



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

DECISION AND ORDER

EB-2015-0026

B2M LIMITED PARTNERSHIP

Application for an order approving revenue requirements for electricity transmission to be effective January 1, 2015 to December 31, 2019

BEFORE: Emad Elsayed
Presiding Member

Ken Quesnelle
Member and Vice Chair

Ellen Fry
Member

December 29, 2015

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1 INTRODUCTION AND SUMMARY

B2M Limited Partnership (B2M LP) was created to acquire a section of electricity transmission line owned by Hydro One Networks Inc. (Hydro One Networks). The line runs from the Bruce Nuclear Generation Complex to Hydro One's Milton Switching Station.

B2M LP is substantially owned by two different entities. The first is B2M GP Inc., a wholly owned subsidiary of Hydro One Inc., the parent company of Hydro One Networks. The other is Saugeen Ojibway Nation Finance Corporation (SON FC). This corporation is jointly owned by the Chippewas of Saugeen First Nation and the Chippewas of Nawash First Nation.

The B2M LP partnership transaction was finalized on December 17, 2014. At that time B2M LP took ownership of the transmission line from Hydro One Networks. B2M LP and Hydro One Networks entered into an affiliate services agreement for the operation and maintenance of the transmission line.

The Ontario Energy Board (OEB) sets rates for electricity transmitters in Ontario by setting a revenue requirement for each transmitter. These individual revenue requirements are incorporated into the Uniform Transmission Rate (UTR) that recovers the revenue requirements uniformly from ratepayers across the province. The OEB approved an interim 2015 revenue requirement for B2M LP on December 11, 2014 and directed B2M LP to apply for final revenue requirement by April 1, 2015.

B2M LP filed an application with the OEB on March 30, 2015 seeking approval of revenue requirements for 5 years from 2015 to 2019. The revenue requirements sought for each year were \$38.7 million in 2015, \$35.9 million in 2016, \$36.5 million in 2017, \$38.2 million in 2018 and \$37.3 million in 2019. As the line transferred to B2M LP is a small part of the Ontario transmission system, the effect of approving the B2M LP proposed revenue requirements on the average residential customer's bill would be minimal.

The OEB approves B2M LP's application substantially as filed. While the OEB approves the revenue requirement for a five year period, it does not accept the proposal for annual adjustments for tax rate and rule changes or changes in third party charges. However, the OEB does approve a deferral account for tax rate and rule changes and finds that B2M LP is eligible to apply for relief if unforeseen, uncontrollable and material expenses arise during the five year term. The ability to apply for such relief means that the requested unplanned capital spending account is also unnecessary.

The OEB approves the proposals for an annual adjustment to the cost of capital. The OEB will require B2M LP to report annually on measures to track its operational and financial performance, but will not require a scorecard. With respect to the 2015 revenue requirement reconciliation account, the OEB finds that the account is unnecessary, as the reconciliation can be made through an adjustment to the 2016 revenue requirement.

To encourage efficiencies as B2M LP gains experience over the five year term, the OEB will reduce the proposed operations, maintenance and administration budget for 2018 and 2019 by \$50,000 each year.

The OEB will allow the \$7.7 million start-up costs to be recovered from ratepayers considering the circumstances of this case as being a novel and complex commercial arrangement which required significant effort on the part of SON FC and Hydro One Networks to structure and negotiate.

The OEB finds that the prohibition against retroactive or retrospective ratemaking is not present in the current situation where the tax benefits from the ownership structure of B2M LP will benefit the same ratepayers that pay the transaction costs required to create that ownership structure.

2 THE PROCESS

The OEB granted interim approval of a 2015 transmission revenue requirement of \$40,550,714 for B2M LP effective January 1, 2015¹. This interim revenue requirement was removed from Hydro One Networks' 2015 transmission revenue requirement for the purposes of setting the 2015 UTR. B2M LP was directed to file its 2015 revenue requirement application no later than April 1, 2015, and did so on March 30, 2015. The application was updated on June 29, 2015.

The Society of Energy Professionals (SEP) and the Canadian Manufacturers and Exporters (CME) were granted intervenor status and participated actively in the proceeding. CME was approved for cost award eligibility. OEB staff also participated actively in the proceeding.

The OEB provided parties the opportunity to ask B2M LP questions about its evidence in writing through interrogatories, and in person at a technical conference which took place on July 16, 2015. A settlement conference was held on August 11, 2015. No settlement was reached among the parties on any of the issues.

The OEB held an oral hearing on October 30, 2015 and heard submissions from all parties. CME did not make submissions on all issues, but indicated that they accepted the OEB staff position unless they made submissions on a specific issue. SEP made submissions only on the issue of the recovery of start-up costs. The evidence in this case, the reply argument, and the transcripts of the technical conference and the oral hearing can be found on the OEB's website, www.ontarioenergyboard.ca under file number EB-2015-0026.

