

**IN THE MATTER OF** the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15 (Schedule B);

**AND IN THE MATTER OF** an application by Ontario Power Generation Inc. pursuant to section 78.1 of the *Ontario Energy Board Act, 1998* for an Order of Orders determining payment amounts for the output of certain of its generation facilities.

**AND IN THE MATTER OF** Rule 42 of the Rules of Practice and Procedure of the Ontario Energy Board.

## **NOTICE OF MOTION**

The School Energy Coalition (“SEC”) will make a motion to the Ontario Energy Board (the “Board”) at its offices at 2300 Yonge Street, Toronto on a date and time to fixed by the Board.

### **THE MOTION IS FOR:**

- 1) A review and variance, pursuant to Rule 42.01 of the Board’s Rules of Practice and Procedure, of the Board’s decision with reasons of March 10, 2011 in EB-2010-0008 (the “Decision”) in which the Board erred in fact and law by not addressing an issue, raised by SEC, that is material to the determination of the payment amounts. The issue in question is the treatment of tax deductions taken by Ontario Power Generation (“OPG”) prior to April 1, 2008 relating to amounts recovered or recoverable from ratepayers in the payment amounts on or after April 1, 2008 (sometimes referred to in this Notice of Motion as “timing differences” or “regulatory tax deductions”).
- 2) An Order that this Motion satisfies the threshold test in Rule 45.01 of the Board’s Rules of Practice and Procedure.
- 3) An Order for an oral hearing of the Motion on the merits.
- 4) An Order:
  - a) Establishing the amount of regulatory tax deductions available on April 1, 2008 to offset future taxable income for the prescribed facilities to be \$1,660.4 million.

- b) Applying the amount of \$212.9 million of the regulatory tax deductions as of April 1, 2008 to reduce forecast taxable income for the previous test period to zero, leaving a balance of \$1,447.5 million of regulatory tax deductions available for the ratepayers as of December 31, 2009, thus reducing the amount recoverable from the Tax Loss Variance Account by the grossed-up tax provisions included for that period.
- c) Applying the amount of \$121.7 million of the regulatory tax deductions as of December 31, 2009 to reduce the expected taxable income for 2010 to zero, leaving a balance of \$1,325.8 million of regulatory tax deductions available for ratepayers as of December 31, 2010, thus reducing the amount recoverable from the Tax Loss Variance Account by the grossed-up tax provision included for 2010.
- d) Applying an amount of the regulatory tax deductions as December 31, 2010 equal to the net taxable income of the Applicant for 2011 as otherwise calculated in the final rate order to reduce that taxable income for 2011 to zero, thus reducing the payment amounts for 2011 by the amount of any grossed up tax provisions that would otherwise be required.
- e) Applying an amount of the regulatory tax deductions as of December 31, 2011 equal to the net taxable income of the Applicant for 2012 as otherwise calculated in the final rate order to reduce that taxable income for 2012 to zero, thus reducing the payment amounts for 2012 by the amount of any grossed up tax provisions that would otherwise be required.
- f) Applying \$168.7 million of the regulatory tax deductions to reduce to zero the taxable income otherwise generated by recovery of the 2008/9 mitigation amount, thus reducing the amount recoverable from the Tax Loss Variance Account by the grossed-up tax provision included in respect of the mitigation amount.
- g) Subject to the reports proposed below, declaring a remaining balance of regulatory tax deductions of approximately \$400-\$500 million, to be available to reduce taxable income for ratemaking purposes in the period after 2012.
- h) With respect to timing differences for Pension and OEB costs, directing the Applicant to file a detailed report in its next cost of service case providing sufficient information for the Board to determine whether Pension/OPEB timing differences in 2005-2008 relate to the period prior to that time or subsequent to that time.
- i) With respect to the pre-2005 tax losses utilized by the Applicant to reduce unregulated income in 2005 and 2006, directing the Applicant to file a detailed report in its next cost-of-service application providing full details on how these losses arose, and the extent, if any, that they relate to costs incurred or expected to be incurred and included in rates in the period after March 31, 2008.

- j) In the event that the final rate order for 2011 and 2012 payment amounts is approved prior to the hearing of this Motion, establishing a variance account to record the overcollections from the Tax Loss Variance Account and the base payment amounts as a result of the differences between the amounts in the Decision, and the adjusted amounts resulting from paragraphs (a) through (i) above

Or, in the alternative to the above

- k) Ordering an inquiry to determine the amount of tax deductions taken by OPG prior to April 1, 2008 that relate to amounts recoverable from ratepayers in payment amounts on or after April 1, 2008, such inquiry to include a report by an independent expert, and provision, in a separate proceeding or in the next application for payment amounts by OPG, for a review of that expert report and any other relevant evidence, such that the Board can determine the correct amount of the said regulatory tax deductions at that time, and their impact on the Tax Loss Variance Account and the payment amounts.
- l) Establishing a variance account to record the overcollections from the Tax Loss Variance Account and the base payment amounts as a result of the differences between the amounts in the Decision, and the adjusted amounts resulting from the Board's determination in that subsequent review.

