



January 12, 2009

Ontario Energy Board
P.O. Box 2319
2300 Yonge Street 27th Floor
Toronto, ON
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Attention: Ms. Kirsten Walli, Board Secretary

Re: **Review Initiative: Account 1562, Deferred Payments in Lieu of Taxes (“PILs”)
Board File No. EB-2008-0381 (formerly EB-2007-0820)**

The following comments are being provided with respect to the proceeding of the Ontario Energy Board (the “Board”) on Account 1562 – Deferred PILs on behalf of the Coalition of Large Distributors (“CLD”), namely Enersource Hydro Mississauga, Horizon Utilities Corporation, Hydro Ottawa, PowerStream, Toronto Hydro-Electric System and Veridian Connections. In addition to supporting this submission, Toronto Hydro-Electric System will also file separate comments.

These comments are in three sections. First is a discussion of the overall nature and purpose of this proceeding. Next are comments related to the established principles set out in Appendix A of the Staff Discussion Paper - Account 1562 - Deferred Payments in Lieu of Taxes Methodology and Disposition of Balances for Electricity Distribution Companies affected by section 93 of the *Electricity Act, 1998* (the “Discussion Paper”). The final section responds to the specific questions posed in Appendix B of the Staff Discussion Paper.

Section 1 - Timing and Nature of the Proceeding

Section 1.1 of the Discussion Paper describes a purpose of the proceeding as follows:

“The methodology used in the SIMPIL model is underpinned by certain principles. The principles and methodology have not been reviewed by the Board in a proceeding. In order to determine the final balances in account 1562, the Board must approve a final methodology. The approved methodology will form the basis for a final model to be drafted by Board staff, reflecting the Board’s findings. This final model would include information for the entire October 1, 2001 to April 30, 2006 period.”

Of principle concern to the CLD is the amount of time that has passed between when LDCs became taxable in October 2001, and began to record entries in Account 1562, and this proceeding in 2009. While it is acknowledged that there has been no formal hearing on the subject of Account 1562, LDCs have relied on the guidance provided by numerous versions of the SIMPIL models issued by the Board and the Frequently Asked Questions (“FAQs”) from the Accounting Procedures Handbook. Since 2002, LDCs have filed with the Board on a quarterly basis the balances in Account 1562 and have annually filed SIMPIL models that determined the



amount to be true-up each year. Based on this direction and guidance related to PILs, LDCs have now completed seven sets of audited financial statements, with another soon to be added.

While it might not be the Board's intent, the Discussion Paper implies that the Board could consider a change to the fundamental principles of accounting for PILs that have been adopted in the past seven to eight years. Given the extensive time that the Board has had to address any issues, the only appropriate course of action at this time is to adopt as final any methodologies and principles established from the previously filed SIMPIL models and the FAQs. The scope of this proceeding would then only consider a few issues that were not addressed in previous instructions. With the benefit of hindsight it is easy to identify flaws in the PILs methodology used for the period from October 2001 to April 30, 2006. However, this was the established methodology on which LDCs based their past financial results and associated decisions, and changes should not be made at this late stage.

Furthermore, the CLD considers it inappropriate for the Board to have a "final model" developed and issued by Board staff. LDCs have completed and filed the previous SIMPIL models issued by the Board. These SIMPIL models were used both for the determination of the PILs Proxy amounts previously approved by the Board and to determine any amounts subject to true-up once tax filings for that year were completed. Such models align with the specific annual PILs filings to the Ministry of Finance ("MoF"). There will naturally be some disparity between LDCs with respect to accounting policies and tax filing positions which has direct bearing on individual LDC PILs Proxy filings using the SIMPIL model. As such, and provided that an LDC files a continuity schedule and back-up details for its entries to Account 1562, including the SIMPIL models for each year from 2001 to 2005, no further supporting evidence should be required within an application to clear the account balances. As a result of this proceeding, an LDC may determine that amendments are required to amounts recorded in Account 1562, and these amendments could be filed as part of the application to clear the account.