¹ EB-2014-0330, December 11, 2014

3 STRUCTURE OF THE DECISION

In Procedural Order No. 3, the OEB approved an issues list for this proceeding. Following the settlement conference, parties agreed that they desired additional evidence on only six issues. The parties indicated to the OEB that they could address the remaining issues through argument without the need for further evidence. The OEB determined that it was appropriate to hear evidence at the oral hearing on only the issues on which the parties indicated they desired additional evidence. The full issues list for the proceeding is attached as Schedule A to this Decision.

The issues in dispute among the parties fell into three major areas: the framework of the application (encompassing the 5 year duration, annual adjustments, deferral and variance accounts and monitoring and reporting), operations and maintenance costs, and the start-up costs for the business. In this Decision, the OEB will describe the nature of the B2M LP partnership, and then address each of these major issue areas. The OEB will then address the remaining issues.

4 THE B2M LP PARTNERSHIP

B2M LP is a limited partnership which has acquired from Hydro One Networks a transmission line consisting of a set of continuous transmission circuits running from the Bruce Nuclear Generation Complex to Hydro One's Milton Switching Station. The B2M LP transaction was finalized on December 17, 2014.

As indicated above, B2M LP is owned by two entities. The first is B2M GP Inc., a wholly owned subsidiary of Hydro One Inc. B2M GP Inc. holds the general partner interest and substantially all of Hydro One Inc.'s partnership interests in B2M LP. B2M GP Inc. is responsible for ensuring that the assets of the partnership are operated and maintained in accordance with all applicable regulatory standards and Hydro One Network's transmission maintenance and operating practices, through a comprehensive services agreement with Hydro One Networks.

The other shareholder in B2M LP is Saugeen Ojibway Nation Finance Corporation (SON FC). This corporation is jointly owned by the Chippewas of Saugeen First Nation and the Chippewas of Nawash First Nation. SON FC is an Ontario corporation that has been formed specifically as the vehicle for participation of the First Nations in B2M LP. SON FC holds the partnership interest in B2M LP for the First Nations but has no substantial assets or liabilities other than the financing arranged to fund the acquisition cost of its partnership interest.

SON FC has received advance tax rulings indicating that it will receive the net profit from B2M LP without paying income taxes. The resulting reduction in income taxes in the revenue requirement decreases the cost to ratepayers over the life of the line.

5 FRAMEWORK OF THE APPLICATION

B2M LP requested that the OEB approve its revenue requirements for five years, from 2015 to 2019, the annual adjustments proposed over that 5 year period, proposed deferral and variance accounts, and proposed measures for monitoring and reporting of performance.

OEB staff agreed that approval of revenue requirements for five years is appropriate for this transmitter and is consistent with the direction of OEB policy, which contemplates five-year rate-setting. However, OEB staff argued that the certainty of five years of known revenue should be balanced by a willingness on the part of the applicant to accept some risk over that five year period, and to demonstrate an increase in operational efficiency over the period. OEB staff submitted that those elements are missing in the application as filed, and that the five year approval should be contingent on the imposition by the OEB of appropriate conditions with respect to annual adjustments, deferral accounts, and reporting.

B2M LP submitted that a five year cost of service application is appropriate in this circumstance, as B2M LP owns and operates only one transmission asset. B2M LP stated that its costs are stable, the asset is relatively new and its revenue forecast and spending are stable. B2M LP argued that there is little risk that it can accept and that the most significant risk is an unforeseen catastrophic event which would damage its assets. In its view, a five-year revenue requirement provides certainty to both the utility and ratepayers, and also promotes regulatory efficiency, and therefore is beneficial to ratepayers. A two year approval would not provide the same efficiency and certainty.

Findings

The OEB finds that a five-year approval of revenue requirement is appropriate for B2M LP. This is based on B2M LP's stable revenue forecast, lack of need for investments over this period, and the benefits of rate stability and regulatory cost reduction.

Annual Adjustments

In seeking a five year approval, B2M LP asked for three adjustments to be made in each year during the five year period: a cost of capital adjustment, an adjustment to reflect changing tax rates and rules, and an adjustment for changes in third party pass-through charges.

OEB staff argued that no annual adjustments were required over the period of the rates set.

With regard to the proposed cost of capital adjustment, OEB staff argued that the nature of this transmitter with a stable rate base and a lack of need for investment over the five-year period suggested that a consistent cost of capital would be appropriate. CME disagreed with OEB staff and supported B2M LP's proposal for an annual adjustment for cost of capital.

B2M LP argued in favour of an annual update of cost of capital parameters, to enable it to earn its fair rate of return. In its view, an update would be mechanistic, transparent and fair to both the utility and ratepayers. B2M LP submitted that the OEB has stated a preference for the most recent and relevant data. In its view, a cost of capital update fulfills this objective and is consistent with past OEB practice.

Regarding tax rate and rule changes, OEB staff submitted that the OEB should not approve this annual adjustment if it approves the proposed deferral account for tax rate and rule changes (discussed below), as having both mechanisms would be redundant. Rather than use an annual adjustment, B2M LP could apply to clear the amount in the account if it became too large for the company to support. CME supported OEB staff in this submission.

