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

January 18, 2002

To: All Electricity Distribution Companies

Re: Supplemental Instructions Regarding Filing Guidelines for March 1, 2002 Distribution Rate Adjustments

This letter provides further instructions to electricity distribution utilities on how to complete their filings for the upcoming 2002 rate adjustments.

I. Input Price Index

The Board's correspondence of December 21, 2001 stated (at page 2) that "to facilitate the rate adjustment process for March 1, 2002, the Board intends to release the Input Price Index ("IPI") measure no later than January 21, 2002.

The IPI (calculated as stipulated in the Board's decision with Reason's RP-1999-0034 and outlined in the Electricity Distribution Rate Handbook) increased by 0.4% in 2001.

For their upcoming rate filings, utilities should therefore enter 0.004 on Sheet 2 Cell D8 of the Rate Adjustment Model (RA Model or RAM).

II. PILs Provision

As indicated in the Board's correspondence of December 21, 2001, a PILs spreadsheet and accompanying instructions were posted under the "What's New?" part of the Board's web site (www.oeb.gov.on.ca).

One cell formula error has been brought to our attention in the spreadsheet itself (see errata item (a)(i) below), and instructions on how to correct this have been provided. Note the error does not impact the material to be filed as part of the March rate adjustment filings. The Board will be posting a new spreadsheet model on its Web site January 18, 2001; however, utilities may simply modify the spreadsheet as noted below.

Since the December 21, 2001 filing instructions were issued, stakeholders have provided various suggestions on how the instructions should be applied in specific circumstances. For the benefit of all applicants, those inquiries of wide potential impact are set out below in b) "Footnote/Instructions Clarifications". The posted Web site footnotes/instructions will also be updated by Friday, January 18, 2002.

Please note that the spreadsheet, footnotes and supporting examples posted on the Board's Web site on December 21, 2001 will be removed by February 1, 2002. Utilities should refer to the revised material posted January 18, 2002 as soon as possible. Utilities may wish to retain their own copies for future reference.

a) <u>Errata</u>

The following oversights were contained in the material originally posted:

i) On Form TAXREC (not needed until June 2002), the correct formula in cell E133 should be "=SUM(E97:E132)". Utilities should make this change to the spreadsheet themselves.

ii) Footnote 5: Change in Tax Reserves - An increase in the tax reserve liability from one tax period to the next tax period will be shown as a **negative** number. Opening reserves are added back and period-end reserves are deducted.

iii) A few miscellaneous clerical errors have been noted in the footnotes/instructions (e.g. the reference to line 33 in Footnote 14B should be line 40).

The Board's Web site has been updated January 18, 2002 to include a revised SIMPIL model and footnotes/instructions to reflect items (i), (ii) and (iii) above.

b) <u>Footnote/Instructions Clarifications</u>

i) <u>2001 Proration</u> - The general intent of the PILs spreadsheet and instructions was to prorate the 2001 calculation to reflect the fact that s. 93 PILs will be due for only the last three months of 2001. Utilities must consider the instructions issued in light of their particular circumstances and the applicable tax rules (for example, s. 125(5) of the Income Tax Act and Regulation 1100(3)) and decide how to appropriately prorate 2001 figures.

To assist in the review of the submissions, utilities should indicate in their manager's summary both the Board-approved effective date and implementation date for their 2001 unbundled rates.

It should be reiterated that the proration guidance provided in the PILs model footnotes/instructions are designed for the most common situation: a utility that had its 2001 rate increase effective on or before October 1, 2001. For a utility that unbundled its 2001 rates effective (which may differ from the implementation date) November or December 2001, please contact Board staff to discuss the PILs provision further (for example, the formula in 1B should be changed to 1/4 of the 1999 return plus the amount of incremental revenue phased-in during the 2001 Q4). Interest expense for year 1 (and Q4, 2001) as calculated on the worksheet entitled REGINFO may be incorrect if there are less than three months incremental revenue in Q4, 2001.

ii) 2001 Q4 Proration - After the December 21, 2001 instructions were issued, stakeholders have provided a number of specific suggestions on how they plan to implement the 2001 proration to ensure consistency. For the most common situation (utility that had unbundled rates in effect on or before October 1, 2001) the Board wishes to add the following instructions:

- Re Footnote 8B 2001: CCA for Q4 2001 should be prorated by 1/4 (this is in addition to the half-year rule).
- Re Footnote 12B 2001: The interest expense associated with this income (debt component of MARR) must also be prorated by 1/4. To do this, the amount from REGINFO for year 1 should be divided by 4.
- Re Footnote 14B 2001: The 40.62% tax rate should be applied if regulatory taxable income is in excess of 1/4 of $700,000; and the 19.12% rate should be used, if under 1/4 of $200,000.
- Re Footnotes 18 & 19: Note the instructions already state that 2001 Ontario capital tax and the gross amount of LCT should be prorated by 1/4. The examples provided for Q4, 2001. Corrected examples were posted on the Web site January 18, 2002.

iii) Transition Costs - Many comments have been received regarding the tax treatment of transition costs.

