



December 16, 2016

By RESS and Courier

Ms. Kirsten Walli, Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, Ontario
M4P 1E4

Dear Ms. Walli;

**Re: Horizon Utilities Corporation Annual Filing for Electricity Distribution Rates
(EB-2016-0077)**

Horizon Utilities Corporation (“Horizon Utilities”) submitted its second Annual Filing to its 5-year Custom Incentive Rate-making Application (EB-2014-0002) to the Ontario Energy Board (“OEB”) on August 11, 2016, for electricity distribution rates effective January 1, 2017.

In response to the additional submissions received from OEB Staff and the School Energy Coalition and pursuant to Procedural Order #2 received December 5, 2016, please find attached herewith Horizon Utilities’ final reply submission in this proceeding.

Two hard copies will be couriered to the OEB.

Please do not hesitate to contact me if you have any questions.

Yours truly,

Original signed by Indy J. Butany-DeSouza

Indy J. Butany-DeSouza, MBA
Vice-President, Regulatory Affairs
Horizon Utilities Corporation
Tel: (905) 317-4765

Attachment

1
2 **IN THE MATTER OF** the *Ontario Energy Board Act, 1998*, being
3 Schedule B to the *Energy Competition Act, 1998* S.O. 1998, c. 15;

4 **AND IN THE MATTER OF** an Application by Horizon Utilities
5 Corporation to the Ontario Energy Board for an Order or Orders
6 approving of fixing just and reasonable rates and other service
7 charges for the distribution of Electricity as of January 1, 2017.

8 **HORIZON UTILITIES CORPORATION (“HORIZON UTILITIES”)**

9 **FINAL REPLY SUBMISSION**

10 **DELIVERED: DECEMBER 16, 2016**

11
12 **INTRODUCTION:**

13 Horizon Utilities Corporation (“Horizon Utilities”) is a licensed electricity distribution company
14 operating in the City of Hamilton and the City of St. Catharines under Ontario Energy Board
15 (“OEB” or the “Board”) Electricity Distribution Licence ED-2006-0031.

16 Horizon Utilities’ electricity distribution rates were set according to the OEB’s Custom Incentive
17 Regulation (“Custom IR” or “CIR”) methodology for the 2015-2019 period. Horizon Utilities and
18 the Intervenor in the Custom IR Application (EB-2014-0002) (the “Parties”) reached a partial
19 settlement, which was accepted by the OEB. An oral hearing was held on the issues of cost
20 allocation and rate design. The OEB issued its Decision and Order on the outstanding issues on
21 December 11, 2014.

22 Horizon Utilities is about to enter into the third year of its OEB-approved Custom IR plan. On
23 August 11, 2016, Horizon Utilities submitted its second annual filing under its OEB-approved
24 Custom IR plan (the “Annual Filing”), requesting an Order or Orders pursuant to Section 78 of the
25 *Ontario Energy Board Act, 1998* as amended (the “OEB Act”) for approval of its electricity
26 distribution rates and other charges, effective January 1, 2017. Horizon Utilities sought
27 adjustments to 2016 rates, in accordance with the OEB-approved Settlement Agreement and the
28 Decision and Order.

29 On November 16, 2016, OEB Staff and intervenors filed written submissions with the OEB. OEB
30 Staff disagreed with the calculation of the return on equity (“ROE”) for the purpose of the earnings
31 sharing mechanism (“ESM”). Horizon Utilities filed a reply submission November 25, 2016

1 addressing issues raised in the written submissions received from the OEB Staff and three of the
2 four intervenors. Horizon Utilities disagreed with the OEB Staff's position.

3 The OEB found that Horizon Utilities raised some arguments in its reply submission that were not
4 specifically addressed by the OEB Staff and the intervenors. The OEB determined that it would
5 be assisted by additional submissions in order to complete the record in this proceeding. The
6 OEB issued Procedural Order ("PO") No. 2 on December 5, 2016. In the PO, the OEB permitted
7 OEB Staff and intervenors to submit a second written submission limited to the arguments made
8 on the ESM. More particularly, the OEB limited the scope of the additional submissions "*to the*
9 *arguments made on pages 4 to 6 of Horizon's reply submission regarding the calculation of the*
10 *2015 return on equity and applicability of the Earning Sharing Mechanism.*"

11 Horizon Utilities is in receipt of additional written submissions from the following:

- 12 • OEB Staff; and
- 13 • School Energy Coalition ("SEC").

