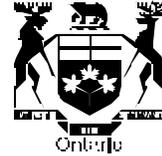


**Ontario Energy
Board**
P.O. Box 2319
2300 Yonge Street
26th. Floor
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

**Commission de l'Énergie
de l'Ontario**
C.P. 2319
2300, rue Yonge
26e étage
Toronto ON M4P 1E4
Téléphone; 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273



September 17, 2001

To: All Electricity Distribution Companies

**Re: Immediate Pass-through of 2001 s. 93 PILs for Utilities Claiming
Financial Distress**

The Board's correspondence of August 24, 2001 indicated that local electricity distribution companies ("LDCs") should add the amount of their upcoming 2001 section 93 payments in lieu of taxes ("PILs") to their application for annual rate adjustments to be effective March 1, 2002 and that further details on this approach will be provided after consultations.

The Board also stated it was mindful that LDCs will face an increased cash flow burden for a few months under the above approach, and that utilities which can demonstrate financial distress would be provided with an opportunity to adjust their rates to include provisions for PILs based on their annualized 2001 PILs estimates. This correspondence will explain the suggested methodology to be followed in these circumstances.

While the PILs consultation process proceeds, the Board has set out two methods to adjusting rates to incorporate 2001 PILs. Utilities are cautioned that the methods outlined below may be modified as a result of the consultation process to a single, new tax gross-up methodology for use in the March 1, 2002 adjustments. Both methods used to incorporate a 2001 PILs provision into rates assume that the amount of PILs which can be passed on through distribution rates will be limited to the "wires-only" activities. For purposes of immediate applications to increase rates to reflect 2001 PILs due to financial distress, utilities are free to choose the approach that proves most suitable to their specific circumstances.

Please note that in the correspondence of August 24 the Board indicated that it would be discussing the mechanics of a deferral account at its upcoming consultation process. Whatever methodology results from the consultation process will be applied consistently to all utilities, and this may result in a variance to be recorded in a deferral account.

Method 1) Use Own 2001 PILs Estimate

The Board understands that in order to calculate the first PILs instalment due on October 31, 2001, LDCs must first estimate their total section 93 PILs liability for the 2001 short tax year. As most utilities have a calendar year-end, the 2001 tax year will generally cover the period October 1, 2001 to December 31, 2001.

Under this method, the applicant would use the 2001 PILs estimate produced for instalment purposes to generate an annualized tax gross-up figure for insertion into the current rate year RUD model. Detailed instructions are attached. Please note that utilities are required to provide their background tax calculations to support the estimates filed.

Method 2) Use (Revised) Tax Gross-up Formula

The current RUD model (sheet 8 - MARR with taxes) includes a tentative income tax gross-up formula. The Board has revised and expanded this calculation (for example, a capital taxes estimate was added), and therefore the present version of sheet 8 should not be used. A new formula is set out in a spreadsheet available for downloading at the Board's Web site (under "What's New?"). The final product of the formula is a dollar figure that should be manually inserted, in sheet 8 of the RUD model filed in the distribution rate unbundling application (at "MARR with taxes minus MARR without taxes"), as the 2001 tax gross-up amount. Detailed instructions are contained in the spreadsheet.

Under both methods, LDCs will be required to re-run the RUD model filed with the unbundling application. The other data contained in the original model should not be changed (in other words, inserting a new tax figure at sheet 8 is the only change required).

Once the RUD model is re-run, it will generate a new set of rates. Applicants should file the new RUD model and revised 2001 rates schedules (see attached checklist).

Procedural Directions

The Board will treat any application for immediate pass-through of 2001 PILs as an amendment to the utility's rate application. Applicants will not be required to publish a new notice of application in conjunction with this rate adjustment, as the notice of applications previously published referred to the further phases of proceedings and to the future imposition of PILs.

Three copies of all supporting material must be filed with the Board's Secretary in the usual manner. A suggested covering letter, that formally requests an amendment, is

attached.

The Board directs that the applicant serve a copy of its submissions on all interveners and on all municipalities within its service area. A draft covering letter to accompany that material is attached and should be completed.

Unless otherwise necessary, the Board will process any applications received by way of written hearing.

