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

BY EMAIL

February 14, 2022

Ms. Nancy Marconi
Acting Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4
Registrar@oeb.ca

Dear Ms. Marconi:

Re: Ontario Energy Board (OEB) Staff Submission
Hydro One Networks Inc.
Motion to review and vary aspects of the EB-2021-0033 Decision and Order relating to Account 1576 and Account 1592, and a request for a partial stay of the implementation of certain aspects of the Decision
OEB File Number: EB-2022-0071

Please find attached OEB staff's submission in the above referenced proceeding, pursuant to Procedural Order No. 1.

Yours truly,

Original Signed By

Kelli Benincasa
Incentive Rate Setting and Regulatory Accounting

Encl.

ONTARIO ENERGY BOARD

OEB Staff Submission

Hydro One Networks Inc.

Motion to review and vary aspects of the EB-2021-0033 Decision and Order

EB-2022-0071

February 14, 2022

Overview

On December 16, 2021, the Ontario Energy Board (OEB) issued a Decision and Order in Hydro One's 2022 rate application approving Hydro One's 2022 distribution rates in respect of the legacy service areas for the former Norfolk Power Distribution Inc. (Norfolk Power), the former Haldimand County Hydro Inc. (Haldimand County Hydro) and the former Woodstock Hydro Services Inc. (Woodstock Hydro) (together, the Acquired Utilities)[1]. On January 7, 2022, Hydro One filed a Notice of Motion to Review and Vary (Motion) to review and vary the Decision pursuant to Rule 42 of the OEB's *Rules of Practice and Procedure*.

The Motion is in respect of two discrete aspects of the Decision, namely the OEB's findings in relation to (a) Account 1576 - CGAAP Accounting Changes for the former Woodstock Hydro for the 2016 to 2022 period, and (b) Account 1592 - PILs and Tax Variance, Sub-account CCA Changes for all three of the Acquired Utilities.

On January 12, 2022, the OEB issued Procedural Order No. 1, which set out a schedule for written submissions. Procedural Order No. 1 indicated that the OEB would not be seeking preliminary submissions on the "threshold" issue described in Rule 43 of the OEB's *Rules of Practice and Procedure* (Rules).

Motions to Review

The Rules set out the permitted grounds of a review:

> Every notice of motion … shall:
>
> a) set out the grounds for the motion, which grounds must be one or more of the following:
>
> i. the OEB made a material and clearly identifiable error of fact, law or jurisdiction. For this purpose, (1) disagreement as to the weight that the OEB placed on any particular facts does not amount to an error of fact; and (2) disagreement as to how the OEB exercised its discretion does not amount to an error of law or jurisdiction unless the exercise of discretion involves an extricable error of law

For the reasons described below, OEB staff submits that Hydro One's Motion has not demonstrated an error of fact, law or jurisdiction, and that the Motion should be dismissed.

[1] EB-2021-0033

I. OEB Staff Submission with respect to Account 1576

<u>Background</u>

The Motion argues that the part of the Decision requiring Hydro One to record and file with the OEB transactions in Account 1576 - CGAAP Accounting Changes for the former Woodstock Hydro for the years 2016-2022 should be overturned. Hydro One argues that the OEB made two errors with respect to this order:

> 1) it interpreted the scope of Account 1576 as applying to the former Woodstock Hydro which at all relevant times used and was approved by the OEB to use US GAAP as its accounting standard, and thereby amending and expanding the scope of Account 1576 and retrospectively applying that new scope to prior periods, which is contrary to the rule against retroactive ratemaking; and
>
> 2) it incorrectly assumed, contrary to the evidence, that there are relevant financial differences for 2016-2022 to be recorded in Account 1576 in respect of the former Woodstock Hydro.

OEB staff will address both of these alleged errors.

