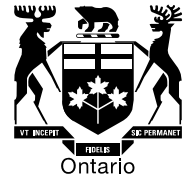


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**BY EMAIL**

December 12, 2016

Ontario Energy Board  
P.O. Box 2319  
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Toronto ON M4P 1E4  
Kirsten.Walli@ontarioenergyboard.ca

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

**Re: Horizon Utilities Corporation (Horizon Utilities)  
Application for Rates  
OEB Staff Additional Submission  
OEB File Number EB-2016-0077**

In accordance with Procedural Order No.2, please find attached the OEB Staff Additional Submission in the above proceedings. This document is being forwarded to Horizon Utilities Corporation and to all other registered parties to this proceeding.

Horizon Utilities is reminded that its Reply Submission is due by December 16, 2016, should it choose to file one.

Yours truly,

*Original Signed By*

Donald Lau  
Project Advisor  
Encl.



# **ONTARIO ENERGY BOARD**

## **STAFF ADDITIONAL SUBMISSION**

**2017 ELECTRICITY DISTRIBUTION RATES  
YEAR 3 CUSTOM IR**

**Horizon Utilities Corporation**

**EB-2016-0077**

**December 12, 2016**

**OEB Staff Additional Submission  
Horizon Utilities Corporation  
2017 electricity distribution rates, year 3 custom IR  
EB-2016-0077**

**Introduction**

Horizon Utilities Corporation (Horizon Utilities) filed an application for its annual update to its 2015-2019 Custom Incentive Regulation (Custom IR) application (EB-2014-0002) with the Ontario Energy Board (OEB) on August 11, 2016 under section 78 of the *Ontario Energy Board Act, 1998* seeking approval for changes to the rates that Horizon Utilities charges for electricity distribution, effective January 1, 2017 (the Application).

Procedural Order No.1 was issued on September 28, 2016 which allowed OEB staff and intervenors to submit written interrogatories on October 12, 2016 and October 17, 2016 respectively. Subsequently, Horizon Utilities filed written responses on November 2, 2016.

On November 16, 2016 OEB staff filed written submissions with the OEB. In particular, OEB staff disagreed with the calculation of the return on equity (ROE) for the purpose of the earning sharing mechanism (ESM). On November 25, 2016 Horizon Utilities filed written reply submissions with the OEB that disagreed with the OEB staff's position.

The OEB found that Horizon raised some arguments in their reply submission that were not specifically addressed by OEB staff and the intervenors. The OEB decided that it would be assisted by additional submissions in order to complete the record in this proceeding. Procedural Order No. 2 was issued on December 5, 2016 allowing OEB staff and intervenors to file additional written submissions, limited to the arguments made on the Earning Sharing Mechanism.

**Earnings Sharing Mechanism**

The approved settlement proposal in EB-2014-0002 provided for a deferral account for earnings in excess of the OEB's annual approved regulatory ROE, as adjusted in the Settlement Proposal. Earnings in excess of the approved ROE would be divided on a 50/50 basis between Horizon Utilities and its ratepayers. For 2015 Horizon Utilities has calculated a ROE of 9.275% for the purpose of the Earnings Sharing Mechanism and states that no earnings sharing is required as this ROE is less than the approved ROE of 9.30%. Horizon Utilities calculated the ROE based on the RRR 2.1.5.6 net income,

less adjustments approved in the OEB-approved Settlement Agreement, and excluded an out of period tax adjustment.