Utilities requiring further information or guidance on these matters should contact John Vrantsidis (416 481-1967 or toll free, 1-888-632-6273) or e-mail at vrantsjo@oeb.gov.on.ca

Yours truly,

Peter O'Dell
Assistant Board Secretary

Covering Letter for 2001 PILs Financial Distress Application

Date

Mr. Paul Pudge
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street
26th Floor
Toronto, Ontario
M4P 1E4

Re: [Insert: "*Electricity Distributor's Name*"]
File Number RP [Insert: File Number - e.g. 2000-XXXX]

Dear Mr. Pudge:

Section 93 of the *Electricity Act, 1998* will impose payments in lieu of taxes, commencing on October 1, 2001, upon local electricity distributors that were previously exempt from income and capital taxes.

As our utility will experience financial distress as a result of the new payments due to the Province, please consider this letter an amendment to our existing rate application, file number RP [Insert: File Number - e.g. 2000 -XXXX] to enable us to recover this added cost from our customers as of [Insert: date requested; no earlier than October 1, 2001].

[Insert: "*Electricity Distributor's Name*"] hereby applies to use the Board's standard method of implementation number [Insert: 1 or 2] as the basis for this increase. The procedural checklist issued by the Board has been completed and attached, as well as the supporting material required under the implementation method chosen.

A complete copy of the material filed in support of this amendment will be served on all interveners of record and on all municipalities within our service area.

For additional information regarding this application, [Provide: contact name] may be contacted at [Provide: telephone number and any email address].

Yours truly,

[Provide: Signing Officer Name]

[Provide: Position]

[Provide: Electricity Distributor's Name]

[Provide: License Number]

attachment(PILs Checklist)

2001 s. 93 PILs RATE ADJUSTMENT CHECKLIST

1. Documentation to establish financial distress.
2. Choose rate adjustment Method 1 or Method 2.
3. Provide either:
utility's own supporting tax calculations (Method 1)
or
completed Board-issued tax gross-up spreadsheet (Method 2)
4. Provide hard and electronic copy of RUD Model run after tax gross-up figure inserted.
5. Provide manager's summary and proposed new 2001 rates schedule.

Required Covering Letter to Interveners

Date

[To each intervener in original unbundling application,
and to all municipalities within service area]

Re: [Insert: "*Electricity Distributor's Name*"]
File Number RP [Insert: File Number - e.g. 2000-XXXX]

Dear Sir/Madame:

Section 93 of the *Electricity Act, 1998* will subject previously income tax-exempt local electrical distributors to payments in lieu of taxes commencing October 1, 2001.

As we believe our utility will experience financial distress as a result of the new payments due to the Province, we have applied to the Board for an amendment to our existing rate application, file number RP [Insert: File Number - e.g. 2000-XXXX], to enable us to recover this added cost from our customers as of [Insert: date requested; no earlier than October 1, 2001].

Please find attached a complete copy of the material filed in support of this amendment. This material will be served on all interveners of record and on all municipalities within our service area.

The Board has directed that any comments should be filed with the Board's Secretary, within two weeks of the date of this letter, at the address shown below.

For additional information regarding this application, the applicant or Board may be contacted at the addresses provided below.

Yours truly,

[Provide: *Signing Officer Name*]

[Provide: *Position*]

[Provide: *Electricity Distributor's Name*]

[Provide: *License Number*]

Addresses

Ontario Energy Board
P.O. Box 2319
2300 Yonge Street
26th Floor
Toronto, Ontario
M4P 1E4

Attention:
Mr. Paul B. Pudge
Board Secretary
1-888-632-6273 (Toll free)
416-440-7656 (Fax)

OR

[Insert: LDC Name]
[Insert: Full Mailing Address]

[Insert: Name of Contact Person]
[Insert: Title]
[Insert: Telephone number]
[Insert: Fax number]

Method #1 - Use Own 2001 s. 93 PILs Estimate

Note: A PILs estimate is required for each set of rates developed using the RUD model. For example, if an LDC filed separate rate schedules for specific companies, a PILs estimate should be calculated for each company and inserted into the RUD model establishing rates for that company. If rates were prepared for an amalgamated utility, for the purpose of determining a PILs estimate, please sum the tax estimate for each legal entity.

Unless otherwise indicated, the instructions below assume the case of a single LDC with a calendar year end. The same general approach, but with some adjustments, will be applied in other circumstances.

Step 1. Provide estimated total section 93 PILs liability for the period October 1 to December 31, 2001 (for “wires-only” business). \$_____.