<u>Submission</u>

A. The OEB's order did not break the rule against retroactive ratemaking

Hydro One argues that the Decision has the effect of retroactively amending and expanding the scope of Account 1576 to include financial differences arising from a transition from Canadian Generally Accepted Accounting Principles (CGAAP) to US Generally Accepted Accounting Principles (US GAAP), whereas in Hydro One's view the account was created only to capture financial differences arising from the transition from CGAAP to International Financial Reporting Standards (IFRS). In its submissions to the OEB on Account 1576 prior to the Decision, Hydro One did not specifically argue that recording or clearing balances for the time period after 2015 would constitute retroactive ratemaking; however, it did clearly state that it did not believe that Account 1576 applied to US GAAP.[2]

For the reasons described below, OEB staff submits that the Decision requiring Hydro One to record and file balances for disposition in Account 1576 for the former Woodstock Hydro for the years 2016-2022 does not constitute impermissible retroactive ratemaking.

The Rule against retroactive ratemaking

[2] EB-2021-0033, Hydro One reply submission, pp. 14-15

It is a well-known principle that economic regulatory tribunals such as the OEB must exercise their ratemaking authority on a prospective basis, unless the governing statute specifically contemplates otherwise. Generally speaking, a tribunal cannot exercise its authority retroactively or retrospectively.[3] There are, however, a number of exceptions to this general rule. The most important of these for the purpose of this Motion are deferral and variance accounts.

Deferral and variance accounts are a mechanism whereby costs or revenues that would normally be recognized in one period are deferred and recognized in a future period, usually aligning with the period in which these costs (or revenues) are approved to be recovered from (or returned to) customers though rates. Often, deferral and variance accounts are established in a proceeding where a cost or revenue in the test period (i.e. the future period for which the OEB is setting rates) cannot be predicted with sufficient accuracy. In the current case, the OEB established an electricity sector wide deferral account (Account 1576) to capture the property plant and equipment (PP&E) impact for capitalization and depreciation policy changes from those embedded in rates at last rebasing, made during the incentive rate-setting term. This was done to ensure that distributors could not realize a gain or loss resulting from a change of accounting policies or accounting standards that took place between rebasing applications. The account was established in 2012, and was based on the OEB's conclusions from a 2011 report (as described further below).

The key factor in determining whether a retroactive rate adjustment is permitted is whether the parties (which include the distributors and ratepayers) were aware that the rate was subject to after the fact adjustment. As both the Alberta Court of Appeal and the Ontario Court of Appeal have noted, "[s]lavish adherence to the use of interim rates and deferral accounts should not prohibit adjustments" in proper cases. Moreover, "[s]imply because a ratemaking decision has an impact on a past rate does not mean it is an impermissible retroactive decision." Rather, "[t]he critical factor for determining whether the regulator is engaging in retroactive ratemaking is the parties' knowledge" that the rates were subject to change.[4]

All parties to this Motion agree that Account 1576 was in place at all the relevant times (it was established in 2012, and the disputed period is 2016-2022). The only dispute is whether Account 1576 was established to capture the impacts of **any** capitalization and depreciation policy changes regardless of accounting standards the policies were based on (which would include a change from CGAAP policies to US GAAP policies, or IFRS policies to US GAAP policies), or if it was intended to capture only impacts arising from a change from CGAAP policies to IFRS policies. Hydro One argues that Account 1576 was only ever intended to capture impacts resulting from CGAAP policies to IFRS policies. OEB staff submits that Account 1576 was always intended to capture impacts

[3] *Union Gas Ltd. v. Ontario Energy Board*, 2015 ONCA 452 (CanLII), Para. 82
[4] *Ibid*., para. 91, and *Atco Gas and Pipelines Ltd. v. Alberta (Utilities Commission)*, 2014 ABCA 26, at paras. 52 and 56.

resulting from any capitalization and depreciation policy changes regardless of accounting standards the policies are based on, therefore including CGAAP to US GAAP policies.