**THE GROUNDS FOR THE MOTION ARE:**

***Background***

- 5) In its decision in EB-2009-0038 (the "Review Decision") the Board established a Tax Loss Variance Account for OPG. The Review Decision was on a motion for review of the Board's decision (the "Payment Decision") in EB-2007-0905 setting the payment amounts for OPG for 2008 and 2009. Included in the Payment Decision was a determination that the payment amounts would be reduced by way of mitigation. OPG had asked for that reduction in its application, to reflect regulatory tax losses for the period prior to April 1, 2008. The Payment Decision ordered the requested mitigation, but without tying it to the regulatory tax losses. The Review Decision overturned that determination, reconnecting the mitigation to the regulatory tax losses. The Tax Loss Variance Account was the intended vehicle to connect the two. The Review Decision specified that "the clearance of this account will be reviewed in OPG's next payment application hearing when a future panel of the Board reviews the tax analysis ordered in the Payment Decision".

- 6) In its 2010 cost of service application for payment amounts in 2011 and 2012 (EB-2010-0008, the “Application”), OPG sought approval to recover amounts in various deferral and variance accounts, including the Tax Loss Variance Account, and also sought approval to recover PILs payable with respect to taxable income in the Test Period. These approvals were included in the proceeding on the Board-approved Issues List under 10.1 and 10.2 (amounts in deferral and variance accounts) and 6.11 (income taxes recoverable). OPG sought recovery from the Tax Loss Variance Account of \$492 million over a 46 month period.
- 7) As the evidence in the proceeding unfolded, it became clear on the record that, in the period prior to being regulated by the Board (i.e. prior to April 1, 2008), OPG took tax deductions for amounts that have been, or will be, recovered from ratepayers in the period after March 31, 2008. The effect of that fact is that some amount of expenditures being recovered from ratepayers in Board-approved payment amounts in each of the years 2008 through at least 2012, and likely beyond, are not tax deductible because the tax deductions for those amounts were taken by OPG previously. The result is an artificial increase of the payment amounts for the period April 1, 2008 and beyond.
- 8) Based on the “benefits follow costs’ principle, SEC identified this issue and argued that the issue the Board must address was not what tax losses exist, but rather the amount of the pre-regulation tax deductions taken by OPG prior to April 1, 2008 for which ratepayers in future have had, or will have, to bear the underlying cost. SEC argued, in its analysis of OPG’s written and oral evidence, that the amount of timing difference benefits that should be accrued to ratepayers from the pre-regulated period totals \$1,660.4 million.
- 9) At an effective tax rate of 28.5%, this translates into incremental taxes to be included in the payment amounts, over and above those properly included in the payment amounts for costs incurred since April 1, 2008, of \$473.1 million. Grossed-up for the taxes on those incremental amounts, the effect is to artificially increase the payment amounts by \$661.7 million over a period of approximately 2008 through 2015.
- 10) Further, \$169.7 million of those deductions relate directly to the taxes payable in the Test Period. As set forth in the Draft Payment Order presented by OPG to the Board (Tables 6 and 7), the amounts recoverable from ratepayers included in the payment amounts exceed the tax deductions

available by \$169.7 million (\$132.1 million nuclear, and \$37.6 million hydroelectric), having an impact on taxes payable of \$42.4 million, which grossed up results in the payment amounts being overstated by \$56.6 million. Under the “benefits follow costs” principle, since the ratepayers are bearing those costs, the ratepayers should receive the benefits associated with their tax deductibility.

11) SEC’s position on timing differences was supported by other parties in their final arguments to the Board.

***Failure to Address a Material Issue***

12) The primary error in the Decision is that the Board did not deal with the issue of the timing differences and how they should be treated. This is an error that goes to the correctness of the Decision.