B2M LP submitted that both an annual update for changes in tax rates and rules and a tax rule and rate changes deferral account are appropriate. The deferral account would capture in-year tax rate changes. The annual update would work to minimize the accumulation of the amounts captured in the deferral account, which would otherwise not be disposed of until the next revenue requirement proceeding.

Concerning the annual adjustment requested for changes in third party pass-through charges, OEB staff submitted that scope of the annual pass through charges and the associated materiality was unclear. OEB staff submitted that annual adjustments should be predictable, mechanistic and automatic, and if there is uncertainty about what should be included or judgment involved in calculating eligible amounts, an annual adjustment is not appropriate. OEB staff suggested that if there is a real risk of a material change in third party pass-through charges, a deferral account could be appropriate, but submitted that the evidence does not show that any real risk exists sufficient to justify an annual adjustment or a deferral account.

While B2M LP continued to request an annual update for third party pass-through charges, it acknowledged that there is no certainty or predictability to changes to these charges and indicated that a deferral account could be equally appropriate.

Findings

The OEB finds that an annual update to the cost of capital would be fair for both the utility and the ratepayers from a risk allocation perspective given that these updates would reflect the most current information, whether it be an increase or decrease. The OEB also agrees that such an update would be mechanistic and transparent. The OEB will also require B2M LP to update its 2016 cost of capital for the 2016 revenue requirement determined by the OEB.

Regarding the proposed tax rate and rule changes annual adjustment, the OEB considers that there is no need for the annual adjustment given that the OEB is approving the proposed tax rate and rule changes deferral account (see Deferral and Variance Accounts section). By having the deferral account without the annual adjustment, the annual regulatory administration effort is minimized while achieving the same result at the end of the five-year period.

Regarding the proposed annual adjustment for changes to third party pass-through charges, B2M LP provided examples such as OEB charges or costs associated with compliance with reliability standards.

The OEB finds that neither an annual adjustment nor a deferral account to capture potential third party pass-through adjustments is warranted. The OEB considers the proposed revenue requirement on the basis of B2M LP's forecast of known costs. B2M LP has characterized the types of costs that would be captured in this adjustment or account as being required costs and beyond its ability to control. The OEB considers these types of costs to be similar to the unplanned capital costs that are also not included in the proposed revenue requirement. The OEB has determined that unplanned capital costs are best dealt with through a Z-factor approach² (see next section).

The Z-factor approach recognizes that the risk of material unforeseen costs being incurred for reasons beyond the company's control always exists. The Z-factor approach embodies a materiality threshold of 0.5% of the revenue requirement and is calibrated to align with what the OEB considers a reasonable level of cost absorption risk that a company should be exposed to. If a third party pass-through cost was to exceed the materiality threshold established in the Z-factor approach, B2M LP would be eligible to apply to the OEB for revenue relief. The OEB finds that a Z-factor approach

² The "Z-factor approach" is the policy of the OEB that allows a request to recover costs associated with unforeseen events that are outside the control of a distributor's ability to manage and cause a material impact, such as damage that is the result of a storm.

for changes to third party pass-through charges would be more appropriate than an annual adjustment.

Deferral and Variance Accounts

B2M LP requested the approval of three new deferral/variance accounts as part of the five year approval: an unplanned capital spending account, a tax rate changes account and a 2015 revenue requirement reconciliation account.

A deferral account tracks the cost of a project or program for which a forecast was not included in the rates set. When the costs are known, the utility can request permission to recover the costs in future rates. Variance accounts track the difference between the forecast cost of a project or program, which has been included in rates, and the actual cost. If the actual cost is lower, the excess is refunded to customers. If the actual amount is higher, the excess may be recovered in future rates.

The proposed unplanned capital spending account was intended to cover unforeseen events that are outside of management's control and would prompt a material increase in capital spending.

OEB staff argued against approval of this account. OEB staff acknowledged that B2M LP's circumstances are unusual in that they have no planned capital spending, and they do not have a portfolio of assets over which to spread the consequences of an unforeseen event. However, OEB staff submitted that a Z-factor approach, similar to that explicitly provided for electricity distributors, would address the risk without having to create a deferral account. OEB staff recommended a materiality threshold of 0.5% of revenue requirement (approximately \$200,000).

CME argued that the amount of deferral account protection that is proposed in this application seems excessive, given the amount of risk that is actually being assumed. CME acknowledged that the risk of an unanticipated and significant event exists over the five year period, but agreed with OEB staff that a Z-factor policy would be the best way to address the risk. CME also agreed with the \$200,000 materiality threshold suggested.

The proposed tax changes account would cover changes in tax rules and policy as well as any differences from the advance rulings obtained by B2M LP from the tax authorities. OEB staff submitted that the OEB should approve this proposed account. OEB staff submitted that this approach would have the advantage of enabling the OEB to examine the prudence of actions leading to any recorded costs at the time of disposition of the account. CME agreed with OEB staff.

The 2015 revenue requirement reconciliation account was proposed to allow B2M LP to record the difference between the final approved 2015 revenues to be recovered and the revenues received under the interim order. OEB staff supported the proposal for a 2015 revenue requirement reconciliation account.