Account 1576

Account 1576 was established to capture the PP&E impact for capitalization and depreciation policy changes as mandated by the OEB in anticipation of a change in accounting standards, from those embedded in rates at last rebasing, made during the incentive-rate setting term. The account specifies that journal entries are required starting with the year of accounting policy changes until the year prior to when a distributor rebases its rates. Although for the reasons described below much of the text in the account and related documents refers to a transition from CGAAP policies to IFRS policies, the OEB was also clear that the same approach should apply to US GAAP policies where appropriate.

It is important to understand the context under which Account 1576 was created. On June 13, 2011, the OEB issued its *Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment* (Report). During this time, many distributors were expecting to transition from the CGAAP accounting standard to IFRS (or Modified IFRS for regulatory purposes). In general, IFRS permits less assets to be capitalized than CGAAP, mainly due to administration and general overhead costs being prohibited from capitalization under IFRS. Also, for the electricity sector, estimated useful lives of assets (which underpin depreciation) tended to be longer under IFRS, resulting in a higher comparable net book value for capital assets, at a given time. The capitalization policy change impact offsets the depreciation policy change, but typically, based on OEB staff's past experience with these policy changes in the electricity sector, the net impact to rate base is that rate base is higher under IFRS policies than CGAAP policies. The capitalization and depreciation policy changes will also have a correlating impact to other elements of revenue requirement (e.g. depreciation and OM&A). Although Account 1576 was not formally established until several months after the issuance of the Report to separate out capitalization and depreciation policy changes from other PP&E changes resulting from a change in accounting standard, the account and its rationale are directly discussed in the Report and it was established as expressly contemplated in the Report.[5]

The eventual adoption of IFRS created a challenge for distributors that were between rebasings, and in particular within an incentive rate-setting mechanism (IRM) term, as their rates (and in particular their rate base) at the commencement of the IRM term had been set based on CGAAP. The transition to IFRS typically resulted in changes to capitalization and depreciation policies and therefore, adjustments to rate base (which

[5] Report, pp. 11-12.

were in most cases increases to rate base). This created a potential problem in that when distributors filed for new rates at the end of their IRM term where there was a lack of continuity in rate base from the last rebasing to their next rebasing. At the end of the IRM term, distributors were expected to rebase under IFRS, and they would typically have a higher rate base than if they had maintained rate base under CGAAP. Account 1576 was created to ensure that distributors would not be permitted to "double count" the costs (in cases of net increases to rate base) or have costs "orphaned" (in cases of net decreases to rate base) for certain assets. For example, in the typical case where rate base under IFRS was higher than that under CGAAP: first, depreciation and the resulting rate base was reflected in rates set under CGAAP. Then, the depreciation policy change during the IRM period resulted in lower depreciation and higher rate base than that was approved to be recovered in the prior rebasing application. Subsequently, in the first rebasing case after the IRM term, opening rate base under IFRS would be higher and therefore the depreciation that was previously recovered will be proposed for recovery again. In this case, Account 1576 would capture the difference in rate base due to depreciation policy change, and return the depreciation that will be recovered again to customers.

The Report largely discussed this issue in the context of the change from CGAAP to IFRS for the simple reason that this was the accounting standard change that most distributors were undergoing at the time. However, the same principle applies for any changes in accounting policies or accounting standards (for example, from CGAAP to US GAAP). This was made clear by the OEB in the Report:

> The Board will approve the proposed PP&E deferral account. The account addresses the unique circumstance of a change in accounting standards and provides for the continuity of rate base. The account allows utilities to avoid the potential for material out of period costs (or over-recovery) that might not be eligible for inclusion in the current period determination of rates. The deferral account also facilitates monitoring of the extent of potential impact during the IRM period, and provides the opportunity to identify any unusual circumstances requiring attention before completion of the IRM period.[6]

This passage references the principle based rationale that led to the establishment of the account, and does not specify that the account applies only to changes from CGAAP to IFRS. The account is intended to capture impacts resulting from changes to accounting policies between rebasings.