- The amount of transition cost claimed in the 2002 application (i.e. March RAM model) should be listed as an add-back at Line 6, per Footnote 6A 2002 (Regulatory Adjustments).
- A deduction should be made on Line 11 Regulatory Adjustments, to the extent items recorded as transition costs will be claimed as deductions for tax purposes.

iv) MARR Phase-in - Properly completing lines 39-40 on the REGINFO Tab will impact the determination of the phase-in of interest. A variety of cases exist, and the following examples should be followed:

- If MARR is phased-in over three years, and the first year phase-in is effective anytime between March 1, 2001 and October 1, 2001[1], then enter 1/3 of the Board-approved amount to be phased-in on each of lines 39, 40 and 41.

- If MARR is phased-in during one year due to financial distress, then list the full amount on Line 39.

- If MARR is phased-in over three years, but the first year increment is effective in November 2001, then enter 2/12's of the first year phase-in on Line 39, and on Line 40 add the normal second year phase-in plus 10/12 of the first year phase-in.

v) Employee Benefits - Employee benefits for current employees and Other Post Employment Benefits (OPEBs) are combined on both the line for additions of accrued amounts (Line 4) and deductions of paid amounts (Line 9). Generally, companies accrue (expense) for current employee's service costs and pay in the following month. At the end of the period, the amounts accrued (and expensed) for current employee service costs and the amounts paid will be similar amounts. OPEBs will generally represent the largest difference between the amounts on Lines 4 and 9.

vi) Capital Taxes - The model was designed on the assumption that distribution utilities, which are typically capital intensive, would be subject to provincial and federal capital tax. For smaller utilities, this may not be the case and the following additional instructions may apply:

- Regarding Line 65 (Net Amount of Ontario capital tax), if Rate Base is less than $5,000,000, then override the calculation and input zero in the appropriate column(for 2001, Cell G65; for 2002, Cell C65).

- Regarding Line 77 (Net Amount of federal LCT), if Rate Base is less than $10,000,000, then override the calculation and input zero in the appropriate column (for 2001, Cell G77; for 2002, Cell C77).

III. RA MODEL

a) Filing to Recover Transition Costs

A utility that implemented unbundled rates in November 1, 2001, but which received a three month rate rider, would have an effective date pre-October 1, 2001.

As noted in the December 21, 2001 letter to distribution utilities, recovery of transition costs will be based on amounts reported in the utility's trial balance already filed with the Board and that reflect the audited financial results of the utility as at December 31, 2000. Should the utility seek rate recovery of accumulated transition costs for a period beyond December 31, 2000, it will need to undertake a focused audit of the balance accumulated in Account 1570 (or other relevant APH accounts) of the Board's Accounting Procedures Handbook for Electric Distribution Utilities ("APH") for the period beyond December 31, 2000. In its November 9, 2001 letter (the "Transition Cost Recovery Letter"), the Board established an interim recovery limit for these amounts.

In their applications, those LDCs applying for interim, partial recovery of transition costs should provide information regarding:

- The LDC management's representation that transition cost amounts included in the RA model for recovery are indeed transition costs that meet the criteria in the Electricity Distribution Rate Handbook and APH Article 480.

- Evidence that the amounts entered in each of the cost categories listed in APH Article 480 meet the specific criteria in the Rates Handbook. Specifically, recovery of balances for 2000 as provided for in the Board's Transition Cost Recovery Letter should be based on a materiality measure for that same period (net assets or rate base). As noted in Article 480 of the APH, the utility should remove accumulated balances from this account that do not meet the four part criteria for recovery provided in the Board's Rate Handbook. Recovery of 2001 transition costs for utilities undertaking the focused audit would be based on a 2001 materiality measure. The materiality measure for 2001 should be prorated to reflect the proportion of the year represented by the transition costs subject to the audit (e.g. use 10/12 of net assets if the focused audit covers transition costs accumulated to Oct 31, 2001).

