November 20, 2009

Ontario Energy Board
P.O. Box 2319
2300 Yonge Street 27th Floor
Toronto, ON
M4P 1E4
Attention: Ms. Kirsten Walli, Board Secretary

Re: Deferred Payments in Lieu of Taxes ("PILs") Threshold Question
Board File No. EB-2008-0381

As part of Procedural Order #6 issued on October 26, 2009, the Ontario Energy Board (the "Board") made provision for submissions from any parties regarding a threshold question for this proceeding. Following is the submission of the Coalition of Large Distributors ("CLD"), namely Enersource Hydro Mississauga, Horizon Utilities Corporation, Hydro Ottawa Limited, PowerStream Inc, Toronto Hydro-Electric System Limited and Veridian Connections Inc., working jointly with EnWin Utilities Ltd.

The CLD and EnWin have jointly retained the following counsel:

George Vegh
McCarthy Tétrault LLP
Suite 5300
Toronto Dominion Bank Tower
Toronto, Ontario
Canada M5K 1E6
Telephone: 416-601-7709
Fax: 416-868-0673
Email: gvegh@mccarthy.ca

Please include Mr. Vegh on the distribution list for future communications on this issue. Thank-you for this opportunity to provide our submission.

Yours truly,

Original Signed By

Lynne Anderson
Chief Regulatory Affairs and Government Relations Officer

On behalf of the CLD and EnWin Utilities

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

AND IN THE MATTER OF a proceeding commenced by the Ontario Energy Board on its own motion to determine the accuracy of the final account balances with respect to account 1562 Deferred PILs (for the period October 1, 2001 to April 30, 2006) for certain 2008 and 2009 distribution rate applications before the Board.

SUBMISSIONS BY THE COALITION OF LARGE DISTRIBUTORS AND ENWIN UTILITIES LTD.

George Vegh

McCarthy Tétrault LLP
Toronto Dominion Bank Tower
Suite 5300, Box 48
Toronto, ON M5K 1E6

gvegh@mccarthy.ca

Tel: (416) 601-7709
Fax: (416) 868-0673

Counsel for the Coalition of Large Distributors and EnWin Utilities Ltd.

PART I: Introduction and Summary

1. These are the submissions of the Coalition of Large Distributors, namely Enersource Hydro Mississauga, Horizon Utilities, Hydro Ottawa Limited., PowerStream Inc. Toronto Hydro Electric System and Veridian Connections Inc. (the "CLD"[1]) working jointly with EnWin Utilities Ltd.

2. The question that Board staff proposed, and on which the Board requested submissions, is as follows:

> "The Board's authority to adjust electricity rates was limited by Bill 210 from November 11, 2002 until January 1, 2005. Does the Bill 210 limitation on the Board's rate setting authority in the rate-freeze period in effect to December 31, 2004, impose any restrictions on the Board's ability to make adjustments to the account 1562 balances as they existed, and were audited, as of December 31, 2004?"

3. The limitation on the Board's ability to make rate orders from November 11, 2002 to January 1, 2005 (the "Rate Freeze Period") impacts these proceedings in two ways. The treatment of these as threshold issues is helpful so that it can guide the Board in determining and scoping its next steps.

4. The first impact is jurisdictional and relates to amounts that were approved in final rate orders that operated during the Rate Freeze Period, in particular, the Board-approved PILs amount for 2001. These amounts ("Board-approved PILs amounts") were approved in final orders for 2002 and thus were maintained throughout a portion of the Rate Freeze Period until they were replaced in subsequent rate orders. The Board does not have the jurisdiction to retroactively seek to deny recovery of Board-approved PILs amounts for 2001. Board staff submissions do not contradict this position. However, given that it does raise a threshold legal issue, it is important to characterize the legal implications explicitly and accurately. This will be addressed in Part II.

[1] References to CLD members include their predecessors.

