EB-2020-0194

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch.B, as amended;

AND IN THE MATTER OF a proceeding on the Board's own motion to implement the decision of the Divisional Court dated July 16, 2020 in its File #200/19, and for an Order or Orders approving or fixing just and reasonable rates for Hydro One Networks Inc. for the transmission and distribution of electricity as of January 1, 2021.

FINAL ARGUMENT
OF THE
SCHOOL ENERGY COALITION

February 26, 2021

SHEPHERD RUBENSTEIN
PROFESSIONAL CORPORATION
2200 Yonge Street, Suite 1302
Toronto, Ontario M4S 2C6

Tel: 416-483-3300
Fax: 416-483-3305
jay@shepherdrubenstein.com

Jay Shepherd
Counsel for the School Energy Coalition

TABLE OF CONTENTS

1 GENERAL COMMENTS

1.1 *Introduction*

1.1.1 This Application has a lengthy and complex history[1]:

(a) On November 5, 2015[2] the Applicant ceased to be subject to the PILs regime in Ontario, and instead became subject to the Income Tax Act, Canada, the federal income tax regime (and related Ontario income tax regime). Under the two relevant acts, the Electricity Act, Ontario and the Income Tax Act, Canada, the Applicant was deemed to have disposed of its assets at fair market value (FMV).

(b) The disposition under the PILS regime caused recapture of CCA and capital gains that resulted in a Departure Tax of $2.6 billion[3]. This amount was paid to Ontario Electricity Financial Corporation (OEFC) by Hydro One[4].

(c) At the same time, the Applicant entered the federal tax regime with a bump in the FMV of its assets (the FMV Bump), generating a deferred tax asset of $2.596 billion[5]. Of that, $1.476 billion was allocable to the transmission business, and $1.120 billion was allocable to the distribution business.

(d) Since the Departure Tax was an actual cash outlay, and the deferred tax assset of similar amount was a non-cash asset with future value, the Applicant needed to fund the cash shortfall, and did so by issuing additional common shares in its parent company to the Province of Ontario, its sole shareholder, in the amount of $2.6 billion[6].

(e) The Applicant in EB-2016-0160 sought to recover all of the Deferred Tax Asset from customers in rates, resulting in proposed additions to rates for transmission and distribution over time (over and above actual taxes payable by the Applicant) that would be equal to the grossed-up amount of the Deferred Tax Asset, i.e. $3.532 billion[7]. The Board, after analysis of the

[1] None of the facts below appear to be in dispute, and they are recited for ease of reference only.
[2] EB-2016-0160, Ex. K11.1, p. 11.
[3] This amount has variously been reported as $2.271 billion, $2.264 billion, and $2.6 billion. We have used the latter figure, contained in Note 7 of the Hydro One 2015 Annual Report (page 68), which is excerpted at p. 15 of Ex. K11.1. Nothing turns on this difference, which appears to be an artifact of the various times and circumstances under which the Departure Tax was estimated.
[4] EB-2016-0160, Tr. 11:36.
[5] EB-2016-0160, Decision on DRO, November 9, 2017, Table 15-1 Revised, for both the total and the breakdown between transmission and distribution.
[6] EB-2016-0160, Tr. 11:27-8.
[7] EB-2016-0160, Undertaking J11.20.

ratemaking issues involved, and after several adjustments to the percentages, determined on November 9, 2017 (the "Original Decision") that 38% of the grossed-up Deferred Tax Asset would be allocated to customers, and the 62% balance would be allocated to the shareholder[8].

(f) The Applicant moved to vary the Original Decision in EB-2017-0336. On August 31, 2018 the Board found (the "Review Decision") that there were material errors in the Original Decision, and remitted the Deferred Tax Asset allocation question back to the original panel to correct it.

(g) The original panel, reconstituted with a change, considered the Review Decision in EB-2018-0269, and on March 7, 2019 determined (the "Rehearing Decision") that the Original Decision remained an appropriate allocation of the Deferred Tax Asset.

(h) The Applicant appealed to the Divisional Court, and the Court ruled (the "Court Decision") on July 19, 2020 that the Rehearing Decision did not properly apply the benefits follow costs test. The Court remitted the matter back to the Board with a direction as follows[9]:

"The Court therefore orders that the matter be remitted back to the Board and (a) a new panel of the OEB shall consider and make an appropriate order varying the tax saving allocation in the Original Decision by correcting the errors identified in it by the Review Panel..."

(i) The Court also directed the Board that "*no portion of the Future Tax Savings should be allocated to ratepayers when the evidence is clear that HONI paid all of its costs under the standalone utility principle*"[10].

(j) The Board has established the current proceeding to implement the direction of the Divisional Court.

1.1.2 This is the Final Argument of the School Energy Coalition.

1.1.3 The Board will be aware that some of the customer groups who intervened in this proceeding have worked together to avoid duplication, including sharing ideas, positions, and drafts. We have been assisted in preparing this Final Argument by that co-operation amongst parties. In addition, we have been assisted by being able to review the Final Argument of OEB Staff. Although we disagree with most of it, the OEB Staff perspective has been useful to SEC in formulating our Final Argument.

[8] EB-2016-0160, Decision on DRO, November 9, 2017, p. 17.
[9] Court Decision, p. 17.
[10] Ibid, p. 16.

1.1.4 This Final Argument has been organized to follow the logical flow of the issues, and has not followed the organization of the Hydro One Application.

1.1.5 There are some issues on which SEC has made no submissions. Where that is the case, that does not indicate that SEC agrees with all or any part of the Application. Silence is just silence.

1.2 What is the Purpose of This Proceeding?

1.2.1 ***The Board Has Made a Determination.*** In Procedural Order #3 in this proceeding, the Board clarified the scope of this proceeding as follows[11]:

> *"The OEB reiterates that the scope of this proceeding is to reallocate to Hydro One's shareholders any deferred tax savings allocated to ratepayers only for the 2017 to 2022 period. Any determinations related to the calculation of taxes (including future tax savings) for 2023 onwards that may be required will be the responsibility of a future OEB panel."*

1.2.2 Hydro One would like to interpret this narrowly, basically saying that this proceeding can only accept Hydro One's statement of the 38% previously allocated to ratepayers, and order payment by ratepayers to Hydro One of that amount, with interest. The issues in this proceeding would be limited to the time period of recovery, and the interest rate.

1.2.3 OEB Staff appear to say the same thing in their Final Argument, quoting the following excerpt from their submissions on the SEC Motion again in their Final Argument[12]:

> *"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... 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;... regardless, that is not a matter that is currently before the OEB."*

1.2.4 With respect, SEC does not agree that this is the correct interpretation of PO #3, nor does it correctly set out the Board's legal responsibilities in this proceeding, for at least two reasons.

1.2.5 ***The Court Has Provided its Direction to the Board.*** First, the Court, acting within its statutory jurisdiction, gave the Board clear and explicit instructions. The Board was to

[11] Decision on Motion and Procedural Order #3, p. 7.
[12] *Staff Submission on SEC Notice of Motion December 9, 2020,* December 22, 2020.

create a new panel of the Board, and that panel was to correct the errors in the Original Decision in a manner consistent with the Review Decision and the findings of the Court. The new panel would thus have to re-engage the issue of the deferred taxes, and exercise its statutory jurisdiction to re-decide the issue within the strictures directed by the Court. It does not appear to us that this is in dispute, nor do we think the Board in PO #3 intended to reject the clear instructions of the Court.

1.2.6 Paraphrasing the words of the Court, the Court told the Board "There is an amount of Future Tax Savings that rightfully belongs to the shareholders, because they paid the cost associated with that benefit. The Board has to change the Original Decision to ensure that the rates in that Decision are modified so that they cause Hydro One to collect all of those Future Tax Savings from customers in rates."