14 Horizon Utilities repeats and relies upon its initial reply submission, and has provided its additional
15 reply submissions below. For the OEB's assistance, the submissions are organized according to
16 the order of matters set out in the OEB Staff submission.

17 **THE CALCULATION OF THE 2015 ROE AND THE APPLICABILITY OF THE ESM**

18 Horizon Utilities' OEB-approved Settlement Agreement provided for a deferral account for
19 earnings in excess of the OEB's annual approved regulatory ROE, as adjusted in the Settlement
20 Agreement. Earnings in excess of the approved ROE would be divided on a 50/50 basis between
21 Horizon Utilities and its ratepayers. Horizon Utilities has calculated an ROE of 9.275% for the
22 purpose of the ESM and stated that no earnings sharing is required for 2015; this ROE is less
23 than the approved ROE.

24 *Original Submissions of OEB Staff, CCC, AMPCO and Horizon Utilities*

25 In its original submission, OEB Staff submitted that all but one of the adjustments made to the
26 regulatory net income in the RRR 2.1.5.6 by Horizon Utilities are consistent with the OEB-
27 approved Settlement Agreement for the purpose of the earnings sharing calculation. Specifically,
28 OEB Staff disagreed with Horizon Utilities' exclusion of an out of period tax adjustment of \$550k
29 from the calculation of net income for the purpose of the earnings sharing calculation. That

1 adjustment related to a Canadian Scientific Research and Experimental Development Tax
2 Incentive Program (SR&ED) Credit pertaining to qualifying expenditures made in 2014. OEB Staff
3 submitted that the Settlement Agreement did not provide for an adjustment for an out of period
4 tax adjustment; therefore, the out of period tax adjustment should be included for the current
5 year's ROE calculation for the purpose of earnings sharing. CCC and AMPCO supported OEB
6 Staff's original submission.

7 Horizon Utilities, in its reply submission, disagreed with OEB Staff's, CCC's, and AMPCO's
8 submissions on the retention of the out of period tax adjustment for the purpose of calculating the
9 ROE. In summary, Horizon Utilities submitted that the tax adjustment should be excluded for the
10 2015 ROE for the following reasons:

- 11 • The tax credit related to activities which Horizon Utilities conducted prior to 2015 and
12 consequently prior to the 2015-2019 rate plan term. It is therefore out of scope for the
13 2015 ROE calculation;
- 14 • The expenses to which the tax credit relates were recorded in years prior to 2015. The
15 expense and related tax credit both need to be recorded in the same term, or else a hybrid
16 approach will result in a one-sided adjustment to the ROE. Furthermore, Horizon Utilities
17 have followed guidance from RRR 2.1.5.6 ROE Complete Filing Guide and identified the
18 tax credit in Horizon Utilities RRR 2.1.5.6 submission;
- 19 • The OEB-approved Settlement Agreement did make provision for an adjustment for out
20 of period tax adjustments. On page 30 of the Settlement Agreement, the parties thereto
21 agreed that *"the regulatory net income will be calculated, for the purpose of earnings
22 sharing, in the same manner as net income for regulatory purposes under the RRR filings"*;
23 and
- 24 • Tax credits were not included in the 2015 PILs used to determine deemed ROE. To include
25 the credit would result in the achieved ROE and the deemed ROE being reported on an
26 inconsistent basis.

27

1 OEB Staff and SEC Additional Submissions:

2 In its additional submission, OEB Staff agrees that the Settlement Agreement states that the
3 regulatory income is to be calculated consistent with the RRR 2.1.5.6 filing. OEB Staff noted:

4 *“The Current Tax Provision as per the Audited Financial Statements (cell fa in the RRR*
5 *2.1.5.6 report) includes the out of period tax adjustment. As noted in its submission,*
6 *Horizon included the \$550k credit in line fa1 which is for information only. However, the*
7 *reported taxes at line fa of \$4M also include the tax adjustment credit and as a result,*
8 *Horizon’s 2015 net income is higher, as is its reported ROE.”*

9 OEB Staff agrees that Horizon Utilities has followed the underlying principle in the ROE Guide,
10 which was referenced by Horizon Utilities in its reply submission. However, OEB Staff submit that
11 the paragraph referenced also states that *“It is each distributor’s responsibility to identify all*
12 *necessary adjustments to the achieved ROE”*. OEB Staff indicate that the 2015 ROE filing did
13 provide other adjustment cells to *“adjust for other adjustments required to determine the current*
14 *tax provision set out in Chapter 7 of the 2006 EDR Handbook and the EDR Handbook Report of*
15 *the Board”*. OEB Staff submitted that Horizon Utilities did not include the \$550K prior year tax
16 credit under any adjustment lines (thus retaining its effect on the achieved ROE) even though the
17 information was already known to Horizon Utilities.

