charge Rates for Consideration

		2017	2018	2019	2020	2021 [16]	Carrying Cost ($M) 2017-2021[17]	Total TX+DX Carrying Cost ($M)
Approved WACD[18]	Transmission	4.47%	4.52%	4.52%	4.31%	4.31%	$18.3	
	Distribution	N/A	4.33%	4.33%	4.33%	4.33%	$7.8	$26.1
Actual WACD[19]	Transmission	4.55%	4.52%	4.42%	4.14%	4.14%	$17.7	
	Distribution	N/A	4.33%	4.26%	4.05%	4.05%	$7.4	$25.2
Average Annual Prescribed DVA Rate	Transmission	1.20%	1.86%	2.25%	1.38%	1.38%	$ 5.4	
	Distribution	N/A	1.86%	2.25%	1.38%	1.38%	$2.1	$7.5
Average Annual Prescribed CWIP Rate	Transmission	2.79%	3.26%	3.24%	2.47%	2.47%	$10.7	
	Distribution	N/A	3.26%	3.24%	2.47%	2.47%	$4.4	$15.1
Bank of Canada Rate + 150 basis points[20]	Transmission	2.20%	2.90%	3.25%	2.10%	2.10%	$10.0	
	Distribution	N/A	2.90%	3.25%	2.10%	2.10%	$4.3	$14.3
Approved Short Term Rate[21]	Transmission	1.76%	2.29%	2.75%	2.75%	2.75%	$10.7	
	Distribution	N/A	2.29%	2.29%	2.29%	2.29%	$4.1	$14.8

OEB Staff Submission

As explained earlier in the submission, in OEB's staff view, the purpose of the current proceeding is essentially to reverse the effects of the OEB's finding in its Original Decision (and carried over to subsequent decisions), which established the Future Tax Savings allocations to ratepayers. The reversal is primarily done by returning the Future Tax Savings that were allocated to ratepayers to Hydro One. However, OEB staff acknowledges that the effects of the OEB's finding in the Original Decision (as if the Original Decision had never been made, and Hydro One's revenue requirements had never been reduced by the allocated Future Tax Savings) cannot be fully reversed without recognizing the effects of the time value of money. Therefore, OEB staff agrees that carrying charges

[16] Assumes 2021 rate is same as 2020 rate
[17] OEB staff calculated the carrying costs for CWIP rate and actual WACD in the same manner as calculated by Hydro One in Exhibit I/Tab 2/Schedule 2
[18] Exhibit A/Tab 1/Schedule 1/p.8
[19] Hydro One Submission on SEC Notice of Motion, Appendix A, January 11, 2021
[20] Exhibit I/Tab 2/Schedule 2 - IRR LPMA #2
[21] *Ibid*

should apply to the Future Tax Savings proposed for recovery to compensate Hydro One for the lost time value of money.

With regard to the carrying charge rate applicable to the Future Tax Savings, OEB staff disagrees with Hydro One's proposed use of approved WACD. OEB staff submits that the prescribed CWIP rate, or alternatively, the BoC + 150 bp rate, would be the appropriate carrying charge rate for the reasons discussed below.

Hydro One stated that, as a result of the Original Decision, it has incurred a higher level of debt than it otherwise would have incurred. Hydro One further stated that the approved WACD is appropriate because the amount of Future Tax Savings were funds it otherwise expected to be received in normal operations and the cost to finance this shortfall would attract Hydro One's WACD, given that it was over a four-year period.[22,23] OEB staff disagrees with this characterization. In the Original Decision (and associated subsequent decisions), the reduction of revenue requirement for the Future Tax Savings did not impact the OEB's decision on Hydro One's capital program and projects, or the financing of these projects and the refinancing of existing assets. As a result, approved Uniform Transmission Rates (UTRs) and distribution rates reflected the appropriate level of debt financing/refinancing costs for Hydro One and were compensatory to allow Hydro One to recover its cost of capital, including any additional debt incurred as a result of the Future Tax Savings allocation.

OEB staff's view is that the carrying charge rate applicable to this case should reflect the time value of money corresponding to the period in which Hydro One did not have the funds relating to the Future Tax Savings. In other words, this can be viewed as Hydro One lending funds to ratepayers for a five-year period, from 2017 to 2021 (recovery of Future Tax Savings is proposed to commence in 2021). The recovery period may range from a two to seven-year period from 2021 to 2027, as currently proposed by Hydro One. OEB staff notes that Hydro One's approved WACD is comprised of 7% short-term debt and 93% long-term debt.[24] The majority of Hydro One's long-term debt that is reflected in its approved long-term debt rate are for a 30-year period.[25] This is a substantially longer period than the five-year period noted above, and is therefore, not the appropriate carrying charge rate to use.