B2M LP, as noted above, while still arguing for an unforeseen capital spending account, indicated that a Z-factor as suggested by OEB staff would address the risk it has identified. B2M LP submitted that a deferral account would be more efficient because it would eliminate the need for an additional application if an unforeseen capital spending event occurred.

Findings

The OEB agrees that the risk of unplanned capital spending needs to be addressed given that B2M LP has no planned capital spending and only one transmission asset, and therefore would find it very difficult to absorb the consequences of an unforeseen event. However, the OEB agrees with OEB staff and CME that a Z-factor approach, would be more appropriate for this purpose than a deferral account

As indicated under Annual Adjustments section, the OEB finds that a tax changes deferral account is appropriate. The OEB also agrees with OEB staff that using a deferral account would have the advantage that costs recorded in this account will be subject to prudence review at the time of disposition of the account.

With respect to the proposed 2015 revenue requirement reconciliation account, the OEB understands the purpose of the account at the time the request was made. However, given the date of this Decision, the OEB will require B2M LP to calculate the difference between the interim and final 2015 revenues, and refund or recover the difference through an adjustment to the 2016 revenue requirement. An account to record this amount is therefore unnecessary.

Monitoring and Reporting

B2M LP proposed the tracking and annual reporting of four outcome measures: system average interruption frequency, system average interruption duration, average system availability, and North American Electric Reliability Corporation vegetation management compliance.

OEB staff agreed with the reporting of these measures but suggested that B2M LP also report a unit cost measure of efficiency: operations, maintenance and administration costs per kilometre of line. OEB staff also submitted that B2M LP should file a draft scorecard similar to those used by Ontario's electricity distributors, as it would be useful to have a scorecard that reflects the circumstances of this transmitter.

B2M LP indicated that it would be prepared to report on the operations, maintenance and administration costs per kilometre of line measure. However, B2M LP argued that it did not believe that filing an annual scorecard is appropriate, as a scorecard has not yet been established by the OEB for electricity transmitters and would be difficult to create for B2M LP as an operator of a single double circuit transmission line.

Findings

Given the fact that the OEB is approving B2M LP's revenue requirement for five years, it is important to have robust reporting to monitor B2M LP's performance until its next rate application. The OEB agrees that annual reporting of the four outcome measures proposed by B2M LP is appropriate. It also finds that B2M LP should report annually on the operations, maintenance and administration cost per kilometer of line as a measure to track its continuous improvement in cost efficiency. The OEB will not require B2M LP to file a draft scorecard at this time.

6 OPERATIONS, MAINTENANCE AND ADMINISTRATION COSTS

B2M LP proposed Operations, Maintenance and Administration (OM&A) expenses over the five year period of the application, from 2015 to 2019. The proposed OM&A levels are shown in the table below:

Table 1
Operations, Maintenance and Administration Expenses
2015 – 2019

OM&A Costs, \$ millions	Forecast				
	2015	2016	2017	2018	2019
Service Level Agreement with Hydro One Transmission					
- Operations and Maintenance Expenses	0.7	0.5	0.5	1.8	0.6
- Administration and Corporate Expenses	0.2	0.2	0.2	0.2	0.2
Total	0.8	0.7	0.7	2.0	0.8
Incremental Expenses					
- Insurance	0.1	0.1	0.1	0.1	0.1
- Regulatory	0.3	-	-	-	0.3
- Administration	0.1	0.1	0.1	0.1	0.1
- Managing Director's Office	0.5	0.2	0.2	0.2	0.2
Total	1.0	0.5	0.5	0.5	0.8
TOTAL OM&A	1.8	1.2	1.2	2.5	1.5

The OM&A costs cover the services provided by Hydro One Networks through a service agreement.

The largest changes in the OM&A plan are the increase in costs due to the maintenance of the right-of-way including the control and clearing of brush in 2018. Regulatory costs increase in years when an application before the OEB is expected. Costs for the Managing Director's Office are highest in 2015 and reflect the set-up of that office.

OEB staff submitted that the evidence indicated that under B2M LP's contract with Hydro One Networks any efficiencies found by Hydro One Networks would be passed through to B2M LP, but the savings would not be passed through to transmission ratepayers as the revenue requirement for B2M LP is fixed for five years. OEB staff

submitted that reducing B2M LP's OM&A expenses by an amount equivalent to a stretch factor³ of 0.3 percent per year would be appropriate to provide some benefit of efficiency to ratepayers and incent productivity improvement. CME supported OEB staff's proposal.

In addition OEB staff submitted that the costs for the managing director's office in 2015 and 2016 had not been adequately justified. OEB staff also noted that B2M LP received revenue in 2014 of over \$1.6 million, and submitted that this revenue should be used in part to offset the costs in operations and maintenance rather than being directed to the debt payments and dividend payments.