18 OEB Staff agreed with Horizon Utilities’ statement that *“to include the credit would result in the*
19 *achieved ROE and the deemed ROE being reported on an inconsistent basis, which is contrary*
20 *to the clear instructions in the OEB’s ROE Guide.”* and that the deemed ROE in the Custom IR
21 application of 9.3% did not provide for tax credits from prior period adjustments. OEB Staff
22 submitted, however that the Settlement Agreement did not state that the ROE for ESM should be
23 calculated in the same manner as the deemed ROE; rather it stated it should be calculated in the
24 same manner as the reported RRR ROE for 2015, in which Horizon Utilities retained the prior
25 year tax adjustment.

26 OEB Staff agrees with Horizon Utilities that a hybrid approach to out of period tax adjustments,
27 which results in a one-sided adjustment to ROE is not reasonable. The adjustments of the prior
28 period taxes due to reassessments would inevitably impact two or more periods depending on
29 the periods to which the adjustments are related. However, OEB Staff described the issue as one
30 of whether the adjustment should remain in the year in which the adjustment is known to the

1 distributor or should be reallocated to the relevant prior period(s). OEB Staff supports the position
2 of leaving the prior period tax adjustment(s) in the current year for Horizon Utilities for the following
3 reasons:

- 4 • In OEB Staff's view, only this approach will ensure that the 2015 earnings sharing
5 assessment is final.;
- 6 • The \$550k tax adjustment is not material as compared to Horizon Utilities materiality
7 threshold of \$608k; and
- 8 • Within the next few years (either in the rate-setting term or not), there might be more tax
9 reassessments which result in similar amounts of tax adjustments related to 2015 taxes
10 and hence regulatory Net Income and the ROE calculation. OEB Staff asserted that in this
11 case, excluding the tax adjustment in the subsequent years received (Horizon Utilities'
12 proposed approach) would result in a one-side adjustment which is not fair to ratepayers.

13 OEB Staff submitted that the prior tax adjustment of \$550k should not be excluded from the
14 calculation of the ROE for ESM purposes; that the ROE for ESM should be 9.56%; and that
15 Horizon Utilities should record \$251,041 in the ESM deferral account (50% of the difference
16 between the net income at 9.56% and the net income at 9.30%) for future disposition.

17 SEC submitted that:

- 18 • The adjustment to tax proposed by Horizon Utilities should not be allowed unless it can
19 be shown to have been part of the recalculation of tax for a prior year (i.e. a refund
20 cheque), rather than a prior year credit applied to 2015 (i.e. part of the 2015 tax return);
- 21 • The Settlement Agreement does not provide for adjustments for out of period tax impacts,
22 but to conclude that out of period tax adjustment are prohibited based on the theory that
23 only adjustments specifically approved are allowed, is not the intent of the Settlement
24 Agreement. SEC argues that *"the clear intent of the Settlement Agreement is that ROE is*
25 *to be calculated on a regulatory basis, using the normal rules of calculating regulatory*
26 *income"*;
- 27 • SEC argues that Horizon Utilities' position that *"regulatory income will be calculated, for*
28 *the purpose of earnings sharing, in the same manner as net income for regulatory*
29 *purposes under the RRR filings"* means that if the tax credits were not in the tax calculation
30 filed in the Custom IR Application (EB-2014-0002), then they cannot be in the tax

1 calculation for ESM purposes. SEC then asserts that the position it attributes to Horizon
2 Utilities is incorrect for the reasons set out in the SEC submission.

3 SEC's argument relies on the difference between the receipt of a refund cheque versus tax credits
4 that are claimed on the 2015 tax return because of prior year expenses.

5 SEC believes that the OEB should allow Horizon Utilities to file documentary evidence showing
6 the precise nature of the tax credits, and their applicability to either 2015 taxes or taxes for a prior
7 year, with that additional evidence subject to discovery, if necessary.

8 *Horizon Utilities' Reply*

9 Horizon Utilities disagrees with the OEB Staff and SEC submissions that the out of period tax
10 adjustment of \$550k should be included in the 2015 ROE calculation for the purposes of the ESM
11 calculation.