[22] Exhibit A/Tab 1/Schedule 1/Page 10
[23] OEB staff believes that this should be a five-year period from 2017 to 2021, not a four-year period.
[24] Debt structure of 4% short-term debt, 56% long-term debt.
[25] Energy Probe IRR #4, Attachments 1-4

OEB staff's view is that the prescribed Deferral and Variance Account (DVA) rate and Hydro One's approved short-term rate would not be appropriate either as these rates reflect short term debt (i.e. three-month maturity period).

OEB staff submits that a mid-term rate[26] would be appropriate and correspond to the five-year period. OEB staff submits that the prescribed CWIP rate should be used as the carrying charge rate as it is a mid-term rate.[27] OEB staff further notes that in the past, the OEB has directed that the prescribed CWIP rate be used in certain circumstances, giving due consideration to expected timing of cash flows.[28]

OEB staff notes that the BoC + 150 bp rate is similar to the prescribed CWIP rate for the 2017 to 2021 period, as shown in Table 1 above. OEB staff is of the view that the BoC + 150 bp rate may be considered as an alternative to the prescribed CWIP rate. The BoC rate is the Target for Overnight Rate, which is the interest rate at which major financial institutions borrow and lend one-day funds among themselves. The Bank of Canada sets a target level for this rate. This target for the overnight rate is often referred to as the Bank of Canada's policy interest rate.[29] Hydro One has argued that the precedent set in the AUC proceeding of using the BoC + 150 bp rate does not apply to their case as the AUC case involved a line loss issue, which is a cost category that is part of the provision of rate-regulated services, whereas the underlying cost category for the Future Tax Savings of issue in this current proceeding is not properly within the rate setting paradigm.[30] OEB staff is of the view that, given the certainty of recovery of Future Tax Savings resulting from the Court's decision, the Future Tax Savings could be viewed akin to a regulatory asset and therefore, the precedent of using the AUC's application of the BoC + 150 bp should apply to the circumstances in this proceeding as well. Therefore, the OEB may wish to consider the BoC + 150 bp as an alternative to the prescribed CWIP rate.

---

[26] OEB staff views this rate as being somewhere between a short-term rate and a long-term rate and notes that the CWIP rate is based on a mid-term bond index.
[27] Source of the CWIP rate is FTSE Canada (formerly DEX) Mid Term Bond Index All Corporate per https://www.oeb.ca/industry/rules-codes-and-requirements/prescribed-interest-rates
[28] Prescribed CWIP rate applies to the Pension and OPEB Forecast Accrual versus Actual Cash Payment Differential variance account as per the Report of the Ontario Energy Board, Regulatory Treatment of Pension and Other Post-employment Benefits (OPEBs) Costs, EB-2015-0040, September 14, 2017
[29] https://www.bankofcanada.ca/core-functions/monetary-policy/key-interest-rate/
[30] IRR CCC #4

3.1.2 Carrying Costs Incurred During the Recovery Period

Background

Hydro One proposes that carrying charges be applied during the recovery period. Hydro One proposes two accounts be established to accomplish this:[31]

1. An account for Distribution to track the difference between approved and recovered Future Tax Savings on an annual basis, with differences to be disposed of at the end of the recovery period; and
2. A Carrying Cost Differential Account for Transmission and Distribution to capture the monthly carrying charge on the outstanding balance of the Future Tax Savings over the recovery period. Hydro One proposes that the balances be brought forth for disposition at its 2028 rebasing, or such other time as the OEB determines.

In response to interrogatories,[32] Hydro One indicated that it is proposing to use actual carrying charge rate during the recovery period. However, Hydro One also referenced its response to explain its rationale for proposing to use the approved WACD. It is unclear to OEB staff why Hydro One referred to its proposal to use approved WACD, while also explaining that it proposes to use the actual carrying charges.

OEB Staff Submission

OEB staff notes that the first account Hydro One proposes, for Distribution to track differences between approved and recovered Future Tax Savings, serves the same purpose as the generic Account 1595 - Disposition and Recovery/Refund of Regulatory Balances, Sub-account Principal Balances, available to all electricity distributors. This 1595 sub-account records variances between the amounts approved for disposition and the amounts recovered or refunded. OEB staff notes that this 1595 sub-account is applicable for all Group 1 and most Group 2 deferral and variance accounts. OEB staff supports the establishment of the proposed account for Distribution. This will ensure that neither Hydro One, nor its ratepayers, benefit from (or are harmed by) the result of forecasting variances that may arise when determining the recovery mechanism. OEB staff notes that this account would not be applicable to Transmission as the disposition of deferral and variance accounts are applied

[31] OEB IRR #2
[32] *Ibid*.

against the Transmission revenue requirement instead of being disposed through rate riders, which can be easily tracked.