Even more importantly, at page 20 the Report specifically notes that: "[u]tilities that file and report under USGAAP (or another accounting standard) should, in general, read references to IFRS and MIFRS in the Board Report, amendments to it, and this Addendum to include USGAAP (or other alternate accounting standard)." This

[6] *Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment*, p. 11

represents a clear indication by the OEB that the guidance provided in the Report (which includes the rationale for the subsequent creation of Account 1576) is meant to encompass changes not just resulting from CGAAP to IFRS, but also CGAAP to USGAAP. Hydro One therefore had knowledge as early as 2012 that Account 1576 could be used to record financial differences arising for a transition from CGAAP to USGAAP.[7]

The former Woodstock Hydro last rebased in 2011 under the CGAAP accounting standard, and then made capitalization and depreciation changes to align with IFRS in 2012. Since its acquisition by Hydro One in 2015 it has been reporting under US GAAP. The former Woodstock Hydro has not rebased – either under MIFRS or US GAAP, since its last cost of service proceeding under CGAAP in 2011. This is exactly the scenario the OEB was addressing with the issuance of the Report and the establishment of Account 1576. The account specifies that journal entries are required starting with the year of accounting policy changes until the year prior to when a distributor rebases its rates. There remains a strong rationale for Hydro One to continue recording balances for the former Woodstock Hydro in Account 1576 until it rebases, both on a general policy basis and because the Report clearly contemplates that Account 1576 should apply to distributors under US GAAP where appropriate. Based on the Report, all parties had knowledge that Account 1576 would apply to any changes to accounting standards between rebasings.

B. Hydro One's argument that there are no relevant differences between CGAAP and US GAAP to record in Account 1576

Hydro One argues that, even if Account 1576 applies to the Woodstock service area from 2016-2022, there are no relevant differences between CGAAP and US GAAP to record in the account for that time period.

As a general matter, Account 1576 captures two types of impacts: impacts resulting from changes to depreciation policy, and impacts resulting from changes to capitalization. Hydro One has said that the switch to US GAAP has resulted in no material changes to depreciation rates for the former Woodstock Hydro.[8] It does not appear to have confirmed anywhere that it has not changed its capitalization policies.

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[7] OEB staff understands that the Report also notes that: "The deferral account authorized in Issue 2 [i.e. Account 1576] may not be necessary for such utilities." OEB staff submits that this statement should not be read as an indication that Account 1576 does not apply to transitions from CGAAP to USGAAP. Instead, it was a recognition by the OEB that the transitions from CGAAP to USGAAP may not result in any material transactions to record in the account. However, to the extent that material transition adjustments do result from a change from CGAAP to USGAAP, OEB staff submits that the OEB always intended that these adjustments be recorded, and clearly announced that policy in the Report.

[8] Page 15, Hydro One's Argument in Chief

To the extent capitalization policies have been changed on account of the switch to US GAAP, these impacts should be recorded in Account 1576.

Regardless, to the extent there actually are no material balances to record in Account 1576 for the former Woodstock Hydro for the years 2016-2022, Hydro One could simply file those balances as directed by the OEB in its Decision. It is not clear why a motion to review is required where, according to Hydro One, the balance in the account would be immaterial.

II. OEB Staff submissions with respect to Account 1592

Background

In its Decision and Order, the OEB directed Hydro One to calculate balances, including a forecast to the end of 2022, in Account 1592, Sub-account CCA Changes using a specified methodology for each of the Acquired Utilities. The Motion asks that this decision be overturned, and be substituted with a finding for each of the Acquired Utilities that it is appropriate that there are no balances in the sub-account, and therefore, revoking the direction to calculate balances for the 2018 to 2022 period.

The Motion argues that two errors were made in connection with the Account 1592 finding. First, that the Decision misapplied the concept of rate base additions and incorrectly found that there were additions embedded in the Acquired Utilities from 2018 onward. Second, that the Decision misapplied the foregoing finding by determining that Hydro One realized windfall gains from accelerated capital cost allowance (CCA) on those additions.