- Reasons for the choice of methodology used to allocate the costs of each applicable cost category listed in APH Article 480 to rate classes (note default is revenue share).

- Amounts the utility is proposing to recover from APH Account 2055 - Construction Work in Progress shall be considered as a non-capital amount in the assessments of materiality for the categories of activity provided in Article 480 of the APH. As currently stated in Article 480, the balance in Account 2055 will not be transferred to Account 1570 until "the asset is substantially complete". Therefore the balance in Account 2055 will not be considered as part of the materiality assessment.

- A reconciliation between the specific line items in the audited financial statements that contain transition cost recovery amounts (e.g. Account 2055 Construction Work in Progress may be presented as part of several line items on the audited financial statements), and the amounts listed for recovery in the RA model. Given the different recovery percentages provided in the Board's Transition Costs Letter, the Board has provided an example in the attached appendix of a reconciliation which highlights the utility's compliance with the recovery process established in the Board's Transition Cost Letter.

Other evidence to substantiate the amounts as true transition costs is not required (this will be required when the transition costs are reviewed by the Board at a future date). The March 1, 2002 approval of recovery of a portion of these costs is interim until a full review is conducted.

b) Errata (RA Model and Documentation)

Utilities have indicated two errors in the RAM and Appendix A of the Board's December 21, 2001 filing guidelines:

- On page 5 of Appendix A, the reference to Appendix C in the first paragraph under Sheet 13 - Transition Cost Adder Calculation, should be ignored. There is no Appendix C. Utilities should refer to the Accounting Procedures Handbook, the November 9, 2001 letter and the instructions above in filing for recovery of transition costs.

- In Sheet 13 of the RA Model, the amounts appearing at B22, D22, F22, H22, J22, L22, N22, P22, R22, T22 can be ignored and/or replaced with the utility's own figures. In addition, the SUM command appearing from W23 to W30 should be replaced with:

  (B22+D22+F22+H22+J22+L22+N22+P22+R22+T22)

  to allow a calculation across the cost categories. Remember that utilities should enter zeros if no cost is claimed in any category.

- Also in Sheet 13, the amount entered in the yellow box at Cell B19 should be allocated by cost category and rate class in the Transition Cost Category Table. The amounts that then appear in the totals in Column W also appear in the 2001 Statistics by Class Table which are then employed by the Model to create rate adders. Please ensure that the amount entered in Cell B19 agrees with the totals at Cells G52 and W33.

- In Sheet 14 of the RA Model, at Cell B115 the formula reads

  =('12. Z-Factor Adder Sch'!B115)+('13. Transition Cost Adder Calc'!C222)

  But should read:

  =('12. Z-Factor Adder Sch'!B115)+('13. Transition Cost Adder Calc'!C221)

Please change the reference in the formula to C221.

IV. Publishing Notice of Rate Change

Individual utilities will not be required to publish a Notice concerning this rate change. The Board will publish a generic Notice in select Ontario newspapers in the week of January 28, 2002. The Notice will inform electricity rate payers of the proposed changes to distribution rates. Rate payers will be directed to contact their own electricity distributor for information on the rate change in their service area.

Individual utilities may wish to inform their customers of the proposed rate changes.

V. Effective Date of New Rates

Utilities are reminded that the Board expects that only consumption of electricity on or after the effective date should be billed at the new rates. The bill should be prorated for electricity usage before the effective date.

VI. Late Payment Penalty Change

Those utilities that have not applied to the Board to change the traditional 5% late payment policy are reminded that they are required to apply for a change in late payment policy in their January 25, 2002 applications. As stated in the Board's October 1, 2001 letter to distribution utilities, these utilities are expected to file with the Board: (a) their proposed policy changes with supporting documentation for approval, and (b) a statement of rate impacts to address any anticipated rate adjustment requirements.

Utilities requiring further specific guidance on the March 1, 2002 Distribution Rates Adjustment or completing the RA model may contact Harold Thiessen (416-440-7637, e-mail thiessha@oeb.gov.on.ca) , while questions regarding the SIMPIL model for PILs may be forwarded to Duncan Skinner (416-440-8127, e-mail skinnedu@oeb.gov.on.ca) or John Vrantsidis (416 440-8122, e-mail vrantsjo@oeb.gov.on.ca).

Yours truly,

Original Signed by

Peter O'Dell
Assistant Board Secretary