1.2.7 It is clear that the Original Decision only dealt with transmission rates for a finite period of time, and so PO #3 properly notes that correcting the Original Decision does not involve setting rates for any other period. Similarly, the decisions in EB-2018-0130, EB-2019-0082, and EB-2017-0049, which each expressly deferred to the Original Decision on this issue, dealt with transmission or distribution rates for a finite period of time, together with the Original Decision covering all of 2017-2022, the period referenced by the Board in PO #3. Again, this does not appear to us to be in dispute.

1.2.8 However, the Board in the Original Decision did not simply make a random 38% allocation, and leave everything else to the future. The Board made a decision of principle that the Future Tax Savings should be shared in a certain way, and that rates should be established to implement that sharing. This was, after all, an exercise of the Board's ratemaking jurisdiction, so the decision on the Future Tax Savings was an implementation of ratemaking policies and principles.

1.2.9 The Court has told the Board that the decision of principle in the Original Decision was incorrect, and that a different principle must be applied. The Board therefore is obligated to go back to the Original Decision and make the decision that should have been made, consistent with the Court Decision. The Board must then apply that to the three subsequent transmission and distribution proceedings that relied on the Original Decision.

1.2.10 To do anything else would be non-compliant with the Court Decision, and could not have been the Board's intention in PO #3.

1.2.11 ***Ratemaking Principles Cannot be Ignored.*** Second, and related to the first reason, the Board's jurisdiction in this matter is its ratemaking jurisdiction. Once that jurisdiction is engaged, as it is here, it would be a decline of that jurisdiction to exercise it without giving consideration to all of the relevant ratemaking principles.

1.2.12 In this situation, the four decisions that have allocated Future Tax Savings have allocated 68% of those savings, or a total of $500.6 million[13], which grossed up to rates is $681.1 million. That has been or is being collected from ratepayers in a specific way (an adjustment in the tax line for revenue requirement in those four proceedings), without any real debate. The Board is now faced with increasing the amount collected by 61%, $417.4 million in rate increases, and doing it after the fact.

1.2.13 SEC therefore submits that it is necessarily in scope in this proceeding, once the total tax savings in the 2017-2022 period have been identified, for the Board to determine using proper ratemaking principles how that should best be collected from customers in rates.

1.2.14 In fact, it appears clear that all parties agree with this. Some part of the Future Tax Savings that arise in the 2017-2022 period have been or will be collected in that period. The remainder will be collected after that period. The Board is faced with determining how much those amounts will be, and when and how they will be collected from ratepayers.

1.2.15 ***Conclusion.*** Hydro One seeks to limit the options for collection to their proposal, with the only variables being the length of the collection period and the interest rate. Any other approach to collecting that money is, they say, out of scope. This would appear to us to be contrary to the Board's own submissions to the Divisional Court, which were characterized by the Court as follows[14]:

> *"The OEB argues that remitting the case to the Board would not be pointless, and that this is not a case where there is only one reasonable outcome that can be reached if the matter is sent back. Rather the OEB submits that this Court should certify its opinion about any errors of law or jurisdiction so that the Board can reconsider the matter in view of that opinion, applying its expertise and experience to that task."*

1.2.16 The Court agreed with that submission, and sent the matter back to the Board so that the Board could "apply its expertise and experience".

1.2.17 With respect, if a better approach to the collection of the misallocated tax savings is proposed by a party such as SEC, we would assume that the Board will apply relevant ratemaking principles to assess whether the SEC Proposal accomplishes the goals

[13] This is simply 62/38 times the adjustment proposed of $257.4 million until the end of 2021, plus $49.4 million for 2022, for a total of $306.8 million ($417.4 million grossed up). If the 38% that has not been allocated to shareholders over 2017-2022 is $306.8 million, as Hydro One claims, then 100% is $807.4 million ($1,098.5 grossed up), and the amount that has already been allocated to shareholders (including 2022 rates) is the difference, $500.6 million ($681.1 million grossed up). There is an issue of how IRM escalation is treated, which creates a dispute about the amount that has already been allocated, but it is a small part of the total.

[14] Court Decision, p. 16.

established by the Board and the Court, but does so in a way that is better ratemaking.

1.2.18 In our submission, this is in no way inconsistent with PO #3, but it also implements both the instructions of the Court, and the statutory jurisdiction the Board is exercising.

1.3 ***Summary of SEC Proposal***

1.3.1 ***Analytical Framework.*** SEC divides the problem into two components:

(a) The appropriate method of recovering $3.532 billion from customers over time, as ordered by the Court, if different from the method being used to collect the previous 62% amount, i.e. $2.190 billion[15], and

(b) Trueing up the 2016-2022 period so that it is consistent with the optimal ratemaking approach established by the Board.

1.3.2 ***Deferral Account.*** SEC proposes that the Board establish a deferral account for each of transmission and distribution, and charge the grossed up amount of the applicable Deferred Taxes to that account. This amount appears to be $2.008 billion for transmission and $1.524 billion for distribution (subject to the True Up adjustment described below).

1.3.3 ***Rate Rider***. The Board should (notionally) calculate a rate rider for each of transmission and distribution[16] that will collect the grossed up Deferred Tax from customers over the expected life of that Deferred Tax Asset, 30 years for transmission and 23 years for distribution. The rate rider should be structured to increase annually at the same rate as rates generally increase, so that after its initial implementation it has no net rate impact. When the full amount in the Deferral Account has been collected in rates, the account will terminate and the Rate Rider will end.

1.3.4 ***Carrying Charges/Time Value of Money***. The Board has clear admissions from the Applicant that the Departure Tax and therefore the Deferred Tax Asset were financed by the issuance of common shares. Those common shares carry no cost, because the Province held 100% of the common shares before and after that transaction. Therefore, the cost of the fnancing is zero, and there is no reason to add interest or carrying charges.

1.3.5 ***True Up***. Hydro One should be directed to calculate how much has already been recovered, or will be recovered in existing rate plans, from customers in rates to the end of 2022 on account of the Deferred Tax Asset (i.e. the 62% allocated to

[15] 62% of the grossed up amount Hydro One has already stipulated.
[16] In the case of transmission this is likely structured as an annual revenue adder.

shareholders), and deduct that amount from the balance in the deferral accounts. As a result, as of the end of 2022, when another Board panel considers transmission and distribution rates for 2023 and beyond, the balances in the deferral accounts will reflect the amounts of grossed up Future Tax Savings that remain to be collected, and that Board panel can determine the best approach to clearing those accounts going forward (either using the SEC proposal or some other approach).

2 ISSUES WITH THE HYDRO ONE PROPOSAL

2.1 *Introduction*

2.1.1 Nowhere in the Application does the Applicant describe to the Board the structure of recovery of the Deferred Tax Asset (or Departure Tax, strictly speaking) that Hydro One is proposing. It is, however, implied, and from that the Board can determine the concepts in play.

2.1.2 Hydro One is proposing that it calculate taxes for regulatory purposes as if there were no FMV Bump. Thus, none of the tax shelter that arises because of the FMV Bump would find its way into rates, and 100% of the Deferred Tax Asset would be allocated to shareholders.

2.1.3 While this seems like a simple and elegant solution from the point of view of the utility, it generates a number of problems from a customer and regulatory point of view, as can already be seen. This section details some of those problems, which in each case arise because the Hydro One approach is not based on sound ratemaking principles, but is based on keeping the utility whole, and nothing more. It is an accountant's approach to the problem, but is not a regulator's approach.