B2M LP indicated that while any efficiencies gained by Hydro One Networks will be passed through to B2M LP, any additional expenses would be borne by B2M LP as well. B2M LP also submitted that the stretch factor proposed by OEB staff is inappropriate, as only a small portion of the revenue requirement relates to operational costs. B2M LP argued that its operational costs are low and it would be impossible to realize the savings proposed by OEB staff, as that would amount to 5 -10% of its total annual OM&A.

B2M LP also disagreed with the OEB staff submission that 2014 revenues be used to offset OM&A costs in 2015. B2M LP argued that its predominant cost is the return on equity and it is appropriate that the revenues earned be used towards paying dividends. In addition, the costs of establishing the managing director's office are necessary and appropriate, as B2M LP is a separate legal entity with separate business requirements.

Findings

The OEB expects utilities to take a continuous improvement approach to increase productivity. As B2M LP gains experience working with Hydro One Networks during the five year period, the OEB expects B2M LP to find opportunities for efficiency gains, and ratepayers should benefit from these gains. This may take some time to materialize, given that this is a start-up company. Accordingly, the OEB will impose a reduction in OM&A of \$50,000 in 2018, the fourth year of the period, which would be carried through into 2019 OM&A. The \$50,000 reduction represents 2.0% of the 2018 budget and 3.3% of the 2019 budget.

³ A stretch factor is intended to reflect the incremental productivity gains that a utility is expected to achieve under incentive regulation and is a common feature of incentive regulation plans. A stretch factor may be implemented through a percentage reduction applied to the real, constant dollar value of the utility's revenue requirement to encourage the utility to find efficiencies in its operations.

7 START-UP COSTS

B2M LP is claiming start-up costs incurred in 2012-2014 for developing and implementing the organizational structure established for B2M LP. The costs claimed were \$7.7 million in total. B2M LP proposed that these costs be recovered over a four year period, with \$1.925 million being recovered in each of 2016, 2017, 2018 and 2019.

The start-up costs were made up of the following:

- Advice on formulation of the partnership structure
- Legal fees to assist in the negotiation and draft the requisite agreements
- Tax advice to determine an optimal tax structure and to obtain the tax rulings from federal and provincial tax authorities
- Advice and fees to procure partnership financing
- Regulatory counsel to represent the applicants before regulatory bodies and provide advice on appropriate corporate setup
- Other administrative support for filings and related matters.

The start-up costs are shown in Table 2:

Table 2
Summary of Start-Up Costs
(\$ million)⁴

<u>Description</u>	<u>Cost</u>
Legal Costs for SON	4.3
Legal Costs for Hydro One	1.8
Inergi Set Up Costs	0.6
Hydro One Initial Costs	1.0
Total	7.7

⁴ The Inergi set up costs relate to the information technology system set up for B2M LP.

The evidence submitted by B2M LP indicated that it had a unique structure that was designed to allow for the equity participation of two First Nations affected by the Bruce to Milton transmission line project.

B2M LP indicated that given the non-taxable status of the two First Nations, this structure provides a benefit to ratepayers over the long term through the reduced effective tax rate of the transmitter. B2M LP submitted that if ratepayers are the beneficiary of the savings that result due to this transaction, then it is only appropriate that recovery of the costs to set up the transaction be recovered in rates.

OEB staff argued that the start-up costs should not be recovered from ratepayers. OEB staff submitted that commercial ventures must be willing to invest some money in hopes of future profit. The B2M LP venture was not set up just for the benefit of ratepayers, but also to enable the transmission company to establish itself. OEB staff pointed out that in the East West Tie proceeding (EB-2011-0140) the OEB did not allow recovery of costs to set up the designated transmitter.

OEB staff also submitted that to allow recovery of the start-up costs would constitute retroactive ratemaking, as the start-up costs sought to be recovered were incurred prior to the B2M LP interim rate order. The Uniform Transmission Rates, finalized in previous rate orders, included the recovery of costs of the transmission line as part of the revenue requirement of Hydro One Networks. OEB staff argued that the case law holds that a regulator like the OEB, operating under a positive approval scheme of ratemaking, must exercise its ratemaking authority on a prospective basis.

OEB staff submitted that the critical factor for determining whether a regulator is engaged in retroactive ratemaking is the parties' knowledge that the rates were subject to change. Two mechanisms that allow recovery of costs incurred in a prior period are a deferral account or an interim rate order. No deferral account existed in this case, and the interim rate order was made on December 1, 2014, after the majority of the start-up costs were incurred. However, OEB staff submitted that an order for recovery of past costs can be made in the absence of these mechanisms if the affected parties had knowledge that the previous rates were subject to change.

OEB staff pointed out that the B2M LP licence application was filed on March 28, 2013, along with the asset transfer application⁵. The evidence in this application shows that over \$1.8 million in costs had been incurred by that point, but the licence application indicated that the start-up costs were still estimated to be \$1 million (although an interrogatory in that proceeding gave an estimate of over \$2.4 million). OEB staff

⁵ EB-2013-0078.

suggested that B2M LP could have made an earlier licence application or could have sought a deferral account to ensure that these costs could be appropriately treated.