OEB staff notes that the Carrying Cost Differential Account Hydro One proposes for Distribution and Transmission to record monthly carrying charge amounts on the remaining balance of the Future Tax Savings serves the same purpose as Account 1595 - Disposition and Recovery/Refund of Regulatory Balances, Sub-account Carrying Charges for Net Principal available to all electricity distributors. This 1595 sub-account records carrying charges on the opening monthly principal balance in the Account 1595, Sub-account Principal Balances. As discussed above, OEB staff agrees with the application of carrying charges to the Future Tax Savings. Therefore, OEB staff also agrees with the establishment of this proposed account for the application of carrying charges during the recovery period. OEB staff supports the establishment of the two aforementioned accounts as it will allow for greater transparency in the tracking of the significant amounts related to the Future Tax Saving, rather than using the existing Account 1595 sub-accounts which tracks disposition and carrying charges for all Group 1 and the majority of Group 2 deferral and variance accounts.

It is unclear whether Hydro One is proposing that actual carrying charges or its approved WACD be applied to the proposed Carrying Cost Differential Account during the recovery period. OEB staff submits that the prescribed CWIP rate, (or alternatively the BoC + 150 bp rate if the OEB approves the use of this rate instead) should also apply during the recovery period. A mid-term rate would be a balance between a seven-year total recovery period, as submitted by OEB staff in the "Options For Recovering Misallocated Tax Savings Amounts" section below, and the annual recoveries that are proposed to occur during the recovery period.

3.1.3 Start Date for Recovery Period

Background

Hydro One proposed that the implementation date of misallocated tax savings amounts recovery should be January 1, 2021 or, if that is not possible from a timing perspective, approximately 30 days from the date that the OEB issues its decision in this matter.

Hydro One stated that implementation in 2021 is recommended for the following reasons. First, in its annual update for 2021 distribution rates[33] Hydro One is proposing a rate decrease which will partially offset the rate impacts associated with the recovery of the misallocated tax savings amounts. Second, recovery of the misallocated tax savings amounts in 2021 mitigates rate impacts that may arise in 2022 and 2023.

Hydro One noted in this context that, in 2022, rates will be impacted by the fact that Hydro One's revenue requirement is proposed to no longer include any allocation of Future Tax Savings in the calculation of regulatory income tax. Furthermore, in 2023, rates will be impacted by the new distribution and transmission revenue requirement that will be established through a common joint rate application and rebasing process. Hydro One stated that its proposed approach mitigates rate impacts to customers by staggering rate increases over time.

OEB Staff Submission

OEB staff notes that it will not be possible to implement misallocated tax savings amounts recovery on January 1, 2021, but agrees with Hydro One that given that rates will be impacted in 2022 and 2023 as described above, recovery of these amounts as early as possible will assist with rate impact mitigation.

OEB staff, however, also notes that there may be some element of administrative convenience and correspondingly reduced costs if these changes could be implemented on a date when Hydro One's rates would also otherwise be changing, although it would appear that the next such date is likely to be January 1, 2022.

January 1, 2022 will also involve adjustments going forward of Hydro One's revenue requirement, not just for the tax savings discussed in this submission, but also for those matters arising from the annual update. While it is unknown at this time what those impacts will be in total, in OEB staff's view, commencing recovery of the historically misallocated amounts in 2021 over the seven year period that will be discussed below, will impact customers by approximately 0,3% or lower and better smooth the transition to the remaining 2022 impacts that will commence on January 1, subject to the OEB's approval.

[33] EB-2020-0030

If the OEB was to approve a 2021 implementation date, OEB staff estimates that this will likely not take place earlier than June 1, 2021 for distribution given the OEB's typical timelines and the potential need for a draft rate order process and July 1, 2021 for transmission given the need to reset the revenue requirement UTR pools and allocation factors.

3.1.4 Options For Recovering Misallocated Tax Savings Amounts

Background

Hydro One presented three options for the recovery of the misallocated tax savings amounts.

Option 1 – Recovery from 2021 to 2022

Option 1 was to recover these amounts and carrying costs over the 2021 and 2022 rate periods with this option commencing as early as possible in 2021.