2.2 *Front End Load*

2.2.1 The Deferred Tax Asset arises because CCA under the Income Tax Act will be higher than would otherwise be the case, since the capital cost of assets is based on FMV, not actual cost. Income is calculated using accounting depreciation, which is based on actual cost, and the excess of CCA over accounting depreciation reduces taxable income and thus tax payable. As can be seen by Hydro One's own evidence[17], the Deferred Tax Asset is simply the expected tax rate (26.5%) multiplied by the amount of the FMV Bump[18].

2.2.2 The FMV Bump is a fixed amount, calculated at the time of the deemed disposition, and it doesn't ever change. The FMV Bump is the total amount of additional tax deductions available over time, and the tax savings are thus the amount of those deductions, times the tax rate applied.

2.2.3 Unlike most accounting depreciation, CCA is calculated[19] as a fixed percentage of the amount that has not yet been claimed, which is called the declining balance method. If

[17] EB-2016-0160, Decision on DRO, November 9, 2017, Table 15.1 (Revised).
[18] In practice, the calculations are considerably more complicated each year, because of the interaction of other deductions and credits, minimum taxes, etc. However, at its root the Deferred Tax Asset is 26.5% of the FMV Bump, nothing more complicated than that.
[19] For most classes, but excluding Class 13.

a $100 asset has a 7% CCA rate, then the CCA in year 1[20] is $7.00, and in year 2 the CCA is 7% of the remaining $93 (called the undepreciated capital cost, or UCC), which is $6.51. This continues year after year, with the result that the CCA on any given original capital cost is lower in each successive year.

2.2.4 In normal utility tax calculations, this impact is not an issue, because while the CCA on existing assets is declining, new assets are being added. As rate base increases, CCA also tends to increase, although at a somewhat slower pace.

2.2.5 In the case of the FMV Bump, however, that is a one time "extra" asset that will only decline in value. There are no future additions. That is, the UCC of the FMV Bump will go down each year, and so will the tax shelter it generates. The tax savings that arise out of the FMV Bump are therefore said to be "front end loaded", which from a tax planning point of view is a good thing, but from a ratemaking point of view is not as good.

2.2.6 SEC has calculated the tax shelter generated each year, starting in 2016, by the FMV Bump for transmission. A table of the results is below, with the actual available tax savings from the extra CCA labelled as "Tax Savings", the grossed up amount labelled as "Rate Impact", and the annual decrease in that rate impact calculated as "Annual Decrease"[21]. A similar table could be produced for the FMV Bump in distribution, and would show the same pattern.

[20] Subject to the half year rule and other adjustments.

[21] The full spreadsheet model containing these calculations has been filed with this Final Argument. SEC made some simplifying assumptions to produce the results, but none of them are likely to have any material impact. For example, the FMV Bump was allocated to the CCA classes in the same ratio as the assets were included in those classes before the FMV Bump (Source: Opening UCC in Exhibit C/4/1/2, p.1 of EB-2016-0160). There is a detailed breakdown of the FMV Bump by CCA class in EB-2016-0160, Undertaking J11.3, Attachment 1, but it is not broken down between Transmission and Distribution. It is unlikely that the SEC assumption is far off, since three classes of assets – Cumulative Eligible Capital, Class 1 and Class 47 constitute 87% of the assets, and likely a similar amount of the FMV Bump. The allocation of non-land FMV Bump in J11.3 to those three classes of assets is about 72%, but the difference appears to be Class 2 assets, which are probably distribution. In any case, even if the allocation in transmission is different than we have assumed, the pattern will be the same, because of the nature of declining balance depreciation. SEC has also assumed that all assets cease service when they are fully depreciated for tax purposes, which is likely not correct but on average is probably a good approximation. Again, nothing turns on it, as there is no suggestion a different assumption would make a material difference. Recapture and terminal loss and capital gains, while relevant to the Board in the future, will not make a difference in modelling impacts today. Note that the tax savings and rate impacts in the table for the period 2016-2022 are not identical to the amounts allocated to shareholders and ratepayers in that same period, since other factors such as minimum taxes and Hydro One tax planning have had an impact as well. This does not change the pattern of available savings.

Summary Table of Transmission Tax Savings from FMV Bump										
Year	***2016***	***2017***	***2018***	***2019***	***2020***	***2021***	***2022***	***2023***	***2024***	***2025***
Tax Savings	108.7	96.3	87.3	80.0	73.7	68.1	63.1	58.5	54.4	50.5
Rate Impact	147.9	131.0	118.8	108.8	100.3	92.7	85.8	79.6	73.9	68.7
Annual Decrease		11.4%	9.3%	8.4%	7.9%	7.6%	7.4%	7.2%	7.1%	7.1%
Year	***2026***	***2027***	***2028***	***2029***	***2030***	***2031***	***2032***	***2033***	***2034***	***2035***
Tax Savings	47.0	43.7	40.7	37.9	35.4	33.0	30.8	28.7	26.8	25.0
Rate Impact	63.9	59.5	55.4	51.6	48.1	44.9	41.9	39.1	36.5	34.1
Annual Decrease	7.0%	6.9%	6.9%	6.8%	6.8%	6.8%	6.7%	6.7%	6.6%	6.6%
Year	***2036***	***2037***	***2038***	***2039***	***2040***	***2041***	***2042***	***2043***	***2044***	***2045***
Tax Savings	23.4	21.9	20.4	19.1	17.9	16.7	15.7	14.7	13.7	12.9
Rate Impact	31.8	29.7	27.8	26.0	24.3	22.8	21.3	19.9	18.7	17.5
Annual Decrease	6.6%	6.5%	6.5%	6.5%	6.5%	6.4%	6.4%	6.4%	6.3%	6.3%

2.2.7 SEC notes that the essence of the Court Decision is that either:

(a) The ratepayers are paying the Departure Tax to Hydro One over time[22]; or

(b) Rates are to include over time Future Tax Savings[23] (amounts of tax that Hydro One will not in fact pay) that represent extra amounts to which Hydro One is entitled, but are above the actual costs to provide transmission and distribution services.

In either formulation, the Court effectively ordered the Board to ensure that customers pay $3.532 billion extra in rates over time.

2.2.8 What the table above demonstrates[24] is that, under the Hydro One Proposal, Hydro One recovers more of that $3.532 billion from customers in the earlier years, and a declining amount in later years, with the amount of the recovery dropping at a rate of 6-8% per year for most years[25].

2.2.9 SEC submits that this is contrary to good ratemaking practices and principles. We have never, in fact, seen an example in which a utility is directed to recover from customers an amount using a pattern of recovery in which the amount goes down each year over a long period of time.

2.2.10 As we will discuss in more detail below, a better approach to ratemaking that

[22] Court Decision, p. 5.
[23] Court Decision, p. 16.
[24] And if Hydro One inserts different assumptions, it will still demonstrate the same result.
[25] While this table is limited to transmission, to save time, the same pattern will arise in distribution, for the same reasons. Overall, the recovery will follow the pattern shown in this table.

accomplishes the same result would have the utility recover an increasing, not decreasing, amount each year, so that any net annual impact on ratepayers is removed, and the front end load is also eliminated.

2.3 *Two Sets of Books*

2.3.1 The second problem with the Hydro One proposal is that it will require Hydro One to keep two sets of books for decades to come.

2.3.2 Hydro One has gone on record many times as opposing solutions that require two sets of books, especially for long periods of time, as they generate unnecessary additional costs[26]. Generally, the Board has agreed with that sentiment[27] (as does SEC in most cases).

2.3.3 In the Hydro One proposal, there is no single amount of Deferred Tax Asset that is collected from customers in rates. There is a calculation of income taxes each year using historical UCC (without the FMV Bump), and another using actual UCC. The net amount is the extra being collected in rates in that year.