OEB staff acknowledged that one reason for the rule against retroactive ratemaking was not a concern in this case. No inter-generational inequity would occur if the start-up costs were recovered, as the future ratepayers who would pay the costs are also the beneficiaries of the savings resulting from the expenditure.

CME took no position on the retroactive ratemaking issue as raised by OEB staff but concentrated its submissions on the quantum of costs claimed. CME argued that there was clearly knowledge within the partnership that start-up costs would significantly exceed \$1 million. CME submitted that there may not have been as much rigour in the examination of these costs as is done in other cases but also indicated that there are benefits of this enterprise for both sides; the applicant and ratepayers. CME therefore argued that the start-up costs should be divided in half and that an amount of \$3.85 million be included in the final revenue requirement.

SEP argued that the benefits of the B2M LP project for ratepayers are real and when considered in light of the potential costs if this project had not been pursued, the value to the ratepayers is even higher. SEP submitted that all of the start-up costs should be recoverable.

B2M LP argued that there is no element of retroactive ratemaking in this case, as no rates were in place for B2M LP other than those declared interim on December 11, 2014. B2M LP was not in existence until the partnership agreement was signed and the assets transferred on December 17, 2014. B2M LP submitted that the recovery of start-up costs would have no effect whatsoever on past UTRs.

B2M LP stated that it was always understood that B2M LP would seek recovery of the start-up costs, and that the initial cost estimate of \$1 million given in the licence application was preliminary. As the project developed, costs were revised. The estimate of SON's costs was revised to \$2.4 million (participant funding agreement dated June 12, 2012 and filed with OEB June 27, 2013), and then ultimately to \$4.3 million (letter of renegotiation of SON costs dated October 8, 2014 and filed with OEB November 4, 2015). B2M LP submitted that the costs were tracked and clearly defined, and submitted that there is no practical negative impact resulting from the absence of a formal deferral account.

B2M LP argued that there is no principled basis for accepting CME's argument for disallowance of half of the costs. B2M LP stated that the costs were incurred in a careful and prudent way and were necessary to bring into existence a novel and complex commercial arrangement. Unforeseen complications and delays arose, and

expert advice was necessary to resolve contractual, financial, tax and regulatory issues over a three year period. B2M LP asked that the OEB adopt the presumption of prudence as no evidence of imprudence was offered.

Findings

The OEB finds that the prohibition against retroactive or retrospective ratemaking does not prevent the inclusion of the transaction costs in B2M LP's revenue requirement and hence in the UTR effective January 1, 2015, because it allows for the matching in time of the transaction costs and tax benefits of the transaction. As discussed below, this is consistent with OEB policy on changes in system ownership.

The parties structured the transfer of B2M LP assets from HONI to B2M LP to ensure that tax savings available to B2M LP would offset the transaction costs to transfer the assets and set up B2M LP. It was clear from the application for approval of B2M LP's licence and the asset transfer that the parties were seeking to include the transaction costs in B2M LP's future revenue requirement and hence in future UTRs.

When the OEB approved the transfer of assets, it indicated that given that this was a change in ownership of part of a transmission system, the "no harm" test should apply, although this was an application to dispose of assets rather than consolidate. The offsetting of transaction costs via tax savings was a key element in the OEB's approval of the transfer of the assets.

In consolidation transactions, the OEB's policy allows applicants to recover transaction costs. This is achieved by allowing applicants to retain productivity gains (subject to earnings sharing above a certain level) for up to ten years. The question of prohibited retroactive or retrospective rates does not arise because the transaction costs are not incorporated into rates.

However, in the current situation, incorporating the transaction costs into rates is the only mechanism now available to allow them to be recovered.

The transaction and start-up costs were incurred in 2012 to 2014. However B2M LP, as a new transmitter, will have its revenue requirement approved and incorporated into the UTR effective January 1, 2015. Accordingly, the request is to include the transaction and start-up costs from 2012 to 2014 in rates starting in 2016 (subject to smoothing). Although the revenue requirement for the transmission line was being recovered through the UTR since its energization, it was part of the revenue requirement of Hydro One, not B2M LP. This is not a situation that the OEB has encountered previously.

B2M LP's revenue requirement was not included in the UTR prior to 2015 and the OEB finds that in this case the request for recovery of the start-up costs does not constitute

retroactive ratemaking. However, it does raise a potential issue of retrospective ratemaking. Retrospective rate-making is ostensibly prospective, as it sets rates only for the future, but the future rates it sets are designed not only to meet future costs but also to recover past costs. The case law indicates that:

Retrospective ratemaking, in contrast, imposes on the utility's current consumers shortfalls (or surpluses) incurred by previous generations of consumers. It is generally prohibited because it creates inequities or improper subsidizations as between past and present consumers (who may not be the same). "[T]oday's customers ought not to be held responsible for expenses associated with services provided to yesterday's customers": Yvonne Penning, "*The 1986 Bell Rate Case: Can Economic Policy and Legal Formalism be Reconciled*" (1989), 47(2) U.T. Fac. L. Rev. 607 at 610. This is sometimes referred to as the problem of inter-generational equity.⁶

In other words, the intent is to avoid a mismatch in time between revenues and expenses.