The development of a new and generic model based on new or revised principles and methodologies is tantamount to retroactive regulation. Such a result here, might undermine the ability of LDCs and their auditors to depend on FAQs and models issued by the Board or its staff in making decisions, and introduce a new level of regulatory uncertainty. PILs is a complex matter and the CLD has serious concerns about the proposed "one size fits all" approach to this issue. LDCs have different accounting and tax policies that may have affected the nature of annual true-ups. The Board must review each LDC's Account 1562, past SIMPIL filings, and related MoF tax filings on a case by case basis in order to determine the clearing of this account

Section 2 – Comments on Discussion Paper Appendix A

As discussed previously, regardless of whether there is consensus on the specific principles that underpin methodologies incorporated in the SIMPIL model and described in the FAQs to the Accounting Procedures Handbook, these principles were established and should not be changed and retroactively applied to LDCs. For the most part, the CLD accepts the description of the principles in Appendix A to the Discussion Paper. Of paramount importance is the identification on Page III of the items that are not subject to true-up. This was a fundamental principle of the past PILs methodology and should not be open for debate.

As to the items that were subject to true up, these items were incorporated into the SIMPIL models that the Board released each year for LDCs to complete and file with the Board. The calculated true-up variance adjustment was then to be recorded in Account 1562. While there was some evolution of the SIMPIL models from 2002 to 2006, LDCs did rely on these models to determine the appropriate true-up. It would therefore be inappropriate to change the elements to be true-up at this stage. We also note that certain items identified by Board staff for true-up, such as accounting reserves, were, in fact, not initially subject to true-up under the 2001 SIMPIL model. The Board should apply true-up items only to those years for which such applied.

One item of note is the true up of tax reserves. If these reserves were related to regulatory asset balances, then no true-up would be appropriate because regulatory assets balances were excluded from the determination of the PILs Proxy amounts.

Section 3 - Responses to Discussion Paper Appendix B Questions

Part I – Items where the Board provided guidance on PILs implementation but still require final resolution due to the manner in which PILs expenses were incorporated in rates for the October 1, 2001- April 30, 2006.

1. **Question:** Should the distributor prorate the PILs amount approved by the Board based on the effective date of the rate adjustment, rather than follow the instructions outline above which assumed a full year implementation?

Response:

All members of the CLD followed the Board’s instructions for the PILs account 1562 and implemented rates on March 1, 2002 as contemplated by these instructions. As such, this issue would not apply to any of the members of the CLD. However, all LDCs became taxable on October 1, 2001 regardless of the effective date for rates. LDCs in this situation may have accrued revenue or set up a receivable as part of their audited financial statements for 2001 and 2002 that could affect PILs expense. Generally speaking, LDCs should expect to recover PILs from the date at which such became applicable, irrespective of when rates were implemented. It seems inappropriate to establish new rules for these LDCs nearly seven years after the associated rates were approved and implemented.

2. **Question:** a) Should the 2001 PILs amount included in rates (which was true-up in 2002) be also true-up in 2003 and 2004, or up to the date the Board removed this amount from rates? b) If yes, how should the true-up be calculated for each period?

Response:

Board staff have defined two different components of a true-up. The first component is the variance between the approved PILs Proxy and the amount actually billed to

customers. Continuing a variance between the total 2001 and 2002 PILs Proxy and the total amounts billed to customers for PILs until such time as the 2001 PILs amount was removed from rates is appropriate. Since the approved PILs Proxy, the PILs rate adders and the quantities billed to customers in 2003 are all known, determining this variance is straightforward.

The second component involves a true-up of a few specific items from tax filings as identified in the Filing Guidelines for PILs Proxy and the Notes to Proxy Model (“SIMPIL”) issued by the Board. By definition, this involves differences between 2001 components in the PILs Proxy calculation and these same components in the 2001 tax filings. As such, the calculation must always be based on 2001 values and cannot be calculated appropriately any other way. If the Board had intended for LDCs to record this same 2001 value again in 2003, the appropriate instructions should have been part of the true-up model issued for 2003. LDCs have relied on these models not only for their regulatory accounting, but also for the recording of regulatory assets that form part of audited financial statements.