Hydro One notes that the OEB established a separate CCA Changes sub-account to track the impact of any differences that result from the accelerated CCA to the tax rates or rules that were used to determine the tax amounts that underpin rates. [9] Given the purpose of the 1592 sub-account, Hydro One notes that the primary issue for the Account 1592 findings is whether the amounts at issue relate to tax amounts that underpin rates for the Acquired Utilities during the period from 2018 to 2022.

Hydro One indicates that there are no assets underpinning the Acquired Utilities' existing distribution rates, for which accelerated CCA has been claimed. Hydro One notes that Norfolk Power, Haldimand County Hydro and Woodstock Hydro last rebased for rates effective May 1, 2012, May 1, 2014, and May 1, 2011, respectively under a cost of service rate application which included a capital forecast only for the test year.

[9] OEB Letter dated July 25, 2019 regarding *Accounting Direction Regarding Bill C-97 and Other Changes in Regulatory or Legislated Tax Rules for Capital Cost Allowance*

Subsequently, each of the Acquired Utilities' rates were subject to a mechanistic rate adjustment under incentive regulation and a five-year rate freeze with a 1% reduction following approval of its acquisition by Hydro One.

In addition, Hydro One indicates that the method for calculating balances for 2018 to 2022 as specified in the Decision is not consistent with the approved terms of Account 1592.

Submission**:**

OEB staff disagrees with Hydro One's position on the Account 1592 findings. Note that OEB staff's discussion below focuses on a rate-setting framework of a cost of service proceeding followed by a typical IRM term and/or a deferred rebasing period.

A. The Additions in Rate Base Underpins Rates

Hydro One stated the following:

> …additions underpinning rates from the time of each Acquired Utility's last rebasing application, i.e. their rate base additions, would have been made up of assets that were placed into service prior to or during the test years for those rebasing applications. Those test years ranged from 2011-2014 for the three utilities. The AIIP applies to first year CCA claims for eligible assets, but only if those assets are acquired after November 21, 2018 and in-serviced before 2027. Therefore, none of the rate base additions underpinning rates from the time of each Acquired Utility's last rebasing applications could possibly have been eligible for Accelerated CCA.

In OEB's staff view, Hydro One's argument is flawed. OEB staff agrees that none of the test year additions included in rate base as part of each Acquired Utility's last rebasing application would have specifically been eligible for accelerated CCA. However, the additions embedded in each of the Acquired Utilities' rate base are those that are currently underpinning each of the Acquired Utilities' rates that Hydro One has been charging customers since its last rebasing rate proceedings. In those cost of service proceedings, the forecasted in-service additions included in each of the Acquired Utilities' approved rate base, along with opening rate base, formed each Acquired Utilities' approved test year capital-related revenue requirement. The revenue requirement for those capital additions and opening rate base includes depreciation, a return on rate base component, and PILs calculated under the legacy CCA rules. Subsequently, the rates that were derived from this approved revenue requirement have been subject to an annual Price Cap IR framework and a five-year rate freeze. Under a cost of service ratemaking framework, the test year revenue requirement (including the

rules in effect at that time, such as legacy CCA rules) serves as the underlying basis for rates until a utility rebases, without any regard for how many years it has been since that proceeding, or whether rates are subject to subsequent inflationary increases or freezes. Therefore, OEB staff submits that the additions embedded in each of the Acquired Utilities' rate base in the test years of their last rebasing proceedings underpin current rates until the Acquired Utilities rebase. Furthermore, OEB staff submits that each of the Acquired Utilities' approved revenue requirement is deemed to be sufficient to recover each of the Acquired Utilities' capital envelope, including any new in-service capital additions in the years subsequent to a cost of service rate application.