This figure will need to be derived by tax-exempt electricity distribution utilities in any event, as these utilities are required by the Province to estimate total 2001 PILs in order to determine their October 31st PILs instalment. All utilities with a calendar year-end will have a short 2001 tax year.

Step 2. Provide supporting calculations for above total.

The Board will require reasonable justification for the total amount listed in step 1 before rates can be adjusted.

The Board requests the following level of supporting figures be provided, at a minimum, regarding the income tax calculation. Forms (attached as an appendix) have been provided as a guide to assist in the completion of this information. (These forms will also be helpful in completing the manager’s summary under step 6.) Supporting calculations should be provided for each legal entity.

Wires-only Accounting Income

- Explicitly identify the removal of any non-wires income.
- List total revenues, expenses, and net operating profit
- Expenses should specifically identify the amount of interest expense claimed
- Any special adjustments to non-wires income made when estimating PILs used in determining tax instalments for “Provincial purposes” should be noted (for example, any regulatory adjustments recorded).

Timing and Permanent Differences

- Depreciation amount used (please indicate the asset values used to determine the depreciation expense used in the calculation)
- Capital Cost Allowance (please indicate the value of assets used in the calculation if it differs from the asset value used for depreciation above)
- Any pension and other post employment benefit differences
- Other significant differences.

Income Tax Expense

- Rates used for federal, federal surtax and provincial tax determination and the implications of any small business tax deductions.

Documentation regarding Other Taxes:

- Federal Large Corporation Tax (please provide the calculation supporting taxable capital or a proxy such as net assets used in the calculation, itemize any deductions claimed and indicate the rate used). Please also indicate the amount of federal surtax which offsets this tax.
- Ontario Capital Tax (please provide the calculation supporting taxable capital or proxy such as net assets used in the calculation, itemize any deductions claimed and indicate the rate used).
- Ontario Corporate Minimum Tax calculation details (if applicable).

Step 3. Annualize PILs estimate.

An annualized approach is employed as the RUD model uses an annual revenue requirement and annual volume information to establish rates at a sufficient level to recover a utility's base requirements on a "going-forward" basis.

In order for the RUD model to pass-through the proper amount of taxes to rates, the figure in step 1 should be multiplied by 12 and divided by the number of months between October, 2001 and the LDC's year end.

For example, for those utilities with a calendar year end, the figure in step 1 (which represents expected total PILs for the last three months of 2001) will end up being increased fourfold to arrive at a proxy for the annualized PILs expense.

Annualized s. 93 tax gross-up \$_____.

Step 4. Insert tax gross-up into RUD model.

Insert the results under step 3 into cell C46 ("MARR WITH TAXES - MARR WITHOUT

TAXES”) of sheet 8 of the final RUD model filed in the original unbundling application (or sheet 9, if you had local generation). The other input data in the RUD model should not be changed. The utility should use the RUD model supporting its Board-approved rates.

Step 5. Re-run RUD model.

Run the RUD model after completing step 4. The model will automatically generate a new set of 2001 rates. Provide both a hard copy of the new RUD model and file an electronic copy.

Step 6. Prepare manager’s summary and new rates schedule.

Provide a short manager’s summary.

Please state the proposed date for the new rates to come into effect. A complete revised rates schedule should be attached.

The manager’s summary should include a variance analysis of the following key items comparing the original application details with the annualized pro-forma period.

When undertaking the variance analysis, please refer to the information set out in the forms provided under step 2 (which are attached as an appendix).

- Significant changes in revenue and expense items as highlighted in the attached forms.
- Items deducted for tax purposes but not yet allowed for regulatory purposes (transition costs, extraordinary costs).
- Interest expense incurred and the debt structure associated with the interest.
- Interest expense incurred versus the amount allowed under the MARR calculation in the RUD model. If MARR is phased in over three years then the equity and interest gross-up are phased in over the same period.
- Pension costs and other post-employment benefits.
- Tax rates which differ from published rates.
- Book value of fixed assets compared to the values (FMV) used in the tax calculations.

Step 7. Serve material on Interveners.

Collect the evidence in support of financial distress, the background calculations supporting the section 93 proxy tax estimate used (steps 2 and 3), the new RUD model (step 5), manager's summary and proposed new rates schedule (step 6). All this supporting material, along with a signed copy of the draft covering letter provided, should be served on all interveners and on all municipalities within the utility's service area.

Step 8. File material with Board.