12 OEB Staff provided several reasons that the out of period tax adjustment of \$550k should not be
13 included in the 2015 ROE calculation, and Horizon Utilities addresses those below:

- 14 • OEB Staff concluded that had Horizon Utilities included the tax credit in one of the
15 adjustment cells provided in Appendix 6 of RRR 2.1.5.6, then the ROE submitted in its
16 original application would have been correct (i.e. Board Staff would have concluded that
17 no earnings sharing was required for 2015). Horizon Utilities submits that the inclusion of
18 the tax credit in an adjustment cell in Appendix 6 should not be the criteria for adjusting
19 the ESM for an out of period tax credit. Regulatory net income reported in RRR 2.1.5.6
20 can be adjusted for the purposes of determining earnings sharing as demonstrated by the
21 adjustments to income for the Smart Meter Disposition Rider, the Rate of Return on
22 Stranded Meters and one-time costs incurred from Horizon Utilities' Custom IR
23 Application. In response to the OEB Staff assertion on page 4 of its December 12, 2016
24 submission that Horizon Utilities "has its reasons" for including the prior period tax
25 adjustment, Horizon Utilities submits that it understood that any prior period tax
26 adjustments were to be identified as a memo item in cell fa1 – "*Reassessment of taxes*
27 *from prior years included in current tax provision as per AFS*" and not adjusted for in the
28 Other Adjustments Section. Put another way, Horizon Utilities did not "have its reasons"
29 for including the prior period tax adjustment – on the contrary, its intention was to identify
30 it as an amount related to a prior period which, if included, overstated the 2015 ROE.

1 Horizon Utilities' treatment of this adjustment was in the manner it understood to be
2 required by and in compliance with the OEB's guidelines.

- 3 • OEB Staff suggested that the ROE for earnings sharing purposes be calculated on the
4 same basis as actual regulatory ROE and stated that *"the settlement did not state that the*
5 *ROE for ESM should be calculated in the same manner as the deemed ROE, rather it*
6 *stated it should be calculated in the same manner as the reported RRR ROE for 2015, in*
7 *which Horizon retained the prior year tax adjustment"*. Horizon Utilities disagrees with this
8 statement. The Settlement Agreement does not reference *"reported RRR ROE for 2015"*.
9 The Settlement Agreement states on page 30 that *"regulatory net income will be*
10 *calculated, for the purpose of earnings sharing, in the same manner as net income for*
11 *regulatory purposes under the RRR filings"*. As Horizon Utilities identified in its original
12 reply submission, the ROE Guide issued by OEB Staff in March 2016 states (on page 4)
13 that *"costs and revenues not approved by the OEB in a distributor's previous CoS rate*
14 *proceeding are excluded from the calculation of achieved ROE"*. The SR&ED credit
15 related to prior periods was not included in the 2015 CoS application and therefore should
16 not be included in the determination of the actual ROE for 2015.
- 17 • OEB Staff agrees on page 4 of its additional submission that *"a hybrid approach to out of*
18 *period tax adjustments, which results in a one-side adjustment to ROE is not reasonable"*.
19 However, it appears that this is precisely what OEB Staff is proposing. As Horizon Utilities
20 stated in its original submission, *"The SR&ED expense to which the tax credit relates was*
21 *recorded in years prior to 2015... The expense and related tax credit both need to be*
22 *recorded (i) outside the rate setting term; or (ii) in the rate setting term. Horizon Utilities*
23 *adopted the former approach. A hybrid approach results in a one-sided adjustment to*
24 *ROE."*
- 25 • Contrary to OEB Staff's assertion on page 4 of its additional submission, Horizon Utilities
26 is proposing that the earnings sharing assessment for 2015 be considered final, not that
27 it be open to further potential tax adjustments. The 2015 earnings sharing adjustment
28 should be based on the best available information at the time of filing. The SR&ED credit
29 is a known adjustment that should be recorded in the period to which it relates – that is, a
30 period outside the rate-setting term. Recognizing the SR&ED adjustment in a prior period
31 does not preclude finalizing the 2015 earnings sharing assessment.

1 Horizon Utilities has the following submissions in response to those of SEC:

- 2
- 3 • SEC submitted that the adjustment to tax proposed by Horizon Utilities should not be
4 allowed unless it can be shown to have been part of a recalculation of tax for a prior year.
5 Horizon Utilities confirms that the SR&ED credit of \$550K is part of a recalculation of tax
6 for prior years. The tax credit was reported in amended income tax returns for Horizon
7 Utilities for 2014 and 2013. \$515K of the out of period adjustment was refunded to Horizon
8 Utilities in 2015. The remaining \$35K is a receivable.