OEB staff submits that Hydro One's argument undermines the principle behind the 1592 sub-account to ensure that utilities neither benefit nor are disadvantaged from changes to the CCA rules that was reflected in rates. If the 1592 sub-account only applies to in-service additions that were directly included in rate base in the test year of a cost of service proceeding, as argued by Hydro One, the use of the 1592 sub-account would only be limited to those utilities that rebased for 2018 or 2019 rates under legacy CCA rules.[10] The amounts recorded in the sub-account by these utilities would only pertain to additions included in rate base for the test year; no further amounts would be recorded in the sub-account during the Price Cap term. This is clearly not how the 1592 sub-account is intended to function as evidenced by the OEB's July 25, 2019 letter (CCA Letter)[11] that established the 1592 sub-account, where the OEB stated:

> "The OEB expects Utilities to record the impacts of CCA rule changes in the appropriate account (Account 1592 - PILs and Tax Variances and similar accounts for natural gas utilities and OPG) for the period November 21, 2018 **until the effective date of the Utility's next cost-based rate order.**" [emphasis added]

This is also evidenced by the fact that the 1592 sub-account is a generic account that applies to all electricity and natural gas utilities and Ontario Power Generation, and not only those that rebase for 2018 and 2019 rates.[12] In OEB staff's view, the ratemaking circumstances and applicability of the 1592 sub-account for each of the Acquired Utilities is no different than any other distributor under a Price Cap IR framework or deferred rebasing period. Furthermore, OEB staff notes that the OEB has accepted the disposition of the 1592 sub-account balance for many electricity distributors that rebased under a cost of service regime (prior to 2018), followed by a period of incentive

[10] Per the OEB's letter regarding *Accounting Direction Regarding Bill C-97 and Other Changes in Regulatory or Legislated Tax Rules for Capital Cost Allowance* dated July 25, 2019, accelerated CCA was to be reflected in rate applications for 2020 rates and beyond.
[11] OEB letter regarding *Accounting Direction Regarding Bill C-97 and Other Changes in Regulatory or Legislated Tax Rules for Capital Cost Allowance*, July 25, 2019
[12] Ibid.

rate regulation.[13] In OEB staff's view, there is no relevant difference between the circumstances facing these utilities, and that of the Acquired Utilities.

In addition, OEB staff is of the view that the fact that the Acquired Utilities were under a deferred rebasing period during 2018 to 2022 as a result of a mergers, amalgamations, acquisitions and divestures (MAADs) application, is not a relevant consideration for the applicability of the 1592 sub-account. Each of the Acquired Utilities were still recovering rates based on its approved revenue requirement from its last cost of service (adjusted as applicable by IR) and the 1592 sub-account continues to apply. OEB staff notes that, in addition to the numerous electricity distributors that rebased before 2018, and yet recorded and disposed of balances in their respective 1592 sub-accounts, strong precedent also exists in a similar circumstance with Enbridge Gas Inc. (Enbridge Gas).

Enbridge Gas formed from the approved amalgamation of the former Enbridge Gas Distribution Inc. and Union Gas Limited, effective January 1, 2019.[14,15] The former Enbridge Gas Distribution Inc. last rebased its 2014 rates under a five-year Custom IR plan,[16] and the former Union Gas was under a five-year IRM from 2014 to 2018[17] having last rebased for 2013 rates.[18] In the relevant MAADs proceeding, the OEB approved the new Enbridge Gas to adopt the Price Cap IR mechanism over a five-year deferred rebasing period.[19] No capital additions have been added to Enbridge Gas's rate base for ratemaking purposes since it amalgamated. Subsequently, in Enbridge Gas's 2019 rates application, the OEB found that it was appropriate for Enbridge Gas to follow the direction of the OEB's CCA Letter, where the OEB provided direction to record impacts of CCA rule changes in the appropriate account. The OEB has since approved the disposition of Enbridge Gas's 2018 and 2019 balances relating to CCA changes.[20]

OEB staff also notes that Hydro One's argument does not appear to be consistent with its proposed disposition of the 1592 sub-account for Hydro One Transmission, which is currently before the OEB in its 2023 to 2027 Custom IR rate application.[21] Hydro One Transmission's 1592 sub-account balance is composed of 2018 and 2019 transactions.