2.3.4 Hydro One has not made a proposal as to how they will track their drawdown of the amount owing by ratepayers, year by year. It would appear on the face of it that they are proposing not to do so, but instead to continue to calculate income taxes two ways as long as any of the assets that had a FMV Bump are retained (see below).

2.3.5 Hydro One has also not made a proposal as to how they will reflect recapture of depreciation, when it occurs, since recapture of the extra CCA from the FMV Bump would be for account of shareholders, and recapture of at least some of the normal CCA may be for account of customers. The opposite would apply for terminal losses, an even more complicated issue.

2.3.6 Hydro One has also not made a proposal for the treatment of gains on the sale of land, for which there was a capital gain of $1.026 billion[28] that was included in the Departure Tax, but does not produce any CCA tax shelter. Since land is typically a long-lived asset, this will presumably have to be tracked for a very long time.

2.4 *Challenges with OEB Oversight*

2.4.1 The problem with two sets of books also indirectly contributes to the third set of issues, the problems the Board will have over many decades in their oversight of the

[26] See, by way of example, EB-2008- 0104, EB-2011-0399, EB-2011-0268, EB-2016-0160, and many other examples.
[27] See, e.g. EB-2016-0025/0360 Alectra MAADs, and many of the Hydro One cases cited above.
[28] EB-2016-0160, Undertaking J11.3, Attachment 2, p. 3.

collection of this Deferred Tax Asset.

2.4.2 ***Annual Savings***. The problem starts with the calculation of the drawdown of the Deferred Tax Asset each year for each of transmission and distribution. Both the tax based on historical UCC and the tax based on UCC with the FMV Bump will be affected by judgments made by the Finance Department of Hydro One. These include[29]:

(a) How much CCA will be taken each year in each scenario? 100% of available CCA does not need to be taken, and it is often better to take part of the CCA to optimize the use of deductions. The actual tax judgments will be optimized for Hydro One corporate purposes, and not for rate purposes. The historical tax judgments have no impact on Hydro One, so they are not required to optimize. The Board will have to have full information on annual tax calculations to assess whether they are being fair to the ratepayers.

(b) Do any "bumped" assets remain in any asset classes, and if so how should the class balance be allocated if it is pooled? As time goes on, more and more assets that were subject to the FMV Bump will be retired or sold, and this will also have to be supervised by the Board.

(c) In some years there will be minimum tax, which will be affected by the amount of actual CCA taken. Is that minimum tax for account of ratepayers, or shareholders, given that it will in some years only arise because of the FMV Bump?

(d) Similarly, if there are tax credits that interact with CCA, the Board will have to ensure that those interactions are implemented in a manner that is fair to the customers.

(e) From time to time utilities have loss carryforwards and carrybacks, which are affected by how much CCA is taken and how it interacts with other deductions and credits.

(f) How will tax costs be allocated between regulated and non-regulated businesses, and between transmission and distribution, and between rate classes? This is already complex without the FMV Bump, and will be even more so if Hydro One's proposal is accepted.

2.4.3 ***Access to Information***. Hydro One has resisted providing information on their tax

[29] This is just a few examples. As Hydro One is quick to point out, tax issues are incredibly complicated and there are no simple answers: see, e.g. EB-2016-0160, Tr.11:15-79, in which Mr. Vels and Ms. Cheung on behalf of Hydro One regularly refuse to treat any aspect of this has having simple or straightforward answers.

planning, and on the different calculations of taxes with and without the FMV Bump. While the Board in this case determined that it did not need the information sought in the SEC Motion, it is clear that as time goes on all of that information will be needed from time to time.

2.4.4 Hydro One's resistance to providing the Board and parties with full disclosure appears to be based on the notion that, as long as they are calculating regulatory taxes based on the historical values of regulated assets, excluding any impacts from the FMV Bump, then the Board doesn't need to know anything further.

2.4.5 By implication, this means that the Board never has to consider whether they have cumulatively allowed the collection of $3.532 billion extra costs from customers in rates, or some greater or lesser amount. Aside from being contrary to the Court Decision, this would also be contrary to good regulatory practice. Hydro One is legally entitled to collect a certain amount of "phantom taxes", as SEC has called them, from customers over time. They are not entitled to collect more, and it would be unusual for the Board to turn a blind eye to whether they have collected more[30].

2.4.6 SEC submits that what Hydro One is really proposing is a change from the "taxes payable" method of including taxes in revenue requirement to a kind of "deemed taxes" method, which the Board has expressly rejected in the past[31]. SEC does not believe it is good regulatory policy, or an appropriate solution in this case, to allow a major utility to move away from the "taxes payable" method.

2.4.7 ***Dispositions***. As noted earlier, Hydro One has not discussed how the Board will oversee recapture of extra CCA, capital gains or reduced capital gains, retirements, terminal losses, and many other tax implications that arise on the disposition for tax purposes of depreciable and non-depreciable property including goodwill.

2.4.8 While some implications of dispositions are not considered for account of customers, others are. The FMV Bump and the extra CCA it entails means that those implications will be more complex, and it will be necessary to require reporting of those dispositions and their consequences to the Board.

---

[30] We note that the Board has already ordered Hydro One to track how much it is collecting from ratepayers relative to the Deferred Tax Asset: see EB-2016-0160, Decision on DRO, November 9, 2017, p. 17. Is Hydro One now seeking to overturn that part of the Original Decision as well? This does not appear to be stated, if so. If not, then detailed annual reporting to the Board of the difference between historical-based taxes and actual taxes will be necessary, and the Board will have an oversight role to make sure that only the extra amounts that should be collected from customers are actually collected from customers.

[31] This is not entirely the same as the accrual method, since it would presumably still allow some part of the CCA headroom to benefit ratepayers, as the taxes payable method does. However, like the accrual method it would permanently separate actual tax costs from rates. By way of example, the standard Board and intervenor practice today of reviewing actual utility tax returns to ensure that the tax provisions are being reported and calculated correctly would have to end. The tax returns and the tax provisions in rates would be unrelated to each other.

2.4.9 ***Tax Changes***. All of this assumes a steady state, in which for several decades there will be no changes in tax rates, tax rules, or the calculations applicable to the FMV Bump. That assumption is clearly wrong, and the Board will be faced at various times with having to address the implications of each such change.

2.4.10 The simplest example is, of course, a change in tax rates. If the combined federal and provincial tax rate applicable to Hydro One changes once again[32], then the impact of additional deductions is greater. To whom does that flow? Since it is the tax rates applicable to a regulated business and regulated assets, does the additional benefit of an increase in that rate flow to the ratepayers? Conversely, to the extent that it relates to the FMV Bump, should it just be treated as a further windfall to the shareholders? This is especially difficult since an increase in tax rates increases costs for ratepayers otherwise.

2.4.11 It is also possible that CCA rates will change for existing assets, or rollover and replacement rules will allow UCC to transfer to new assets, and things like that. It is probably possible to theorize hundreds of tax changes that could change the impact of the FMV Bump and therefore the Deferred Tax Asset and the extra payments from customers. If and when those arise, the Board will have to deal with each such problem anew.

2.4.12 ***IRM***. The Hydro One proposal is conceptually a cost of service idea. Hydro One does not have its rates set on a cost of service basis every year. In years in which the rates are set on a formula basis, how will the Deferred Tax Asset drawdown be calculated?

2.4.13 The Board will have already seen the disagreement between OEB Staff and Hydro One about calculating the Future Tax Savings so far[33], in which OEB Staff and Hydro One already have accrued a $10 million calculation difference. IRM will continue to cause havoc with oversight over collection of the Future Tax Savings. IRM is inherently not a cost of service concept, and the Hydro One proposal is.