The material prepared in step 7 (including letters to interveners) should be filed with the Board's Secretary (three hard copies should be provided of the complete package, along with one electronic copy of the new RUD model).

APPENDIX
Method 1 -
Use Own s. 93 Pils Estimate

Utility:
 RP-
 Date:

Income Statement
 For the _____ months
 Ended _____ 200__

	Wires Only Used in Original Application (1)	Wires Only Pro-forma Period (2)	Pro-forma Period Annualized (3)
Revenue			
Cost of power			
Distribution revenue			
Distribution expenses			
Administration expenses			
Other income			
Net distribution income			
Interest expense (4)			
Z- Factor items			
Transition costs			
Extraordinary items			
Net income before taxes			

Notes :

- 1) In most cases these numbers will be from the 1999 audited financial statements.
- 2) For most LDCs this will be for the pro-forma period October 1-December 31, 2001.
- 3) Annualization suggested is $(\text{pro-forma} / 3) \times 12$ for a LDC with a December year end. If the pro-forma period is more than three months then it would be $(\text{pro-forma} \times 12) / \text{number of months in pro-forma period}$.
- 4) Interest expense incurred by the utility on its actual borrowings.

**APPENDIX
Method 1 -
Use Own s. 93 PILs Estimate**

Utility
RP-
Date:

Tax Calculation

For the _____ months
Ended _____ 200_____

	Wires Only Pro-forma Period End Data	
Net income before taxes		
Add back:		
Depreciation		
Amortization		
Other items:		
-		
Deduct:		
CCA		
Ontario capital tax (2)		
Ontario minimum tax (2)		
Taxable income		
TAXES	Wires Only Pro-forma Period End Data	Pro-forma Period Annualized
Federal income tax (Rate used %) (1)		
Ontario income tax (Rate used %) (1)		
Large corporation tax (2)		
Ontario capital tax (2)		
Ontario minimum tax (2)		
Total taxes		(3)

Notes

- 1) Please provide small business deduction calculations if taken.
- 2) Provide details of calculations showing, for example, federal surtax offset to LCT, etc.
- 3) The short tax year October 1-December 31, 2001 is a distinct tax year for those with December year ends. On January 1, 2002 a separate tax year begins for most LDCs. The annualized data is for comparative purposes only. For example, the small business deduction may be deductible for the short tax year but income may be too high in the twelve month tax year to take full advantage of small business deductions.

APPENDIX
Method 1 -
Use Own s. 93 PILs estimate

Utility
 RP-
 Date:

FIXED ASSETS / DEPRECIATION
UNDEPRECIATED CAPITAL COST (UCC)
CAPITAL COST ALLOWANCE (CCA)

Pro-forma period ended _____ 200__

	Wires Only From Original Application	Wires Only Pro-forma Period End (2)	
		Book Values	Tax Values
Cost	(1)	(6)	(3)
Accumulated depreciation	(1)	(6)	
Net book value or UCC	(1)	(6)	(4)
Depreciation charge or CCA	(1)	(6)	(5)

Notes:

- 1) Fixed asset values used to calculate rate base in initial rate unbundling application.
- 2) For most LDCs the date for information will be the pro-forma period end, December 31, 2001. For those LDCs which were previously taxable, the date will be the year end month in 2002.
- 3) Cost values for tax purposes should be the fair market values (FMV) required by the tax authorities. Please provide explanations for unusual accounting/ tax cost differences.
- 4) Undepreciated capital cost on which the capital cost allowance is based.
- 5) Capital cost allowance from the utility's own tax calculations.
- 6) Relates to accounting records.

**APPENDIX
Method 1 -
Use Own s. 93 PILs Estimate**

Utility
RP-
Date:

Additional Information

For the _____ months
Ended _____ 200_____

	Wires Only Used in Original Application (1)	Wires Only Pro-forma Period (2)	Pro-forma Period Annualized (3)
Pension costs			
Other post-employment benefit costs			
Other significant differences Please list: - - -			

Notes :

- 1) In most cases this will be from the 1999 audited financial statements.
- 2) For most LDCs this will be for the pro-forma period October 1-December 31, 2001.
- 3) Annualization suggested is $(\text{pro-forma} / 3) \times 12$ for a LDC with a December year end. If the pro-forma period is more than three months then it would be $(\text{pro-forma} \times 12) / \text{number of months in pro-forma period}$.