13) SEC submits that the timing differences constituted a necessary issue to be addressed, because:

- a) The “benefits follow costs” principle requires that whoever pays a cost gets the benefit of the tax deduction related to that cost. This principle appears to be undisputed, as it has been recognized not just by SEC, but by both the Board<sup>1</sup>, and OPG.<sup>2</sup> It has also been supported by the Board in numerous other decisions. In the context of a rate case such as this, the principle requires that if a cost is recovered from ratepayers, then the tax attributes of that cost (including its deductibility) accrue to the benefit of ratepayers. Conversely, if a cost is not to be borne by the ratepayers, the tax attributes should also not benefit the ratepayers.
- b) The evidence on the record before the Board is clear that some amounts of tax deductions related to expenditures included in the post April 1, 2008 payment amounts were actually taken by OPG in the period prior to April 1, 2008. While the total amount of those timing differences may well be in dispute, there does not appear to be any dispute that some material amount of timing differences does exist.

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<sup>1</sup> Payments Decision in EB-2007-0905 at p. 170.

<sup>2</sup> OPG Reply Argument in EB-2010-0008 at p.178.

c) If there is any material amount of timing differences, the benefits follow costs principle would require that the ratepayers be given credit for the tax savings associated with those deductions, since the ratepayers are paying the costs.

14) It is SEC's submission that, in order to set payment amounts that are just and reasonable, the Board was obligated to ensure that all appropriate tax costs and savings were included in all relevant calculations. The Board has, by failing to make a determination on the amount of the tax deductions previously taken by OPG that should properly be available to reduce taxes payable by the ratepayers, included in the payment amounts the costs but not the related tax savings, and thus erred.

15) In addition, the Board has, by calculating the amount accruing in the Tax Loss Variance Account in the period 2008 through 2010 without taking into account tax deductions that should properly be available to reduce tax recoverable from the ratepayers, included in the calculation of the amount in that account the costs but not the tax savings, and thus erred.

16) The Board's findings with respect to SEC's argument on timing differences do not address the underlying rationale of that argument. The Board's only conclusion with respect to this issue is that it did not agree with the final amount that was calculated by SEC:

“SEC argued that the appropriate application of the “benefits follow costs” principle, which was articulated by the Board in the original payments decision, would see the inclusion of the impact of timing differences in the calculation of the tax amounts. The result of SEC's approach would be a proposed credit for ratepayers resulting from net timing differences of \$1,660.4 million. Of this \$1,660.4 million, SEC identified \$1,052.4 million for the prescribed facilities and \$608.0 million for Bruce.

OPG has pointed to significant deficiencies in SEC's analysis, and the Board finds that OPG's criticisms have merit. For example, the Board agrees that OPG's treatment of the amounts related to the PARTS account is consistent with the Board's prior decision which required that the timing of the tax effect be aligned with the recovery of the cost. The Board also accepts OPG's evidence that the effect of timing differences is not always as SEC has posited, and in particular not in the case of asset retirement costs. The Board also concurs with OPG's position that it is clear the Board intended for Bruce revenues and costs to be excluded from the analysis. For these reasons, the Board finds SEC's calculations and estimations to be unpersuasive.”<sup>3</sup>

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<sup>3</sup> Decision in EB-2010-0008 at p. 135.

17) It is submitted that “OPG’s criticisms” are correctly described in the Decision as follows:

- a) “SEC’s analysis consists of untested evidence.”<sup>4</sup> The Board did not deal with this criticism in its analysis and findings. Whether it had accepted or rejected that criticism could not, in any case, result in a decision that all impacts of timing differences should be rejected.
- b) “SEC’s analysis violates Board approved regulatory principles and does not comply with accepted tax and accounting practices.” The Board did not deal with this criticism expressly in its analysis and findings.
- c) “SEC’s generalization regarding the pattern associated with timing differences is incorrect.” The Board accepted this criticism.
- d) “SEC’s analysis is based on misinterpreted facts and faulty assumptions.” This criticism was accepted by the Board.

18) It is submitted that the only aspects of the issue of timing differences to which the Board responded were those with respect to the calculations (i.e., c and d above), not the principle. In our submission, it was not open to the Board to limit its analysis to whether the SEC calculations were correct. Instead, the Board was obligated to make the following determinations:

- a) If OPG took any tax deductions prior to April 1, 2008, and the actual amounts that were deducted are being recovered in regulated rates on or after April 1, 2008, does the “benefits follow costs” principle require that the benefit of those tax deductions flow to the ratepayers paying those costs, notwithstanding that OPG has taken the benefit of the tax deductions in a prior period?
- b) If the answer to (a) is yes, does the evidence reveal whether there is any amount of costs included in rates on or after April 1, 2008 for which no tax deductions were available?

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<sup>4</sup> Ibid at p. 132.