However, the basis for the prohibition against retrospective ratemaking is not present in the current situation. To the contrary, it is a situation where the tax benefits from the ownership structure of B2M LP will benefit the same ratepayers that pay the transaction costs required to create that ownership structure. There is no mismatch between payors and beneficiaries.

The OEB will allow the \$7.7 million start-up cost to be recovered in rates. In allowing this very significant amount, the OEB has taken into consideration the circumstances of this case as being a novel and complex commercial arrangement which required significant effort on the part of SON FC and Hydro One Networks to structure and negotiate.

However, the OEB notes that more effort should have been directed to tracking and controlling these costs. As indicated by B2M LP at the hearing⁷, B2M LP and its component parties may not have had a clear picture of the actual cost at any given time, which would make it difficult to control and project future costs. It is the OEB's expectation that better cost tracking and control measures will be put in place in similar future transactions.

⁶ City of Calgary and Alberta Energy and Utilities Board and ATCO Gas and Pipelines Ltd., 2010 ABCA 132.

⁷ Transcript of the hearing October 30, 2015 at pages 65 – 67.

The OEB also expects that should it receive an application for a similar transaction in the future, experience in structuring such a transaction will result in lower start-up costs.

8 REMAINING ISSUES

As mentioned above, there were a number of uncontested issues in this proceeding. These are addressed below.

Issue 1.1

Has B2M LP responded appropriately to all relevant Board directions from previous proceedings?

The only OEB direction that B2M LP was to respond to was the direction to file its application for final rates by April 1, 2015.

The OEB finds that B2M LP complied with this direction.

Issue 3.2

Are the methodologies used to allocate common corporate costs for 2015 to 2019 appropriate?

B2M LP used the same methodology accepted by the OEB in Hydro One Network's last transmission rates application which was based on a Black and Veatch study. The OEB finds that this methodology is appropriate.

Issue 4.1

Are the amounts proposed for rate base in 2015 to 2019 appropriate?

B2M LP provided evidence showing that the average net fixed assets removed from the Hydro One Networks transmission rate base is equal to the average net fixed assets of the opening B2M LP rate base and has also indicated there is no need for a working capital allowance. In addition, B2M LP does not anticipate any capital expenditures over the five-year period of this application.

The OEB finds that the amounts proposed for rate base in 2015 to 2019 are appropriate.

Issue 5.1

Are the business assumptions and policies used by B2M LP to develop and allocate its revenue requirements appropriate?

The OEB finds that the B2M LP business assumptions and policies are acceptable, as they are based on the corporate cost allocation methodology accepted by the OEB in

the recent Hydro One Networks transmission application and updated for this application, again using a study prepared by Black & Veatch.

Issue 5.2

Is the capital structure and cost of capital component of the revenue requirement for 2015 appropriate?

B2M LP proposed the standard OEB deemed capital structure of 40 percent equity, 56 percent long-term debt, and 4 percent short-term debt. The proposed 2015 return on equity and short-term debt are based on the OEB's cost of capital parameters for 2015 applications. When the transfer of the assets was complete, B2M LP issued a note bearing Hydro One Network's weighted average debt rate. Hydro One Networks provides treasury services to B2M LP, and in obtaining dedicated financing for B2M LP, it issued a note in the second quarter to third party public debt investors with a lower debt cost, reducing B2M LP's average weighted debt rate.

The OEB finds that the capital structure component of the revenue requirement for 2015 to be appropriate, subject to the annual cost of capital adjustment discussed above.

Issue 5.3

Is the depreciation component of the revenue requirement for 2015 to 2019 appropriate?

B2M LP provided a depreciation study prepared by Foster Associates, which is the same firm that prepared Hydro One Networks' depreciation studies for its most recent transmission revenue requirement case. This methodology was accepted in that case by the OEB. The resulting depreciation expense is \$6.8 million and does not change over the five-year period, as no assets are being added to the pool of assets to be depreciated.

The OEB finds that the depreciation component of the revenue requirement for 2015 to 2019 to be appropriate.

Issue 5.4

Is the taxes / PILs component of the revenue requirement for 2015 to 2019 appropriate?

The B2M LP Payments in Lieu of Taxes (PILs) were calculated based on the assumption that 34.19 percent of the net income is not subject to tax. This assumption is based on the four advance rulings received from the tax authorities, The OEB finds that the taxes / PILs component of the revenue requirement for 2015 to 2019 to be appropriate.

Issue 7.1

Is the cost allocation proposed by B2M LP appropriate?

B2M LP has classified its assets as network assets for purposes of calculation in the Uniform Transmission Rates, consistent with the allocation methodology approved by the OEB for Hydro One Networks Transmission. As there are no customer delivery points supplied directly from the B2M LP assets, the B2M LP network charge determinant for the purpose of setting the Uniform Transmission Rates is zero.

The OEB finds that the cost allocation proposed by B2M LP to be appropriate.

Issue 8.1

Are the bill impacts of this application appropriate?

