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via RESS e-filing – original to follow by mail

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
PO Box 2319
2300 Yonge St
Toronto, ON M4P 1E4

Dear Ms. Walli:

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

Pursuant to the Board’s letter dated November 28, 2008 and its accompanying Notice of Combined Proceeding and Notice of Hearing, Toronto Hydro-Electric System Limited (“THESL”) makes the following submissions regarding the August 20, 2008 Staff Paper.

PART I

Section 1: Date for the Initial Entries

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 outlined above which assumed a full year implementation?

Response:

THESL takes no position on this issue.

Section 2: PILs Amount for the Fourth Quarter 2001

Question:

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

Response:

THESL understands that the questions being asked are whether or not account 1562 should be credited for the additional funds collected from customers as a result of the 2001 PILs amount approved by the Board that remained in rates during the years 2003 and 2004. This would have the impact of reducing any amounts that may be collected from customers (or increasing the amounts payable to customers) in the disposition of account 1562.

THESL submits that there should be no true-up (or claw-back) of the notional 2001 PILs amount remaining in rates beyond 2002. Such an approach would selectively undo the effects of the Bill 210 rate freeze and as such should be rejected by the Board as a ratemaking practice. During the period covered by Bill 210, and specifically during 2003 and 2004, distributors were not able to earn their target rates of return because of the rate freeze. For THESL and most other distributors, the rate freeze meant that rate increases designed to add the 3rd increment of MARR were not implemented. As a result, distributors' earnings during this period were significantly less than anticipated. It would be inequitable to make an adjustment today (via a true-up) to one element of the difference in rates from forecast (the 2001 PILs amount) but not take into account the broader developments in rate setting (elimination of the third MARR adjustment). The continuation of the 2001 PILs amount in rates provided only partial relief for the significant reduction in rates as a result of the Bill 210 rate freeze.

Section 3: Regulatory Assets and Liabilities

The Incomplete Cycle

The Discussion Paper from the Board notes the following:

"If account 1562 continued to operate as under the April 2003 FAQ until, for example, 2009, most distributors would be able to record variances associated with regulatory asset recoveries that would offset prior years' expense. Since account 1562 stopped operating as of April 30, 2006, the cycle has been interrupted and consequently there may be many distributors with balances in 1562 that are higher or lower than they should be."

THESL understands that the issue of the incomplete cycle arises from the following:

- A number of utilities calculated true-up variances for account 1562 by incorporating deductions for regulatory costs that were, by design, not included in the initial SIMPL model calculation of the PILs allowance. This was contrary to the Board's intent for the true-up process.
- True-up variances calculated by including adjustments for regulatory costs would generate large credits to account 1562 that would increase the amounts payable to distribution customers.
- Amounts would also have been included as true-up adjustments for additional revenues received for the recovery of regulatory costs in account 1562. The adjustments recorded would generate debits to account 1562 that would decrease the amounts payable to distribution customers.
- The true-up adjustments above in account 1562 would over time equal each other. The problem arises from the recovery of regulatory costs that occurred during the period beginning in 2004 and ending in 2008. Any recoveries occurring after April 30, 2006 would not be recorded in account 1562. The recoveries would also not be recorded in account 1592 since this account only adjusts for legislative/regulatory changes.
- The termination of account 1562 therefore results in an incomplete cycle issue. However, the incomplete cycle is an issue only for distributors that did not follow the Board's intent in calculating true-up variances.

Question:

Should the tax impact of regulatory assets in prior years' tax returns be removed from the SIMPL model reconciliation?

Response:

THESL understands this question to be whether utilities that have taken regulatory costs into account in the true-up process for account 1562 should instead recalculate the balance in this account by removing such costs and recoveries in the reconciliation process.

THESL submits that any true-up adjustments for regulatory costs should be removed from the SIMPL model reconciliation. This would eliminate problems associated with the incomplete cycle. It would also conform to our understanding of the Board's original intent with respect to the true-up process for account 1562 and it would eliminate any inequities that arise from inconsistent application of Board rules.

Section 4: Definition of Over or Under Collection

The Discussion Paper from the Board notes the following:

“Over and under collection is defined as the difference between the amount of PILs expense in rates and that collected from customers. According to the variance account methodology for account 1562, if the distributor collected from, (or billed to), ratepayers more than the approved PILs amount allowed in rates, the distributor would record this over-collection. A similar case is made with under collection. Some distributors and intervenors have interpreted the definition of over and under collection to be the difference between the PILs amount approved in rates, and the amounts actually paid to the Ministry of Finance. A common understanding of over and under collection is desired for consistency in calculating the 1562 deferral account balance.”

Question:

How should the over or under collection be resolved?

Response:

Based on the Board’s Discussion Paper, we understand that certain distributors and intervenors have assumed a definition of over and under collection that is contrary both to the definition intended by the Board and to instructions previously provided to distributors. Thus, the issue to be addressed is the resulting inconsistency among distributors in calculations associated with the 1562 account balance.

THESL submits that the inconsistency should be resolved by having all distributors calculate (or recalculate) their 1562 account balances in accordance with the Board’s original instructions. It would be inappropriate, and set an undesirable precedent, if the Board were to allow errors by distributors in the interpretation of account 1562 to remain uncorrected and to thus retain inconsistencies across distributors.