Hydro One proposed that a base rate adjustment rider would be used for purposes of its distribution rates, while for transmission, an adjustment would be made to the calculation of Hydro One's rates revenue requirement included in the 2021 UTR calculation.

Hydro One provided year-over-year bill and rate impacts for this option which showed that for a typical medium density residential customer (R1), bill impacts would be 1% or lower in both years, while for a transmission customer they would be 0.4% or lower.

The bill impacts for Hydro One's remaining residential classes, low density (R2), Urban density (UR), and seasonal were provided in responses to OEB staff interrogatories.[34] These were shown to be in similar ranges, except for seasonal where a 1.5% bill impact is expected in 2021.

These impacts are exclusive of the bill impacts in 2022 of the 2022 revenue requirement adjustment to regulatory income tax which is discussed in the next section.

Hydro One stated its expectation that R1 and R2 distribution customers would be protected from distribution rate increases associated with the recovery of the

[34] Exh I/Tab 1/Sch 5 and 6.

misallocated tax savings amounts as a result of the distribution rate protection (DRP) program.

Option 2 – Recovery from 2021 to 2024

Hydro One stated that under this option, it would commence recovery of the misallocated tax savings amounts and carrying costs as soon as possible in 2021 and over a four-year period ending December 31, 2024, rather than the two-year period proposed under Option 1.

Hydro One provided year-over-year bill and rate impacts for this option which showed that for a typical medium density residential customer (R1), bill impacts would be below 0.5% in all years, while for a transmission customer they would be 0.2% or lower.

The bill impacts for Hydro One's remaining residential classes, low density (R2), Urban density (UR) and seasonal were provided in responses to OEB staff interrogatories.[35] These were shown to be in similar ranges, except for seasonal where a 0.8% bill impact is expected in 2021.

These impacts are exclusive of the bill impacts in 2022 of the 2022 revenue requirement adjustment to regulatory income tax which is discussed in the next section.

Hydro One stated its expectation that R1 and R2 distribution customers would be protected from distribution rate increases associated with the recovery of the misallocated tax savings amounts as a result of the distribution rate protection (DRP) program.

Option 3 – Recovery from 2021 to 2027

Hydro One stated that under this option, it would commence recovery of the misallocated tax savings amounts and carrying costs as soon as possible in 2021 and over a seven-year period ending December 31, 2027, rather than the four-year period proposed under Option 1.

Hydro One provided year-over-year bill and rate impacts for this option which showed that for a typical medium density residential customer (R1), bill impacts

---

[35] *Ibid*

would be in the 0.3% range or less in all years, while for a transmission customer they would be 0.1% or lower.

The bill impacts for Hydro One's remaining residential classes, low density (R2), Urban density (UR) and seasonal were provided in responses to OEB staff interrogatories.[36] These were shown to be in similar ranges, except for the seasonal class which was slightly higher at 0.4%.

These impacts are exclusive of the bill impacts in 2022 of the 2022 revenue requirement adjustment to regulatory income tax which is discussed in the next section.

Hydro One stated its expectation that R1 and R2 distribution customers would be protected from distribution rate increases associated with the recovery of the misallocated tax savings amounts as a result of the distribution rate protection (DRP) program.

Adjustment to Future Regulatory Income Tax Calculations

Hydro One proposed, that starting in 2022, it would amend its method of calculating regulatory income taxes included in its base revenue requirement by removing the following line item deductions attributable to the future tax savings amounts:

HYDRO ONE 2022 REGULATORY INCOME TAXES ADJUSTMENT ($M)

BUSINESS	AMOUNT	CASE NUMBER
Transmission	$28.4	EB-2019-0082
Distribution	$21.0	EB-2017-0049

Hydro One stated that this adjustment to the calculation of regulatory income taxes would be reflected in Hydro One's annual distribution and transmission filings for 2022 revenue requirements and rates.

Hydro One provided 2022 bill impacts for this adjustment of 0.5% or lower for all of its residential classes, except for Seasonal which was 0.7%. The impact for a transmission customer was estimated at 0.1%. These bill impacts are in addition to those arising from the recovery options discussed above.

[36] *Ibid*

Hydro One's Recommended Approach

Hydro One stated that its recommended approach was based on an attempt to balance the Court's decision that its shareholders must be kept whole, with the objective that to the extent practical, rate impacts to customers be reasonably mitigated.

Hydro One's first recommendation was that the future revenue requirement be adjusted as part of its 2022 annual updates for transmission and distribution to remove the allocation of future tax savings to ratepayers.