In its original submission, OEB staff submitted that four of the adjustments made to the regulatory net income reported in RRR 2.1.5.6 by Horizon Utilities are consistent with the approved Settlement Proposal for the purpose of earnings sharing. These adjustments include the following:

- Exclude revenue associated with the Smart Meter Disposition Rider for Smart Meter installations from 2012 - 2014
- Exclude the Rate of Return on Stranded Meters at the short term debt rate of 2.11%
- Include one-time costs incurred for Horizon Utilities' Custom IR Application, calculated as one-fifth of \$2,476,925 in each of 2015 through 2019
- PILs calculated from actual to reflect the adjusted net income as a result of any revenue and expense adjustments

In addition to the adjustments agreed to in the approved Settlement Proposal, Horizon Utilities has excluded an out of period tax adjustment of \$550k from the calculation of the net income for the purpose of earnings sharing. OEB staff submitted in its original submission that the Settlement Proposal did not make provision for an adjustment for an out of period tax adjustment; therefore the out of period tax adjustment should be retained for the subject year's ROE calculation for purpose of earnings sharing.

Horizon Utilities, in their reply submissions disagreed with OEB Staff's submission to retain the out of period tax adjustment for the purpose of calculating the ROE. Horizon Utilities submitted the tax adjustment should be excluded for the ROE for the following reasons:

- The tax credit is related to activities that were conducted prior to 2015 and consequently prior to the 2015-2019 rate plan term. It is therefore out of scope for the 2015 ROE calculation. In addition, the expenses to which the tax credit relates were recorded in years prior to 2015. The expenses and related tax credit both need to be recorded in the same term, else a hybrid approach results in a one-sided adjustment to the ROE.
- The OEB-approved settlement proposal did make provision for an adjustment for out of period tax adjustments on page 30 of the Settlement Proposal. Namely, that "the regulatory net income will be calculated, for the purpose of earning

sharing , in the same manner as net income for regulatory purposes under the RRR filings.” Furthermore, Horizon Utilities have followed guidance from RRR 2.1.5.6 ROE Complete Filing Guide<sup>1</sup> and identified the tax credit in Horizon Utilities RRR 2.1.5.6 submission.

- Tax credits were not included in the 2015 PILs used to determine deemed ROE. To include the credit would result in the achieved ROE and the deemed ROE being reported on an inconsistent basis

Horizon states that the settlement proposal allows for the ROE for earnings sharing to be adjusted for the out of period tax credit because the proposal states “regulatory net income will be calculated, for the purpose of earnings sharing, in the same manner as net income for regulatory purposes under the RRR filings”. OEB staff agrees that the settlement proposal states that the regulatory net income is to be calculated consistent under the RRR filings, specifically RRR 2.1.5.6. The Current Tax Provision as per the Audited Financial Statements (cell fa in the RRR 2.1.5.6 report) includes the out of period tax adjustment. As noted in its submission, Horizon included the \$550k credit in line fa1 which is for information only. However, the reported taxes at line fa of \$4M also include the tax adjustment credit and as a result, Horizon’s 2015 net income is higher, as is its reported ROE.

OEB staff agrees that Horizon has followed the underlying principle in the ROE Complete Filing Guide<sup>2</sup>, which was referenced by Horizon in its reply submission. However, the paragraph referenced also states that “It is each distributor’s responsibility to identify all necessary adjustments to the achieved ROE.” Furthermore, the 2015 ROE filing did provide other adjustment cells (cells gm, gn, go and cells fm, fn and fo) to “adjust for other adjustments required to determine the current tax provision set out in Chapter 7 of the 2006 EDR Handbook and the EDR Handbook Report of the Board”<sup>3</sup>. OEB staff notes that Horizon did not include the \$550k prior year tax credit under any adjustment lines (thus retaining its effect on the achieved ROE) even though the information was already known to Horizon. If Horizon had excluded the tax credit (i.e. identified it as an adjustment to the ROE calculation), the reported ROE would have been 9.71%. If Horizon had submitted this ROE in its RRR 2.1.5.6 and used it as the starting point for calculating the ROE for ESM then it would have been accurate in its original application when it stated that no earnings sharing was required for 2015.