Section 5: Calculation of Variances for January 1, 2006 to April 30, 2006

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 30th, 2006 would be required to determine these variances. Is this information available?

THESL understands these questions to mean the following:

- Should a monthly adjustment be recorded for the difference between the PILs amount approved in rates and the amount billed to customers for the January 1, 2006 to April 30, 2006 period (the “stub period”)?

- Should a monthly true-up variance (the difference between certain items included in the PILs approved amount and certain items included in the tax returns filed with the Ministry of Finance) be imputed for the stub period?
- Should the monthly adjustment for the difference between the approved PILs amount and the amount billed to customers be based on the 2005 Rate Adjustment Model ("2005 RAM") or the 2006 Electricity Distribution Rate application ("2006 EDR") for the stub period?
- If one is to be calculated, should the monthly true-up variance for the stub period be based on the 2005 or 2006 tax returns filed with the Ministry of Finance?

Response:

THESL submits that a monthly adjustment should be recorded for differences between the PILs amount approved in rates and the amount billed to customers during the period January 1 to April 30, 2006, in order for those differences to be properly recorded to the end of 2005 rate year. The amount recorded should be based on the PILs amount approved in the 2005 RAM and not the 2006 EDR. As noted in the Board's paper, the 2006 EDR process resulted in the implementation of a new philosophy completely different than the 1562 account process. As of May 1, 2006, variances between PILs approved in rates and PILs billed to customers would not be tracked and, therefore, would not be subject to a true-up adjustment.

Differences between certain items included in the PILs approved amount and certain items included in the tax returns filed with the Ministry of Finance for the period January 1 to April 30, 2006 properly belong to the 1592 regime and should not be recorded for resolution under the 1562 regime. Differences between certain items included in the PILs approved amount and certain items included in the tax returns filed with the Ministry of Finance for the 2005 tax year properly belong to the 1562 regime and are addressed in the 2005 SIMPIL true-up filing for 2005. The 2006 tax and cost year (as distinct from the rate year) began January 1, 2006 and should be subject to the 1592 regime, and true-up variances which were part of the 1562 regime should not continue into 2006.

With regard to the final question, THESL confirms that information in respect of an unbilled revenue accrual as of April 30, 2006 is available.

PART II – GLOBAL ITEMS

Section 1: Impact of Ministry of Finance Audits

The Discussion Paper from the Board notes the following:

“Some distributors are currently being audited for the opening October 1, 2001 tax period. Currently, there are no provisions in the PILs guidelines for addressing any changes in taxes payable as a result of the Ministry audits.”

Question:

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

Response:

THESL submits that any changes in taxes payable as a result of Ministry of Finance tax audits should be considered for inclusion in the true-up variance calculated for account 1562. More specifically, changes in taxes payable as a result of an audit, should result in a true-up variance to the extent that these changes pertain to certain items that are subject to true-up. Thus, as proposed by the Board, account 1562 should continue to operate until all assessments and reassessments for the 2001 through 2005 taxation years are received. Similarly, the Board will need to provide a process for disposing of account 1562 balances that may result once tax years are reassessed.

The rationale for taking into account the impact of tax audits in the true-up mechanism, is that the reassessment process is simply a means of obtaining a more accurate picture of the taxes payable during the period concerned. For any period, a tax assessment that is adjusted by audit does not differ in substance from a tax assessment that was correctly estimated in the first instance. Reassessments from tax audits must be considered in the variance process to ensure that adjusted balances are recorded consistently by distributors.

Section 2: Interest True-Up

Question:

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

For Question (a), THESL understands the questions to mean:

- i) Whether interest should be calculated using the traditional simple method (i.e. no compounding) or with compounding.

- ii) Whether the interest carrying charges that the utility originally calculated on the balance in account 1562 should be recalculated for each year with the adjusted balances in 1562 or whether the interest carrying charges should be calculated based on when the adjustments are posted to the account.

For Question (b), THESL understands the question to be whether over or under-accrual of interest carrying charges, as a result of a recalculation, should be treated differently from any other amounts to be recovered (or refunded) in the disposition of amounts now in account 1562.

Response:

- a) If the principal balance in account 1562 is recalculated as part of a tax reassessment or as part of the current process, the carrying charges should be recalculated to reflect what the carrying charge would have been if the balance in the account was computed correctly from the start. Thus, addressing the two points under Question (a) above in turn:

- i) Interest should be calculated using the traditional simple method (no compounding); and
- ii) Restated variance amounts should be assumed to occur at the time of their original accrual rather than at the time that amounts are recalculated. Any other approach could result in inequitable distortions as a result of differences across distributors in the timing or extent of recalculation in variance amounts.

In combination, these approaches will bring the balance in the account up to date and will be the most equitable for both distributors and customers.

- b) Without further information either with respect to the special treatment proposed under Question (b) or the rationale for such treatment, THESL submits that no special treatment should be given to changes in the interest calculated for account 1562. Special treatment would depart from the policy set by the Board in calculating carrying charges for other regulatory assets. No information has been provided to suggest that this is a desirable outcome.

Section 3: Impact of MAADs

Question:

Should the consolidated entity of 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 balances before consolidation be examined in the proceeding?

Response:

THESL takes no position on this issue.

Please contact me for any questions or comments at the contact information listed below.

Yours truly,

[original signed by]

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cc: Registered Intervenors for EB-2008-0381, by electronic mail only