Hydro One's second recommendation related to the means of recovery of the misallocated tax savings amounts and were that: (i) recovery commence as soon as possible in 2021 and (ii) that the WACD be applied to the annual portion of the tax savings commencing from January 1, 2017 and continuing for the duration of the recovery period determined by the OEB.

Hydro One observed that where the duration of the misallocated tax savings amounts recovery period was concerned, that annual rate impacts will be reduced with the imposition of a longer recovery period, but on the other hand, a longer recovery period attracts greater costs arising from carrying costs and gives rise to greater risks of intergenerational inequities as between ratepayers who received the benefit of the misallocated tax savings amounts and those from whom amounts will be recovered.

Hydro One concluded that it took no position in respect of the recovery period, provided that WACD is applied as requested, a position which as discussed earlier, OEB staff does not support. Hydro One did note however that Option 3, recovery from 2021 to 2027, would be the best option for mitigating rate impacts to customers.

OEB Staff Submission

OEB staff agrees with Hydro One's first recommendation that the future revenue requirement be adjusted as part of its 2022 annual updates for transmission and distribution, subject to the two caveats discussed below. OEB staff supports this recommendation because it would eliminate any continuation of the misallocated tax savings amounts flowing to customers in 2022 which would just have to be refunded at a later date.

The first caveat is that OEB staff believes this should only be done as long as the implementation of this adjustment in the 2022 annual update would not excessively complicate or delay this update in terms of the timing of its filing or the ability to be completed in a timely fashion. The second caveat is that if this adjustment is to be undertaken in the 2022 annual update, the inclusion of this adjustment in these filings would not raise issues that could only be dealt with effectively in the impending common joint rate application.

OEB staff is of the view that it would be best for the OEB to select Hydro One's Option 3 for the recovery period of these amounts. This would see the amounts to be recovered from customers collected over a seven-year period. OEB staff takes this view on the basis that the rate impacts of this alternative on customers would be the lowest, especially in the shorter term, which is important given the economic pressures created by the current COVID-19 pandemic.

3.4 Implementation of Recovery of Misallocated Tax Savings Amounts

Background

Hydro One provided the following explanation of how it proposed to implement the recovery of the misallocated tax savings for transmission and distribution.

Transmission

Hydro One proposed that the misallocated tax savings amounts and carrying costs attributable to transmission would be included as an adjustment in the Hydro One rates revenue requirement collected via Ontario Uniform Transmission Rates (UTRs).

Hydro One stated that under Option 3 with the seven-year recovery period, the total misallocated tax savings amounts and carrying costs attributable to Transmission of $183.3 million would be divided by seven[37] and included in the Hydro One rates revenue requirement used to set the UTRs for 2021 and through 2027. Hydro One noted that the resetting of UTRs would impact all customers connected to the transmission system (i.e. LDCs and large industrial customers) in the year in which the UTRs are reset.

[37] Hydro One stated that if either Option 1 or Option 2 were adopted, the denominator value would be adjusted to reflect the shorter durations of those recovery periods.

Distribution

Hydro One noted that the misallocated tax savings amounts and carrying costs attributable to Distribution were part of the total annual rates revenue requirement and, per the OEB's approved Cost Allocation Model, were allocated across rate classes in proportion to each rate class' allocated share of Net Fixed Assets ("NFA").

Hydro One proposed that, as such, and consistent with the OEB approved approach in its most recent distribution cost of service application[38] for disposition of prior changes in tax amounts, the total misallocated tax savings amount of $100.2 million should be split among distribution rates classes in proportion to the NFA amounts allocated to each rate class as per Hydro One's most current 2018 Cost Allocation Model approved in that application.

Hydro One noted that under Option 3, it had proposed that the base rate adjustment riders would be calculated assuming a recovery of the amount allocated to each rate class over the balance of 2021 and the 2022 to 2027 period available for disposition.

Hydro One stated that the approved fixed and volumetric charge determinants for those years would then be used to recalculate the base rate adjustment riders applicable in each year.

OEB Staff Submission

OEB staff supports Hydro One's proposal for the implementation of recovery of misallocated tax savings amounts subject to the OEB's decision of the implementation date. If OEB staff's recommendations are accepted, the UTRs would be adjusted effective July 1, 2021 to commence the transmission portion of the recovery, subject to the timing of the OEB's decision. Hydro One would commence recovery of the distribution portion as early as June 1, subject to the timing of the OEB's decision

- All of which is respectfully submitted-

[38] EB-2017-0049