As a result of the B2M LP application, the estimated change in the average residential customer's monthly bill is zero in 2015, a four cent decrease in 2016, a one cent increase in 2017 and 2018, and a one cent decrease in 2019.

The OEB finds that the bill impacts of B2M LP's application to be appropriate.

9 ORDER

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. B2M LP shall prepare exhibits showing the final revenue requirements for each of 2015, 2016, 2017, 2018 and 2019 reflecting the OEB's findings in this Decision. B2M LP must provide a clear explanation of all calculations and assumptions used in deriving the amounts used in these exhibits.

The calculation of the 2016 revenue requirement must include:

- an update to the cost of capital to reflect the OEB's 2016 cost of capital parameters, and
- an increase or reduction consistent with the calculation of the difference between the interim and final 2015 revenue requirement.

The calculation of each of the 2018 and 2019 revenue requirements must include a reduction in the OM&A budgets of \$50,000.

2. B2M LP shall prepare a draft accounting order for the Tax Rate and Rule Changes deferral account as approved in this Decision.
3. B2M LP shall file the exhibits and the draft accounting order no later than **January 7, 2016**.
4. Intervenors or OEB staff who wish to comment on the exhibits or draft accounting order must do so by filing a submission with the OEB and copying it to B2M LP no later than **January 11, 2016**.
5. If B2M LP wishes to reply to any comments received, it must do so no later than **January 12, 2016**.
6. B2M LP shall make an application in each of 2016, 2017 and 2018 to adjust its revenue requirement for the following year consistent with the OEB's updated cost of capital parameters. At the same time, B2M LP will report on the five outcome measures as required in this Decision.
7. CME shall file with the OEB and forward to B2M LP its cost claim within **21 days** from the date of issuance of this Decision and Order.

8. B2M LP shall file with the OEB and forward to CME any objections to the claimed costs within **28 days** from the date of issuance of this Decision and Order.
9. CME shall file with the OEB and forward to B2M LP any response to any objections to the cost claim within **35 days** of the date of issuance of this Decision and Order.
10. B2M LP shall pay the OEB's costs incidental to this proceeding upon receipt of the OEB's invoice.

All filings to the OEB must quote the file number, EB-2014-0101, be made in searchable / unrestricted PDF format electronically through the OEB's web portal at

<https://www.pes.ontarioenergyboard.ca/eservice/>. Two paper copies must also be filed at the OEB's address provided below. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at

<http://www.ontarioenergyboard.ca/OEB/Industry>. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

All communications should be directed to the attention of the Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date. With respect to distribution lists for all electronic correspondence and materials related to this proceeding, parties must include the Case Manager, Harold Thiessen at Harold.Thiessen@ontarioenergyboard.ca and OEB Counsel, Jennifer Lea at Jennifer.Lea@ontarioenergyboard.ca.

ADDRESS

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DATED at Toronto **December 29, 2015**

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary

SCHEDULE A
DECISION AND ORDER
B2M LIMITED PARTNERSHIP
EB-2015-0026
DECEMBER 29, 2015

B2M Limited Partnership
2015-2019 Transmission Rate Application
EB-2015-0026
Approved Issues List

1.0 GENERAL

- 1.1 Has B2M LP responded appropriately to all relevant Board directions from previous proceedings?
- 1.2 Is the overall increase in 2015 to 2019 revenue requirement reasonable?

2.0 APPLICATION FRAMEWORK

- 2.1 Is the proposed framework of a five year cost of service application appropriate?
- 2.2 Are B2M LP's proposed annual adjustments appropriate?
- 2.3 Is the monitoring and reporting of performance proposed by B2M LP adequate to demonstrate whether the planned outcomes are achieved?

3.0 OPERATIONS MAINTENANCE and ADMINISTRATION COSTS

- 3.1 Are the proposed spending levels for OM&A in 2015 to 2019 appropriate, including consideration of factors such as system reliability and asset condition?
- 3.2 Are the methodologies used to allocate common corporate costs for 2015 to 2019 appropriate?

4.0 CAPITAL EXPENDITURES and RATE BASE

- 4.1 Are the amounts proposed for rate base in 2015 to 2019 appropriate?

5.0 REVENUE REQUIREMENT

- 5.1 Are the business assumptions and policies used by B2M LP to develop and allocate its revenue requirements appropriate?
- 5.2 Is the capital structure and cost of capital component of the revenue requirement for 2015 appropriate?
- 5.3 Is the depreciation component of the revenue requirement for 2015 to 2019 appropriate?
- 5.4 Is the taxes / PILs component of the revenue requirement for 2015 to 2019 appropriate?
- 5.5 Is the proposed recovery of start-up and development costs appropriate? Is the proposed smoothing methodology for the start-up and development costs over the test years appropriate?

6.0 DEFERRAL/VARIANCE ACCOUNTS

6.1 Are the proposed new Deferral and Variance Accounts appropriate?

7.0 COST ALLOCATION

7.1 Is the cost allocation proposed by B2M LP appropriate?

8.0 BILL IMPACTS

8.1 Are the bill impacts of this application appropriate?