2.4.14 ***Conclusion.*** SEC could probably go through another dozen potential challenges the Board will face in overseeing the Hydro One proposal, but just these few should be sufficient to make clear that a simpler approach would be better ratemaking.

2.5 ***Finality***

2.5.1 The Board's practice has usually been to find a just and reasonable solution to a problem, implement it, and move on. This is good regulatory practice, benefitting both the utilities and the customers.

[32] As it has several times since Hydro One became regulated by the Board.
[33] Staff Submission, p. 6.

2.5.2 The Hydro One proposal is exactly the opposite. Under the Hydro One proposal, there will be a difference between actual and deemed taxes as long as Hydro One continues to own even one of the assets that had a FMV Bump, i.e likely 50-70 years.

2.5.3 SEC submits that it is in the best interests of both Hydro One and the customers to implement a solution to the collection of this $3.532 billion that is finite and known, and where at some point in the future the issue will actually have been addressed in full.

2.6 ***Rate Impacts***

2.6.1 The last important problem with the Hydro One proposal is that it builds in a rate reduction over time, year after year for decades

2.6.2 This immediately seems that it might be a good thing, and certainly if the customers could be assured that they would get the benefit of the annual rate decline ($10-15 million rate reduction in the early years for transmission, similar amounts for distribution), then if the high front end cost can be handled, it might actually be a good thing. Sadly, that hope ignores two realities of ratemaking: formulae, and expectations.

2.6.3 ***Formula-Based Rates.*** For Hydro One, in the past and likely in the future, rates have been established using I - X formulae, i.e. IRM models that assume that costs increase by inflation less productivity less stretch. If a major category of costs is known to decline annually, that is usually not taken into account. The assumption is that other costs will increase at more than I – X, and the econometric data on which I – X is based will take all of that into account.

2.6.4 Indeed, that is usually true. However, if the econometric data uses average cost increases, and Hydro One is not like all of the rest because it is the only one with an extra declining cost category, then the formula will overstate the rate increases that keep Hydro One whole. As with so many things in economics, this is just math. If the Hydro One Deferred Tax Asset proposal is accepted by the Board, the effect will be that the industry average data used to establish Hydro One's formula rates will not actually reflect just and reasonable rates, because costs will be overstated by the formula.

2.6.5 ***Cost of Service***. The same impact arises in a different way when Hydro One seeks cost of service or custom IR ratesetting. While there is no formula to be incorrect, two other things happen.

2.6.6 First, to the extent that some components of rates are set by formula (for example in most custom IR proposals), declining costs will still be a problem unless they are

adjusted specifically.

2.6.7 Second, and much more important, the overall percentage rate increase resulting from an application is important to the Board and the customers. A 2% weighted average rate increase might be acceptable. A 3% weighted average rate increase may be considered too high. If Hydro One has a 3% rate increase proposed, offset by a 1% rate decrease due to their Deferred Tax Asset drawdown, is that a 2% rate increase[34]? Clearly not. The effect is to systematically understate rate increases for a relatively long period of time. This is not good regulatory policy.

2.6.8 SEC submits that, unless it is absolutely necessary, it is not wise to build into a utility's cost structure – different from all of its peers – a material annual decline in extra (especially notional) costs that the Board needs to take into account for many years. Customers are already confused enough by the rates they are charged. They are not well served if an additional misleading cost structure is introduced.

2.7 ***Conclusion***

2.7.1 SEC therefore submits that the Hydro One proposal for the recovery of the Deferred Tax Asset from customers over time has serious rate and regulatory problems that would have to be resolved if the Board were to consider it seriously.

2.7.2 In fact, in our view a simpler and more straightforward approach to achieving the same long term goal should be considered, and implemented, by the Board.

[34] When Hydro One does customer engagement, would they be justified in telling their customers they are proposing a 2% rate increase, rather than saying they are proposing a 3% rate increase before a below-the-line adjustment?

3 CARRYING CHARGES/TIME VALUE OF MONEY

3.1 ***Background***

3.1.1 Hydro One and OEB Staff both assume that, if there is any delay in the customers paying Hydro One's Future Tax Savings to them, they will be entitled to interest on that money. They only disagree on the interest rate: weighted average cost of debt (WACD) vs. CWIP rate or Bank of Canada plus 150 bps.

3.1.2 Both cases assume that for the period 2017-2021 Hydro One has undercollected, and therefore has to collect catchup payments over the next 1-7 years. Interest is proposed to accrue until payments are actually received by Hydro One.

3.1.3 SEC's view is that when a proper recovery structure is implemented, there is no material net shortfall of collection, and that over the longer term the interest rate on any amount outstanding and uncollected should be zero because that is the actual cost to Hydro One to finance the Deferred Tax Asset.

3.2 ***Hydro One Proposal***

3.2.1 Hydro One believes that they have been shortchanged over the period 2017-2022, and that when they receive the money that is owing to them for that period they should receive the shortfall, plus interest on that money at the weighted average cost of debt, or WACD.

3.2.2 Leaving aside the question of whether there actually was a shortfall during that period, there is also the question of whether interest should apply, because the time value of money is relevant to fairness.

3.2.3 Hydro One believes that, to the extent that they did not receive any money when they should have received it, they should be compensated for that time value, saying[35]:

> *"It is a principle of the law of compensation that – so far as possible by means of a monetary award – just compensation requires that a party be put in the position it would have been in had it not suffered the wrong complained of. Further, it is well-accepted that awarding interest is the fairest and most effective way of compensating for the lost time value of money."*

3.2.4 They go on to canvass the various regulatory and real-life approaches to compensating for time value, before locking in on what they say is their actual cost of delays in

[35] E. A/1/1 p. 7.

recovering these funds from customers. They say[36]:

> *"In the present circumstances, Hydro One submits that its weighted average cost of debt ("WACD") is an appropriate rate used to calculate all carrying costs and the bill impacts included herein reflect that rate. As a result of the Original Decision, Hydro One incurred a higher level of debt than it otherwise would have. The WACD is the most appropriate carrying charge because the Misallocated Tax Savings Amounts were funds otherwise expected to be received by Hydro One in its normal operations. The cost to finance this shortfall would reasonably attract Hydro One's WACD given that it was over a four year period." [emphasis added]*

3.2.5 Put another way, the cost of delayed receipt of funds should be the actual cost Hydro One has incurred.

3.2.6 SEC agrees, but notes that Hydro One's actual cost to finance this cost was not the WACD. This is simply incorrect, and inconsistent with the sworn evidence of Hydro One and its witnesses.

3.3 *Actual Financing of the Cost*

3.3.1 In fact, Hydro One financed the entire cost of the amount involved by issuing common shares, through its parent, to the province of Ontario for cash proceeds of $2.6 billion.

3.3.2 This is not even a matter for dispute. Hydro One has insisted that this is correct, treating it not as an admission but as a central claim of their original case. This was stated in so many words[37]:

> *"MR. VELS: What you have asked me a question on is how did we finance the payment of the departure tax. The payment of the departure tax was financed by an equity issue to the province."[emphasis added]*

3.3.3 This is also reiterated in numerous other places, including[38]:

> *"MR. SHEPHERD: You're portraying to this Board that the province paid the departure -- paid the equity, and you paid the departure tax, and everybody was in the same position as before. But that isn't true, is it?*
> *MR. VELS: No, so I -- what we are portraying is that there was a transaction that was created by the shareholder, that resulted in both payment of a departure tax, as you correctly pointed out, the necessity to raise and show a*

[36] Ex. A/1/1, p. 10.
[37] EB-2016-0160, Tr.11:29.
[38] EB-2016-0160, Tr. 11:44-5.

deferred tax asset on the balance sheet, and then we needed to finance the cash required to pay the departure tax, and issued shares to the province to fund that. That's what we are representing."