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[13] For example, Niagara Peninsula Energy Inc. (EB-2020-0040), Waterloo North Hydro Inc. (EB-2020-0059), Burlington Hydro Inc.(EB-2020-0007)
[14] MAADs application, EB-2017-0306 / 0307
[15] Page 3 of Decision and Order Enbridge Gas Inc.'s Disposition of Deferral and Variance Accounts and Review of Amounts for Earnings Sharing, May 6, 2021, EB-2020-0134,
[16] EB-2012,0459
[17] EB-2013-0202
[18] EB-2011-0210
[19] Page 19 Decision and Order for MAADs application, August 30, 2018, EB-2017-0306 / 0307
[20] Page 14 of Decision and Order Enbridge Gas Inc.'s Disposition of Deferral and Variance Accounts and Review of Amounts for Earnings Sharing, May 6, 2021, EB-2020-0134. The 2018 pre-amalgamation balance was disposed on a 50/50 shared basis between ratepayers and shareholders, and 100% of the 2019 balance was refunded to ratepayers
[21] Hydro One Custom IR Rate Application for 2023 to 2027 (EB-2021-0110).

OEB staff notes that Hydro One Transmission rebased its 2017 and 2018 rates in a Custom IR proceeding,[22] while its 2019 rates were approved under an IRM.[23] OEB staff is unclear how Hydro One Transmission's 1592 sub-account balance pertaining to 2019, would be different than the Acquired Utilities 1592 sub-account for the 2018 to 2022 period as Hydro One Transmission and the Acquired Utilities' rates were all set under a mechanistic basis during that time.

B. The Findings are Consistent with the Benefit Follows Cost Principle

Hydro One argues that the Decision misapplied the Account 1592 finding by determining that Hydro One realized windfall gains from claiming accelerated CCA. OEB staff disagrees and submits the mere change in CCA rules that allowed Hydro One to claim accelerated CCA deductions instead of CCA deductions based on prior CCA rules, which were reflected in rates, resulted in a windfall gain for the Acquired Utilities. When a utility determines its test year taxes or PILs for regulatory purposes, its actual tax return ending undepreciated capital cost (UCC) that is subject to CCA deductions from the historic year will be used as the starting point to determine CCA deductions in the test year. Therefore, for capital assets placed in-service prior to rebasing where accelerated CCA has already been claimed, there would be lower remaining CCA deductions available to ratepayers in the test year for those assets. The accelerated CCA claimed by a utility will never flow through to ratepayers, resulting in a windfall gain. This is exactly the situation that Account 1592 rectifies.

Hydro One further argues that the Account 1592 aspects of the Decision are inconsistent with the benefits follow costs principle of ratemaking. Hydro One notes that this is because the effect of the Account 1592 findings is that accelerated CCA tax benefits on assets that were put into service during the 2018-2022 period but were not added to the rate bases underpinning the Acquired Utilities' rates during that period, will be for the benefit of ratepayers despite the fact that ratepayers have not borne any of the costs underlying those assets in their rates. As discussed above, OEB staff disagrees with this characterization. Hydro One continued to charge rates, which were derived from an approved revenue requirement, to the Acquired Utilities' customers during the 2018 to 2022 period. OEB staff acknowledges that ratepayers would not have funded the specific assets the Acquired Utilities placed into service during 2018 to 2022, as the capital additions embedded in the approved rate bases were based on a forecast and this forecast was notionally updated each year by an IR adjustment, as applicable. However, OEB staff's position is that ratepayers have been notionally funding the Acquired Utilities' 2018 to 2022 rate bases, including the capital additions in those years, through the rates the Acquired Utilities have been charging customers

[22] EB-2016-0160/EB-2017-0359
[23] EB-2018-0130

during that period, and have indeed borne those costs. It is an established regulatory principle that utilities use annual depreciation expense to at least partly fund new capital additions. In fact, OEB staff submits that if Hydro One does not return the accelerated CCA benefit received during the 2018 to 2022 period, this would result in a windfall gain to Hydro One and it would not follow the OEB's principle of benefit follows cost.