In the Board staff discussion paper it was questioned whether the 2001 PILs amount in rates for the period until March 31, 2004 should be treated as an “over collection”. This would be completely inappropriate, unduly punitive, and contrary to enacted statute affecting LDC rates through this period. In November 2002, the *Electricity Pricing, Conservation and Supply Act* (“bill 210”) froze all rate orders until March 2004. The Bill 210 rate freeze not only resulted in an extension of the 2001 PILs rates, but also prevented LDCs from implementing the incremental revenue increase from the third installment of “MARR”. For many LDCs, these frozen rates were insufficient to fund debt interest expenses, operating costs and depreciation expenses. Furthermore, the frozen rates covered only two-thirds of the regulated return on equity on a rate base that was set at 1999 levels. There are many components of cost of service regulation, of which PILs is only one. Revenue requirement and rate base are calculated on an integrated basis and, as such, it would be inappropriate to consider one component of a revenue requirement (the PILs component) subject to a true-up when there were serious short falls in all of the other components (depreciation expense, operating costs, interest expense, return on equity).

3. **Question:** Should the tax impact of regulatory assets in prior years’ tax returns be removed from the SIMPIL model reconciliation?

Response:

The CLD generally has not included the impacts of regulatory assets in determining the PILs Proxy amount included in distribution rates or the PILs component of the distribution revenue requirement. As such, rates for PILs from 2001 through to 2008 have been unaffected by the creation or disposition of regulatory assets and liabilities. If no amounts have been included in rates for the PILs effect of regulatory assets, the tax impact of regulatory assets from prior years’ tax returns should not be relevant and should be removed from the SIMPIL model reconciliation.

The tax expense related to regulatory asset balances is generally just a question of timing and therefore no true-up is required. There may however be some cases in which material changes in tax rates from one period to the next may need to be addressed. LDCs affected by this issue could file specific evidence to that effect

It may also be possible that the Board has approved amounts in rates related to the tax impact of regulatory assets. In these cases, it may be appropriate to include regulatory assets in the SIMPIL model reconciliation. Those LDCs that have taken this approach would be expected to provide a supporting rationale. This is a specific item that requires a case by case approach by the Board given differences in accounting and tax treatment by individual LDCs.

4. **Question:** How should the over or under collection issue be resolved?

Response:

A fundamental principle has been established since 2001 that the only over or under collection related to PILs is the difference between the amount of PILs expense in rates and the amount billed to customers. The accounting for Account 1562 is described in detail in the Frequently Asked Questions (FAQ) on the Accounting Procedures Handbook from April 2003. The Board Staff Discussion Paper states that entries to Account 1562 are designed to track and record: *“The variances resulting from the difference between the Board approved PILs amount and amount of actual billing that relate to the recovery of PILs”*. The CLD agrees that this statement is an accurate reflection of the main purpose of Account 1562. Given that the guidance in the FAQ was clear on this matter, there should not be any issue to resolve. All LDCs should be expected to record entries in Account 1562 as described in the FAQ. Any interpretation that there would be a true-up between the amount approved in rates and the amounts actually paid to the Ministry of Finance is incorrect and should be out of scope of this proceeding.

5. **Question:**

- a) Should monthly variances for this period be imputed?
- b) If so should it be from the 2005 or 2006 tax returns?
- c) An unbilled revenue accrual for the period ending April 30, 2008 would be required to determine these variances. Is this information available?

Response:

It is not clear what is meant by “imputed” monthly variances in this context. It is appropriate to record the difference/variance between the PILs Proxy amount included in rates from April 1, 2005 to April 30 2006 (the 2005 rate year) and the PILs amount billed to customers in this period. However, it is not appropriate to complete any form of true-up to the 2006 tax filings. The 2005 tax year was addressed with the SIMPIL true-up

filing for 2005, filed as part of the Reporting and Record-keeping Requirements (“RRRs”). The 2006 tax year was addressed as part of the 2006 cost of service rate applications. The 2006 Distribution Rate Handbook Section 7.2.8. Page 64 stated as follows:

“7.2.8 Overlapping year-ends

The 2006 rate year runs from May 1, 2006 to April 30, 2007. The rate year is not contiguous with the calendar tax year. In order to calculate the approved regulatory tax payable for the 2006 rate year, however, the rate year will be assumed to be the same as the tax year. Thus any stub period issues (e.g. loss carry-forwards or CCA) will be ignored when completing the 2006 OEB Tax Model.”

The Board had recognized that there were differences between the rate year and fiscal/calendar year for LDCs but opted to treat them the same for the purposes of setting 2006 rates. As a result, any true-ups for the whole of 2006 (January to December) should be based on the rules established in the 2006 Distribution Rate Handbook, not the rules from the prior years’ PILs Proxy methodology.