3.3.4 But the injection of equity capital into the company did not, according to Hydro One, actually increase the value of the company. It just kept it steady, as described in the following exchange[39]:

"MR. SHEPHERD: The equity injection from the province, $2.6 billion, the province had shares prior to that time, right?
MR. VELS: That's right.
MR. SHEPHERD: They owned a hundred percent of the company.
MR. VELS: Yes.
MR. SHEPHERD: And they then gave you $2.6 billion for more shares. But they still just had a hundred percent, right?
MR. VELS: That's right.
MR. SHEPHERD: But the value of the company went up by the same $2.6 billion, right? That's what happened in that transaction.
MR. VELS: Well, we issued equity, so the value of the equity increased, that's correct.
MR. SHEPHERD: So they got 2.6 billion dollars worth of shares for their money.
MR. VELS: That's right.
MR. SHEPHERD: So if the value of the hundred percent of the company they had before was, let's say, $15 billion and they gave you 2.6 billion, after the transaction their 100 percent was worth 17.6; is that right?
MS. CHEUNG: Well, soon after they pay the departure tax of 2.6 billion, so the company would have been down by another 2.6."

3.3.5 Thus, the province owned 100% of the company before the equity issuance, and 100% after, and the value was the same. The reason why the province made this equity infusion is described elsewhere, as follows[40]:

"MR. VELS: Sorry, I see where you are going. So the cash that we required by an equity issuance was necessary to ensure that the value of the company did not deteriorate because of the impact on our balance sheet and the impact of the departure tax on our credit ratings, for example."

3.3.6 All of this is to demonstrate that there was no cost to Hydro One of issuing new equity to the province. Hydro One and its subsidiaries, including the Applicant, paid the Departure Tax of $2.6 billion to an agency of the province, in its capacity of taxing

[39] EB-2016-0160, Tr. 11:43.
[40] EB-2016-0160, Tr. 11:39-40.

authority. The province then, in its capacity as shareholder, invested in Hydro One to make good that hole in the balance sheet, in order to ensure that the IPO would be successful.

3.3.7 This new equity did not have any additional cost of capital to Hydro One, in part because the same entity owned 100% of the company before and after the transaction. There were no circumstances in which the increased equity would result in an increase in the ROE of Hydro One from its operations. It was not an operational transaction[41].

3.3.8 So did those additional shares cost Hydro One anything? The answer is no. No additional dividends had to be paid. No additional earnings had to be generated to justify that additional funding.

3.3.9 In fact, the issuance of new common shares to the sole existing shareholder operated from a return point of view in a similar manner to a stock split. The same amount of earnings would be spread over the same shareholders, in the same percentages. The only difference would be that the earnings per share would be lower because there were more shares. Otherwise, from the company's point of view, the cost of capital was unchanged.

3.3.10 None of this is really contentious. Hydro One was entering into an IPO, and the payment of the Departure Tax would have otherwise left a hole in Hydro One's balance sheet that would spook investors. The province, which had received the $2.6 billion in any case as Departure Tax, fixed Hydro One's balance sheet problem by investing the same amount in new shares which did not improve the province's financial position.

3.3.11 Hydro One will argue that the equity bears an ROE, and so there is in fact a cost of capital. From a regulatory point of view, that is not correct. These are regulated businesses. Deemed equity bears an ROE, and has a cost of capital. Neither the payment of the Departure Tax, nor the investment by the province in new equity, changed the deemed equity, or changed the allowed ROE on that deemed equity. Hydro One's cost of capital, debt and equity, was identical immediately before and immediately after the payment of the Departure Tax, and before and after the equity infusion.

3.3.12 Thus, by their own admission Hydro One financed the entire amount of $2.6 billion through equity that had no ongoing financing cost.

[41] If anything, the equity issuance reduced the cost of capital, because it reduced the risk that credit ratings would be reduced and thus the cost of debt would rise. However, given the circularity of the transaction, it is unlikely that has any material impact.

3.4 ***SEC Proposal on Carrying Costs***

3.4.1 Hydro One's position is that it should be entitled to carrying costs, until it receives its money, at its actual cost of capital to fund that money.

3.4.2 Hydro One's actual cost of capital on the actual equity capital used to fund the entire $2.6 billion cash shortfall is zero, and therefore while they may be entitled to carrying costs at their actual costs of financing, the carrying costs would therefore be zero.

4 SEC RATEMAKING PROPOSAL

4.1 *Introduction*

4.1.1 Against the backdrop of the problems with the Hydro One proposal, SEC believes that the Board should put itself in the position of the original panel, and determine what is the best way to ensure that Hydro One receives all of their benefit arising out of the payment of the Departure Tax, and the best ratemaking result is achieved.

4.1.2 This section proposes a solution that accomplishes both results, and avoids all of the concerns with the Hydro One proposal.

4.2 *Decision of Divisional Court*

4.2.1 In proposing a solution to the issue, SEC has been guided by the directions of the Divisional Court, not just in terms of what they specifically ordered, but also their findings and the basis of those findings.

4.2.2 The Divisional Court determined that there was a tax benefit, which they referred to as the Future Tax Savings, that arose because Hydro One did an IPO and paid the cost of that, i.e. the Departure Tax.

4.2.3 The Court also made clear that, under the benefits follow costs principle, since Hydro One (on behalf of its shareholders) paid the costs to obtain the Future Tax Savings, the Future Tax Savings themselves should accrue to the shareholders.

4.2.4 The Court recognized that the similarity between the Departure Tax and the Deferred Tax Asset were not a random coincidence, but were evidence that they were two sides of the same coin. Indeed, it was the fact that they were two sides of the same coin that led the Court to determine that if Hydro One paid the Departure Tax, they should get the other side of that transaction, the Future Tax Benefits. They are two parts of the same transaction. The Court did not mince words with its view of the equivalency of the two sides, saying[42]:

> *"It is important to note that the Future Tax Savings do not represent a windfall for HONI. In order to receive the Future Tax Savings, HONI had to exit the PILs regime and pay the PILs Departure Tax as a result of the Deemed Transaction. In effect, the Future Tax Savings are a recovery over time of the PILs Departure Tax paid by HONI and funded by its shareholders." [emphasis added]*

[42] Hydro One v. OEB, July 17, 2020, p. 5.

4.2.5 Taken together, SEC concludes that, based on the Court Decision:

(a) Under the benefits follow costs principle the Future Tax Savings of $2.596 billion belong to Hydro One for account of its shareholders, and Hydro One must be able to recover that amount over time in rates.

(b) This is functionally equivalent to recovering the Departure Tax over time, since the Departure Tax and the Future Tax Savings are two sides of the same coin.

(c) The Board's instructions from the Court are to construct a rate solution for the period in question (2017-2022) that is consistent with paying the Departure Tax/Future Tax Savings to Hydro One over time.

4.2.6 Assuming that characterization of the Court Decision is correct, then the Board is faced with an exercise of finding the best way to transfer $2.596 billion in net tax savings ($3.532 billion grossed up) from customers to Hydro One.

4.2.7 We note that at no time did the Court say – or suggest in any way – that the Board should order Hydro One to calculate its taxes for ratemaking purposes in a manner different from the Board's normal policies. The Court did not engage in second-guessing the ratemaking approach. It instructed the Board that a specific benefit should end up in the hands of the utility, and left it to the Board to determine the best way to achieve that result, relying on the Board's "expertise and experience"**.**

4.3 ***Structure of Recovery***

4.3.1 SEC proposes that the Board use traditional methods of allowing the utility to recover a known amount from ratepayers over time. That would normally be a deferral account, coupled with some form of rate rider to clear that deferral account over time.