9 The nature of the tax credits is a reassessment of tax owing for a prior year; and as such
10 this meets the criteria advanced by SEC for an adjustment to the ESM calculation as
11 identified in paragraph 3a) on pages 3-4 of SEC's reply submission – that is, that the tax
12 credits are “a proper adjustment to the ESM calculation, i.e. excluded from the 2015 tax
13 calculation because they are a part of the tax calculation for a prior year.”

- 14 • As discussed above, SEC asserts that Horizon Utilities interprets the statement in the
15 Settlement Agreement that “*The regulatory net income will be calculated, for the purpose
16 of earnings sharing, in the same manner as net income for regulatory purposes under the
17 RRR filings*” to mean that any tax credits relating to 2015 expenditures would not be
18 applied to the tax calculation for ESM purposes. This is not the case. Rather, Horizon
19 Utilities understands the statement to mean that tax credits relating to expenditures which
20 were incurred in fiscal periods prior to the commencement of the Settlement Agreement
21 should be excluded from the calculation of achieved ROE. SR&ED tax credits related to
22 an IRM year outside the Custom IR period were not included in the calculation of tax for
23 2015 and therefore should be excluded from the calculation of achieved ROE. Further, the
24 expenses that formed the basis for the SR&ED credit were excluded from the calculation
25 of achieved ROE and therefore the associated tax credit should also be excluded.

26 In general, the Settlement Agreement covers the fiscal periods 2015 to 2019 inclusive. The ESM
27 is intended to consider the actual earnings of the corporation during that period, including tax
28 calculations. The corporation computed current income taxes for purposes of the ESM in
29 accordance with the requirements of the Settlement Agreement. The applications for SR&ED
30 income tax credits relate to expenditures that are eligible for the income tax credits in accordance
31 with the Canada Revenue Agency (“CRA”). These expenditures were incurred in fiscal periods
32 2014 and 2013 and the corresponding income tax credits relate to 2014 and 2013; and Horizon
Utilities received a refund for \$515K of the \$550K tax credit. Amounts owed or received in respect

1 of fiscal periods prior to the Settlement Agreement should be excluded from the computations of
2 ESM.

3 **CONCLUSION:**

4 Horizon Utilities submits that for the reasons set out above and in its original reply submission,
5 the prior period tax adjustment of \$550K related to the SR&ED credit for expenditures incurred in
6 2013 and 2014 should be excluded from the calculation of Horizon Utilities' ROE for ESM
7 purposes. Horizon Utilities has adhered to the procedural steps, as defined by the OEB, in this
8 proceeding, and has prepared its 2017 annual update in a manner consistent with the OEB-
9 approved Settlement Agreement and the OEB's policies and guidelines. Horizon Utilities requests
10 that the OEB direct it to prepare a draft Rate Order that implements the requested relief with an
11 effective date of January 1, 2017.

12 Horizon Utilities filed its Annual Filing in advance of the cycle of Incentive Regulation Mechanism
13 applications for 2017. Horizon Utilities believes that there is still sufficient time for the OEB to
14 issue the final Rate Order in advance of the requested January 1, 2017 effective date for electricity
15 distribution rates. This will avoid the need for a forgone revenue rate rider to address the period
16 between January 1, 2017 and the implementation date of the new Rate Order.

17 While the reasons for exclusion of the SR&ED credit from the ESM calculation are clear and, in
18 Horizon Utilities' submission, should be determinative of this issue, Horizon Utilities wishes to
19 make one further observation in this matter. It was an SR&ED credit for a prior period that has
20 prompted these submissions, because the inclusion of that credit in the earnings sharing
21 calculation for 2015 resulted in an ROE that exceeded the OEB-approved ROE. Conceivably, it
22 could have been another form of credit. However, the credit in question related to approved
23 expenditures in the area of scientific research and experimental development. Horizon Utilities is
24 concerned that if half of a credit that serves to encourage investigation and research and,
25 presumably, innovation by an electricity distributor, which in turn has the potential to improve
26 reliability, efficiency and productivity (which ultimately is to the benefit of ratepayers) is to be
27 assigned to ratepayers, this may create a disincentive for initiatives in those areas.

28 Horizon Utilities trusts that it will have the opportunity to make submissions on all Intervenor cost
29 claims in this proceeding.

30

1 **ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 16th DAY OF DECEMBER, 2016.**

2 *Original Signed by Indy J. Butany-DeSouza*

3 Indy J. Butany-DeSouza, MBA

4 Vice-President, Regulatory Affairs

5 Horizon Utilities Corporation