While the CLD does have some information available for April 30, 2006 that could be used if the Board determines that some form of true-up is required, this would not be audited data and generally would not have undergone the same level of review and scrutiny as year-end data.

Concerns have been raised in the past about the misalignment of the rate year (the period over which rates are implemented) and the mandated fiscal year of LDCs (the calendar year). This misalignment creates confusion and complexity that should be addressed in the future. However, the Board has previously determined that these differences should be ignored.

Part II – Global items arising from the application of the SIMPIL model for which the Board has not provided guidance.

1. **Question:** Should the Ministry of Finance tax audits and possible reassessments, underway or planned, have any effect on the decisions of this proceeding?

Response:

To the extent that Ministry of Finance tax audits and reassessments have an impact on those few items identified for true-up, balances in Account 1562 could be affected in the future. For this reason, Account 1562 should remain open until all such activity is concluded. However, audits and reassessments are not expected to result in material adjustments to account balances because, as described by Board Staff in Appendix A, Page III of the Discussion Paper, the items not subject to true-up include:

*“Net Income
Depreciation
Capital Cost Allowance (“CCA”)
Cumulative Eligible Capital Deduction (“CEC”)
Interest up to the Board’s approved debt rate”*

Those items that are subject to true-up are less likely to undergo material changes as a result of a reassessment.

We again note that the above list in Appendix A does not align to the Filing Guidelines for PILs Proxy and related Notes to Proxy Model for all SIMPIL years. The Board should apply true-up and non-true-up items based on the specific years such were applicable.

2. Questions:

- a. If the PILs principal variances were re-calculated, how should the interest carrying charges be re-calculated?

Response:

The Accounting Procedures Handbook provided instruction to LDCs on the calculation of simple interest carrying charges on account balances. These have been filed with the Board quarterly for more than six years. If the PILs principle variances were re-calculated as a result of this proceeding, the rates and methods for the historical carrying charge calculation should remain the same. An adjustment to the carrying charge can be recorded in the current year to correct the result.

- b. If the interest carrying charges were re-calculated, should any special treatment be given to any over or under accrual of interest carrying charges?

Response:

The CLD followed the guidance and instructions issued by the Board in the recording of balances in Account 1562. This guidance took the form of the PILs models with instructions issued each year and FAQ’s released to the Accounting Procedures Handbook. If there are any differences between the approach taken by members of the CLD and the clear intention of the Board in its guidance, then it would be appropriate for the interest to be recalculated and an adjustment entered in the current year. However, the Discussion Paper indicates that “the principles and methodology have not been reviewed by the Board in a proceeding”¹. If members of the CLD have followed previous instructions and now the Board establishes new or different principles, there should be no requirement to re-calculate interest on new balances.

¹ Page 1 OEB Staff Discussion Paper Account 1562 – Deferred Payments in Lieu of Taxes

3. **Questions:** Should the consolidated entity or the acquiring distributor continue to segregate the 1562 accounts in order to calculate the correct final balances for the affected ratepayer group? Or should the accounts be merged and treated in a consolidated manner? How should the balance before consolidation be examined in the proceeding?

Response:

The answer for this question depends on whether the consolidated entity or the acquiring distributor have harmonized their revenue requirement for PILs and the associated rates. If everything has been fully harmonized, it would likely be unduly complicated to try and determine separate balances for Account 1562 for the pre-merged entities.

Also of concern to some utilities for which there were mergers and acquisitions during the period October 2001 to April 2006, is the absence of Board guidance and direction on completion of annual SIMPIL models to accommodate a single tax filing reconciled to multiple original PILs estimates at varying tax rates and circumstances. In addition to the issue of whether separate balances for Account 1562 should be consolidated for disposition, there is concern as to whether the SIMPIL model should be completed on a consolidated basis or somehow allocated to individual predecessor utilities' original PILs estimates. Circumstances of harmonization of proxies and rates vary between consolidated utilities over these years and a single approach to true-up calculations and disposition would not be appropriate.

It is appropriate that the SIMPIL filings for each utility affected by mergers and acquisitions during the period October 2001 to April 2006 be reviewed on a case by case basis with utilities proposing a utility-specific methodology for true-up and consolidation using the SIMPIL model.

Thank-you for this opportunity to provide comments.

Yours truly,

Original Signed By

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On behalf of the CLD