4.3.2 ***Establish Deferral Accounts.*** In this case, SEC proposes[43] that Hydro One be authorized and directed to charge the grossed up transmission Future Tax Savings of $2,008 billion[44] to a deferral account immediately, and treat it as a regulatory asset going forward.

4.3.3 Similarly, Hydro One should be authorized and directed to charge the grossed up distribution Future Tax Savings of $1.524 billion[45] to a deferral account immediately,

[43] Subject to the true up discussion later in this Final Argument.
[44] $1.476 billion divided by the inverse of the tax rate (1- 26.5%).
[45] $1.120 billion divided by the inverse of the tax rate (1 – 26.5%). This may have to be adjusted, as the evidence only includes the Norfolk acquisition. For distribution, acquisitions of Haldimand, Woodstock, Orillia and potentiall Peterborough may result in changes to the Future Tax Savings amount. The concept, however, would not change. This would also be subject to true up for amounts already collected.

and treat it as a regulatory asset going forward.

4.3.4 ***Rate Riders***. Once the regulatory assets are established, the next step is to collect those amounts from customers over time. SEC proposes that the Board establish a rate riders, calculated as if they start in 2016, to collect both the transmission and distribution Future Tax Savings from customers (subject to a true up described below for the period to the end of 2022 during which rates have already been established).

4.3.5 SEC proposes that the rate riders be established at levels that, over a fixed period of time, are expected to collect the entire amount in the deferral accounts. Further, SEC proposes that the rate riders increase at the same rate as the overall rates for the utility, so that from a relative point of view, after their initial implementation the riders will have no impact on customer rates.

4.3.6 By way of example, SEC has calculated the total amounts to be recovered annually for transmission using a 30 year recovery period (the average remaining useful life of the transmission assets that were subject to the 2015 deemed disposition[46]), and assuming that on average rates will increase by inflation of 2% per year over the long term.

4.3.7 The results are overlaid on the previous chart of the Hydro One proposal, and labelled "Annual Rider" below[47]. At the bottom, the table compares the "Amount Accrued", which is essentially the Hydro One proposal, with the "Amount Collected" under the SEC proposal. It can be seen that the SEC proposal collects the full Future Tax Savings over the predetermined period of time. The Hydro One proposal, by contrast, collects just over 85% over the same period, with almost 15% still to be collected. The comparison is below:

[46] EB-2019-0082, Exhibit F, Tab 6, Schedule 1, Attachment 1, page 20 of 62 of exhibit.
[47] Technically, for transmission the amount each year would not be a rate rider, because of the structure of Uniform Transmission Rates. Rather, it would be a predetermined adder to revenue requirement each year, which then gets folded into the UTR calculation. However, functionally it operates in the same way as a rate rider, in that it collects a predetermined amount of the overall Future Tax Savings from customers each year.

Summary Table of Transmission Tax Savings from FMV Bump										
Year	***2016***	***2017***	***2018***	***2019***	***2020***	***2021***	***2022***	***2023***	***2024***	***2025***
Tax Savings	108.7	96.3	87.3	80.0	73.7	68.1	63.1	58.5	54.4	50.5
Rate Impact	147.9	131.0	118.8	108.8	100.3	92.7	85.8	79.6	73.9	68.7
Annual Decrease		11.4%	9.3%	8.4%	7.9%	7.6%	7.4%	7.2%	7.1%	7.1%
Annual Rider	49.5	50.5	51.5	52.5	53.6	54.7	55.7	56.9	58.0	59.2
Year	***2026***	***2027***	***2028***	***2029***	***2030***	***2031***	***2032***	***2033***	***2034***	***2035***
Tax Savings	47.0	43.7	40.7	37.9	35.4	33.0	30.8	28.7	26.8	25.0
Rate Impact	63.9	59.5	55.4	51.6	48.1	44.9	41.9	39.1	36.5	34.1
Annual Decrease	7.0%	6.9%	6.9%	6.8%	6.8%	6.8%	6.7%	6.7%	6.6%	6.6%
Annual Rider	60.3	61.5	62.8	64.0	65.3	66.6	68.0	69.3	70.7	72.1
Year	***2036***	***2037***	***2038***	***2039***	***2040***	***2041***	***2042***	***2043***	***2044***	***2045***
Tax Savings	23.4	21.9	20.4	19.1	17.9	16.7	15.7	14.7	13.7	12.9
Rate Impact	31.8	29.7	27.8	26.0	24.3	22.8	21.3	19.9	18.7	17.5
Annual Decrease	6.6%	6.5%	6.5%	6.5%	6.5%	6.4%	6.4%	6.4%	6.3%	6.3%
Annual Rider	73.6	75.0	76.5	78.1	79.6	81.2	82.8	84.5	86.2	87.9
Amount Accrued	1,722.3	plus	285.8	remaining to be collected						
Amount Collected	2,008.1	full recovery								

4.3.8 SEC notes that, while the initial amount to be collected is established with an assumed rate escalator, the intention with the SEC proposal is that the amount collected each year increase at the same rate as the overall rates, so if for example Hydro One has a formula that increases the transmission revenue requirement by 2.3% under a custom IR structure, then the adder for the Future Tax Savings would also increase by 2.3%, so that it is rate neutral from a customer perspective.

4.3.9 The above example is for transmission. SEC proposes that the same solution be used for distribution, with the following adjustments reflecting the different rate treatment of distribution:

(a) The structure of the collection would be by rate rider.

(b) Allocation of the cost would be based on the allocation of tax cost generally, so that individual rate classes would have rate riders applicable to their cost responsibility.

(c) The recovery period would be the actual remaining life of the assets, 23 years[48].

(d) Norfolk, Haldimand, Woodstock, Orillia and potentially Peterborough would

[48] EB-2017-0049, Exhibit C1, Tab 6, Schedule 1, Statement A, page 14

have rate riders (and deferral accounts) specific to their separate rate zones, at least until harmonization.

4.3.10 The intention with the SEC Proposal is that the deferral account(s) would be reduced annually by the actual amounts recovered from customers, either through the UTRs or through the distribution rate riders. That way, the Board can be sure that it has followed the direction of the Court, and the full amount of the Future Tax Savings are ultimately collected by Hydro One from customers, no more and no less.

4.3.11 Once the structure of the recovery is established, there would have to be a true up to reflect the fact that amounts recovered from 2016 to date are not identical to the pattern established in the SEC proposal. The true up is described in Section 4.5 below.

4.4 ***Benefits of SEC Approach***

4.4.1 The SEC proposal has several advantages over the Hydro One proposal, mostly tracking and reversing the disadvantages of their proposal as outlined in Sections 2.2 to 2.6 of this Final Argument.

4.4.2 ***Smoothed Recovery Pattern***. The SEC recovery pattern has an initial impact on rates (which has almost entirely happened already), and then no rate impact in the future, because the recovery amount increases at the same rate as rates generally.

4.4.3 This is particularly important today, when the pandemic and the current economic outlook suggest that an additional $417 million added to rates (as Hydro One proposes) is not optimal. If that can be avoided while remaining fair to Hydro One and achieving the result required by the Court Decision, SEC believes that the Board should see this as a positive component of this structure.

4.4.4 ***Simplified Accounting***. The problem of two sets of books is largely eliminated. Under this proposal, the amount of taxes included in rates uses the taxes payable method, as with all other utilities regulated by the Board. The Future Tax Savings are paid by the ratepayers to the shareholders through a separate stream, and there are no calculations of tax differentials, etc.