- c) If the answer to (b) is yes, what is the amount of the missing (i.e. unavailable) tax deductions in the period commencing April 1, 2008 that were taken by OPG prior to that period?
  - d) Once the answer in (c) is determined, what is the appropriate method to ensure that the full amount of the tax benefits associated with amounts recoverable from ratepayers accrue to the benefit of the ratepayers?
- 19) The Board did not, in the Decision, determine as it was obligated to do whether the benefits follow costs principle applies to tax deductions taken by a utility in a period different from the period of recovery of the underlying expense from ratepayers. This is a well-accepted regulatory principle, and the Board should have determined that the principle applies to the OPG timing differences.
- 20) The Board did not, in the Decision, determine as it was obligated to do whether there are costs included in rates in the period April 1, 2008 and thereafter for which tax deductions are unavailable. The evidence in the Application was clear that regulatory taxable income was greater than regulatory accounting income in each of 2008, 2009, 2010, 2011 and 2012. Therefore, failing any recalculation of these amounts by OPG or the Board, the Board should have determined that there were amounts in each of those years which were recoverable from the ratepayers as costs, but for which tax deductions were not available in those years.
- 21) The Board did not, in the Decision, determine as it was obligated to do whether the non-deductible costs included in 2008-2012 recoveries from ratepayers related to:
- a) Accounting costs in those years that are never deductible for tax purposes;
  - b) Accounting costs in those years that are not deductible until later years; or
  - c) Accounting costs in those years that were deducted by OPG in periods prior to April 1, 2008.
- 22) It is submitted that the Board was required to make a determination whether there were any timing differences of the type identified by SEC in its final argument, and if so the amount. What the Board determined was “The Board finds SEC’s calculations and estimations to be



unpersuasive”.<sup>5</sup> While it is well within the Board’s jurisdiction to make such a finding, it is not enough simply to reject the numbers proposed by a party. The Board was then required to determine what, on the evidence, were the right numbers. It failed to do so.

23) The Consumers’ Council of Canada (CCC) proposed in their final argument that the entire issue be deferred so that the Board could get an independent expert to report on the evidence. If the Board lacked sufficient evidence to determine the correct amount of the timing differences, it had that option available to it. However, it declined to do so<sup>6</sup>. In our submission it was not open to the Board to say that it had sufficient evidence to determine the issue, but then to fail to make that determination based on that evidence.

24) The failure to determine the amount of the timing differences caused the payment amounts to be too high, in three separate ways:

- a) The payment amounts for the Test Period include an amount for taxes. The regulatory taxable income exceeds the regulatory accounting income by \$169.7 million due to costs that are being recovered from ratepayers in the payment amounts, but are not deductible for tax purposes because of timing differences. The payment amounts are artificially increased by \$56.6 million as a result.
- b) The Tax Loss Variance Account is based in part on regulatory taxes payable in the period 2008 through 2010 (as extended by the Board in the Decision at p. 136). In that period there was a material difference between regulatory taxable income and regulatory accounting income, representing amounts included in the payment amounts for those years that were not deductible for tax purposes because of timing differences. The calculation of tax payable for that period is artificially increased as a result, and after gross-up, the Tax Loss Variance Account was artificially increased for that period.
- c) In each of (a) and (b) above, there is a remaining amount of taxable income, equivalent to the regulatory accounting income, on which tax is then calculated. However, the nature of the “benefit” the tax system provides with respect to timing differences is that

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<sup>5</sup> Ibid, p. 135.

<sup>6</sup> Ibid, p. 135.

deductions are accelerated relative to their timing for accounting purposes. The deductions taken by OPG prior to April 1, 2008 should still be available for deduction (for the benefit of the ratepayers) on or after that date, and under the tax rules can be taken immediately. Therefore, any remaining taxable income for the period 2008 through 2012 should be reduced to zero, as long as there are sufficient regulatory tax deductions available. The reduction would include the mitigation amount of \$168.7 million arising out of the Review Decision, such that, while that amount would be recoverable from ratepayers, it would not have to be grossed-up to reflect taxes.

25) It is therefore submitted that, by failing to make any determination on the tax deductions that should be available to reduce payment amounts in the 2008 through 2012 period, the Board has ordered payment amounts that are in excess of an amount that would be just and reasonable.

**DOCUMENTARY SUPPORT TO BE RELIED ON:**

26) Material from the record in EB-2010-0008, which SEC will prepare in a compendium and file at the time it files its written submissions on the Motion, or at such other time as the Board may direct

27) The Decision, the Payment Decision, and the Review Decision.

28) SEC's submissions on this Motion, to be delivered pursuant to the Board's procedural orders in this matter.

29) Such other material as counsel may advise and the Board permits.

March 30, 2011

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**AND TO: All Intervenors in EB-2010-0008**