<sup>1</sup> RRR 2.1.5.6 ROE Complete Filing Guide issued by OEB Staff in March 2016, Page 4 and 19

<sup>2</sup> RRR 2.1.5.6 ROE Complete Filing Guide issued by OEB Staff in March 2016, Page 4

<sup>3</sup> RRR 2.1.5.6 ROE Complete Filing Guide issued by OEB Staff in March 2016, Page 26

However, Horizon's reported ROE was 10%, which included the prior period tax adjustment. Presumably, Horizon has its reasons for taking this approach to its RRR filings which identified an ROE of 10%.

Horizon also stated that "to include the credit would result in the achieved ROE and the deemed ROE being reported on an inconsistent basis, which is contrary to the clear instructions in the OEB's ROE Guide." and that the deemed ROE in the Custom IR application of 9.3% did not provide for tax credits from prior period adjustments. OEB staff agrees, however the settlement did not state that the ROE for ESM should be calculated in the same manner as the deemed ROE, rather it stated it should be calculated in the same manner as the reported RRR ROE for 2015, in which Horizon retained the prior year tax adjustment.

OEB staff also agrees with Horizon that a hybrid approach to out of period tax adjustments, which results in a one-side adjustment to ROE is not reasonable. The adjustments of the prior period taxes due to reassessments would inevitably impact two or more periods depending on the periods when the adjustments are related to. OEB staff notes that the Ministry of Finance's website<sup>4</sup> states that the normal reassessment period for corporate tax is three years for a Canadian-controlled private corporation (CCPC) and four years for a non-CCPC. OEB staff also notes that the SR&ED credits are often the subject of the tax audits and hence would result in re-assessed amounts. As a result, whether the adjustments should be recorded in the rate-setting term or outside of the rate-setting term is not a relevant issue. The issue is whether the adjustment should remain in the year in which the adjustment is known to the distributor or should be reallocated to the relevant prior period(s). OEB staff supports the position of leaving the prior period tax adjustment(s) in the current year for Horizon because of the following reasons:

- Only this approach will ensure that the 2015 earnings sharing assessment is final. In contrast, Horizon's approach will result in making the 2015 ROE and hence earning sharing open to further potential tax adjustments. The 2015 tax provision currently included in the ROE filing is subject to the re-assessment(s) for the next three or more years. In the scenario of further tax re-assessments that is related to 2015 and received in later years (2016 to 2019), using Horizon's proposed approach would enable Horizon to retroactively record the tax adjustments received in later years in 2015. As a result, assessment of the 2015 ESM would

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<sup>4</sup> <http://www.fin.gov.on.ca/en/>

not be final. While the established deferral account could be used to guard against rate retroactivity, Horizon's approach would not provide certainty for the 2015 year with respect to the ESM, which is OEB staff's understanding, is the intention of the annual review for earnings sharing per the settlement agreement.

- Although the inclusion or exclusion of the prior year tax adjustment in 2015 may change the fact that Horizon would share earnings or not, the \$550k tax adjustment is not material as compared to Horizon's materiality threshold of \$608k. Although Horizon can request the tax re-assessment, staff views that the tax re-assessments are not in the control of the distributors in general. Within the next few years (either in the rate-setting term or not), there might be more tax re-assessments which result in similar amounts of tax adjustments related to 2015 taxes and hence regulatory Net Income and the ROE calculation. In this case, excluding the tax adjustment in the subsequent years received (Horizon's proposed approach) would result in a one-side adjustment which is not fair to Horizon's ratepayers.

In conclusion, OEB staff submits that the prior tax adjustment of \$550k should not be excluded from the calculation of the ROE for ESM purposes. As per the settlement agreement, the ROE used for the ESM should be calculated "in the same manner as the RRR ROE" in which Horizon included the prior period tax adjustment in its 2015 reported ROE. In addition, this approach will ensure that the 2015 ESM review is final. Staff submits that the ROE for ESM should be 9.56% and therefore Horizon should record \$251,041 in the ESM deferral account (50% of the difference between the net income at 9.56% and the net income at 9.30%) for future disposition.

All of which is respectfully submitted