4.4.5 ***Simplified Regulatory Oversight.*** The Hydro One proposal has been shown earlier present a number of unnecessary regulatory challenges for the Board. The SEC proposal eliminates all of those issues, because a simplified recovery method produces a simplified regulatory process.

4.4.6 Recapture, terminal loss, and capital gains would also not be issues, since under the taxes payable method the Board already has well-established methods of dealing with them. There is no allocation of tax costs and savings between ratepayers and shareholders. The Future Tax Savings are given a fixed value, and are collected from

customers. Similarly, changes in tax rules and rates would not become a problem, since fixing the value of the Future Tax Savings puts those calculation issues in the rear view mirror.

4.4.7 We note in particular that this would align the interests of the utility and the ratepayers for tax planning purposes. Effective tax planning by Hydro One would reduce rates, at no cost to Hydro One. The Future Tax Savings, since they are collected separately, would have no impact on tax planning.

4.4.8 ***Finite Collection Period.*** In keeping with the theme of simplicity, this approach has a fixed collection period that matches the assets that generated the FMV Bump. Under the Hydro One proposal, there is a front end load, but then the collection period continues, at decreasing amounts, over a period that could be as much as 70 years. By contrast, the SEC proposal is predictable and certain, for both the shareholders and the ratepayers.

4.4.9 ***Transparency/No Hidden Rate Impacts.*** In the SEC proposal, there is no underlying reduction in costs to be adjusted for in either IRM or cost of service proceedings. Because the rate rider (or, in transmission, revenue adder) piggybacks on the rates otherwise determined, the collection of the Future Tax Savings is transparent and has no impact on rate-setting other than a predetermined adder Percentage rate increases are unaffected.

4.4.10 In addition to those benefits, as discussed below the collections that actually took place in the 2017-2022 period are likely close in amount to the collections that would have taken place had the SEC proposal had been implemented for 100% of the Future Tax Savings at the beginning. While the collections to date have been based on the 62% shareholder allocation in the Original Decision, the front end loading of the Hydro One proposal made that amount quite large. The SEC proposal, at 100% recovery but without front end loading, produces in aggregate similar dollar amounts over that period[49].

4.4.11 The result should be that the implementation of the Court Decision will have minimal immediate rate consequences, which is particularly important at the current time when the pandemic and economic uncertainty are already applying pressure on customers.

4.5 ***True Up***

4.5.1 ***Calculation of Differences.*** The evidence is that, in transmission, Hydro One has collected or will collect with existing rates $424.4 million on account of Future Tax

[49] Although on the numbers we currently have available there is a disjunct between distribution and transmission, which is likely the result of our different proposals for recovery period of each.

Savings over the period 2017-2022[50]. Using the estimates by SEC set out in the Table in section 4.3.7 above, the transmission component of collections should be $322.0 million in that same period[51]. Thus, Hydro One has already collected $102.4 million more than is necessary using this revised SEC approach.

4.5.2 A similar calculation would be done for the distribution side. It appears that Hydro One has collected or will collect, to the end of 2022, $248.8 million[52] in distribution rates on account of the Future Tax Savings. SEC estimates that, if the distribution component is collected over 23 years (as opposed to 30 years for transmission, because of the longer life of the assets), the amount to be collected using the SEC proposal over 2017-2022 would be about $340 million, meaning that there is a shortfall in collections of about $91 million. This will be complicated by acquisitions of LDCs in the meantime, but the actual calculations can be done fairly easily with the appropriate input data[53].

4.5.3 ***Implementation of True Up***. There are two ways to implement the proposed true up:

(a) Establish a rate adjustment now that, over an appropriate period of time, refunds the $102.4 million or corrected amount) to transmission customers, and charges the $91 million shortfall to distribution customers.

(b) Adjust the drawdown of the deferral accounts to reflect the actual collections to date, rather than the optimal collections, so that the balances remaining to be collected starting in 2023 are already trued up.

4.5.4 The first of the two choices is self-explanatory, but the second requires more of an explanation.

4.5.5 Earlier, SEC proposed that the starting point is to charge the Future Tax Savings to deferral accounts, so that they are regulatory assets than can be collected by Hydro On over a predetermined period. In the case of transmission, the initial entry would be $2,008 million, the total Future Tax Savings allocated to transmission. The similar entry for distribution is $1,524 million.

---

[50] Since 38% of the Future Tax Savings in transmission overthis period are $165+$28.4+$193.4 million, that means that 62% is $311.9 million, which grosses up ($311.9/(1-26.5%)) to $424.4 million.
[51] Hydro One would of course have to do a more detailed calculation of the Table produced by SEC and included in this Final Argument. For example, it would have to include a corrected allocation of the FMV Bump, and it would have to adjust the annual payments by the actual rate increases in each year from 2016 to 2022. It is unlikely that this precision would change the outcome very much, but this method relies on those calculations being accurate, so that the ratepayer responsibility is calculated and executed properly.
[52] 38% is ($92.4+21.0 million) $113.4 million, meaning that the 62% collected is $182.9 million of taxes, which grosses up to $248.8 million.
[53] Once more, it is important that Hydro One do more detailed calculations, but the outcome will be in this range.

4.5.6 However, these are Future Tax Savings available at the time of the deemed disposition. Amounts have been collected since that time.

4.5.7 The more straightforward true-up, which would be item (a) above, is to reduce the initial entry for each by the amount that should have been collected over the period 2017-2022. In the case of transmission, $2,008 would be reduced by the $322 million that should be collected over that period under the SEC proposal. This would leave $1,686 million to be collected starting in 2023. It would also leave an excess of actual collections in that period, $102.4 million, which would be returned to ratepayers separately.

4.5.8 Similarly, for distribution the $1,524 original entry would be reduced by the $340 million that should have been collected in that period, leaving $1,284 million to be collected starting in 2023. In addition, there is the shortfall of $91 million in actual collections over that period, which would be collected from customers separately.

4.5.9 SEC believes that the better approach is to adjust for the actual collections in the 2017-2022 period, so that the balance outstanding at the end of 2022 is already a net amount, and no separate refunds or collections are required:

(a) From the total amount going into the transmission deferral account, $2,008 million, would be deducted actual collections at 62% for the 2017-2022 period, $424.4 million, leaving $1,583.6 million to be collected starting in 2023 (based on whatever approach the Board panel in that rate case determines).

(b) From the total amount going into the distribution deferral account, $1,524 million, would be deducted actual collections at 62% for the 2017-2022 period, $248.8 million, leaving $1,275.2 million to be collected starting in 2023 (again, as determined by the Board panel in the combined rebasing case).

4.6 ***SEC Recommendation***

4.6.1 SEC therefore proposes that the Board direct Hydro One to leave their current rates as is, and charge to deferral accounts:

(a) The total uncollected amount of Future Tax Savings for transmission in the amount of $2,008 million less $424.4 collected or to be collected in current and past rates over 2017-2022, for a total of $1,583.6 million.

(b) The total uncollected amount of Future Tax Savings for distribution in the amount of $1,524 million less $248.8 million collected or to be collectd in current and past rates over 2017-2022, for a total of $1,275.2 million.

4.6.2 SEC also proposes that the Board stipulate that the deferral accounts carry no interest

rate.

4.6.3 Finally, SEC also proposes, consistent with PO #3, that the Board make clear that the future collection of the remaining amounts out of those accounts starting in 2023 should be determined by the Board panel hearing the combined Hydro One Transmission and Distribution rate case.

5 OTHER MATTERS

5.1 *Costs*

5.1.1 The School Energy Coalition hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this proceeding. It is submitted that the School Energy Coalition has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible.

All of which is respectfully submitted.

_____

Jay Shepherd
Counsel for the School Energy Coalition