OEB staff notes the CCA rule change is not a permanent change. The total lifetime CCA deductions remain the same under legacy and accelerated CCA rules. Accelerated CCA defers taxes, where taxes are lower in the year a qualifying capital expenditure is placed into service but will be higher in subsequent years. If the accelerated CCA benefits that each of the Acquired Utilities have received are merely costs that ratepayers have to pay later, it would not be fair to expect ratepayers to pay the costs later (by having less CCA deductions available)[24] while Hydro One retains the benefits of accelerated CCA simply because the accelerated CCA rules were temporarily effective[25] during the Acquired Utilities' deferred rebasing period. If ratepayers are expected to absorb those costs in future years when the utility rebases, they should similarly be entitled to the entire benefits, which would require Hydro One to return amounts in each of the Acquired Utilities' 1592 sub-account during the 2018 to 2022 period.

C. The Account 1592 Methodology is Appropriate

OEB staff submits that the methodology of calculating the 1592 sub-account as specified in the Decision is one of the appropriate methods of calculating the balance in the sub-account. The methodology as specified in the Decision compares the CCA calculated using prior CCA rules underpinning rates to the CCA calculated using the actual accelerated CCA rules applicable to each year of the period. This CCA is calculated based on actual additions. Hydro One estimated that the Account 1592 finding would result in a revenue requirement impact of approximately $1.2 million to be returned to ratepayers for the 2019 to 2022 period.[26] Hydro One argues that using actual additions is not appropriate as this would result in the calculations also capturing tax variances arising from differences in fixed asset additions between the assets that are in rate base and which underpin rates, and assets that are in service but which have not been added to rate base and which therefore do not underpin rates.

For 1592 sub-account balances that have been disposed to date, OEB staff notes that the balances have been calculated using either the approved capital additions embedded in the distributors' last rebasing rate applications (Approved Additions

[26] Page 14, Argument in Chief

Method),[27] or actual capital additions (Actual Additions Method)[28], which is the one specified in the Decision. OEB staff submits that both approaches are appropriate.

In OEB staff's view, the Approved Additions Method focuses on the impact of the CCA rule change to existing rates. It attempts to determine the rates (based on the approved forecasted additions) a utility should have received, had the utility reflected the accelerated CCA rules instead of the prior CCA rules in the test year of its last rebasing application. The Actual Additions Method focuses on the impact of the CCA rule change to future rates. As noted above, when a utility determines its test year taxes or PILs for regulatory purposes, its actual tax return ending UCC that is subject to CCA deductions from the historic year will be used as the starting point to determine CCA deductions in the test year. Therefore, for capital assets placed in-service prior to rebasing where accelerated CCA has already been claimed, there would be lower remaining CCA deductions available to ratepayers in the test year for those assets. The Actual Additions Method recognizes the future costs to ratepayers (in the form of lower CCA deductions available at rebasing) and returns the actual benefit a utility realized from accelerated CCA through the 1592 sub-account.[29] The Actual Additions Method is akin to the mechanism for Account 1576, which calculates the actual opening rate base impact at next rebasing from any accounting policy changes. However, in this case, the opening UCC impact for tax purposes at next rebasing is being calculated. Accordingly, OEB staff submits that the Actual Additions Method is an appropriate methodology to calculate the balance in the account, and one that the OEB has approved on a number of occasions already.

Conclusion

For the reasons described above, OEB staff submits that the entirety of the Motion should be dismissed.

[27] 1592 sub-account balances calculated based on approved additions include Waterloo North Hydro Inc. (EB-2020-0059)
[28] 1592 sub-account balances calculated actual additions include Enbridge Gas Inc. (EB-2020-013), Canadian Niagara Power Inc. (EB-2021-0011), Brantford Power (EB-2021-0009), Burlington Hydro Inc. (EB-2020-0007)
[29] The reverse logic will apply when accelerated CCA is phased out during an incentive rate-setting term and the cost to the utility (in the form of higher CCA deductions available at rebasing) will be recorded in the 1592 sub-account and recovered by a utility.