5. The second type of impact of the rate freeze relates, not to amounts that were approved in rates, but to the audited balances of Account 1562 as of December 31, 2004 (the "2004 Audited Amounts"). Those entries were accurately described by the Board staff in its discussion paper that accompanied the launch of this review as "designed to track and record: The variances resulting from the difference between the Board approved PILs amount and the amount of actual billings that relate to the recovery of PILs."[2]

6. Board staff's submission is that the Board is authorized to conduct a "full prudence review" of those amounts, including reviewing the "methodology" applied by distributors to determine these amounts and the final balances of the account for the period from October 1, 2001 to April 30, 2006. The CLD and EnWin do not disagree with this proposition as a general matter, and suggest that the important point at this stage of the proceeding is for the Board to confirm the application of the "prudence review" in this context. This will be addressed in Part III.

7. By way of summary, applying OEB practice and legal requirements respecting prudence reviews, the Board must review the prudence of the 2004 Audited Amounts by applying a two-stage approach. First, the Board must apply the presumption of prudence. In this case, that means applying the presumption that the 2004 Audited Amounts (including their methodology and balances) were prudently incurred. That presumption may be overcome on the basis of evidence that demonstrates reasonable grounds for undertaking a review of specific components of the 2004 Audited Amounts – not a blanket request.

8. The second stage in determining prudence arises only if the Board determines that the presumption of prudence can be overcome and that there are reasonable grounds for undertaking a review. In that case, the Board may determine whether the entries, methodologies and final balances were prudent given the circumstances that were known or ought to have been known to distributors at the time the entries were made. These circumstances include, but are not limited to, direction that was provided by the Board

[2]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*, EB-2007-0820 (the "Staff Paper), at p. 5. See also p. 3, where the Staff Paper states that the purpose of the account is to track "The total difference between the expected amount included in rates and the amount collected." (emphasis added).

and guidance provided by Board staff through materials such as letters from the Board Secretary, the Accounting Procedures Handbook and associated Frequently Asked Questions posted on the Board's web-site, the various annual Spreadsheet Implementation Model for Payments in Lieu of Taxes (the "SIMPIL"), and other information provided to utilities by Board staff with respect to the treatment of those accounts.

9. It is important to emphasize that the Board should not engage in an attempt to measure a utility's entry by reference to any current theories or constructs put forward to justify accounts or create new methodologies. Rather, the Board's measurement of prudence should be by reference to the circumstances of the time.

10. The remainder of these submissions address the jurisdictional and prudence issues. The CLD and EnWin submit that in light of these issues, the next step of these proceedings should be to make it clear that the Board will not be engaging in any review of the Board-approved PILs amounts that were included in 2002 base distribution rates and that the Board will approach its review of the entries, methodologies and final balances of Account 1562 through the prudence framework.

PART II: The Jurisdictional Issue – the 2002 Rate Orders and the Board-approved PILs Amounts.

11. The OEB issued orders setting distribution rates for CLD members and EnWin (and all other distributors) for the 2002 rates year[3]. All of these orders:

[3] The rate orders are: Toronto Hydro-Electric System, February 26, 2002 (RP-2002-0002; EB-2002-0011); Hydro Ottawa Limited, March 7, 2002 (RP-2002-0051); PowerStream (Comprised by Aurora Hydro (RP-2002-0061; EB-2002-0070), Markham Hydro (RP-2002-0079; EB-2002-0088), Richmond Hill Hydro (RP-2002-0083); EB-2002-0092); Hydro Vaughan (RP-2002-0056; EB-2002-0065), and Barrie Hydro (RP-2002-11; EB-2002-20)); Horizon Utilities (comprised of Hamilton Hydro (RP-2002-0014; EB-2002-0023) and St. Catherines Hydro (RP-2002-0045; EB-2002-0054)); Enersource Hydro Mississauga (RP-2001-0084; EB-2002-0093); Veridian Connections Inc. (comprised of Veridian Connections Inc. (RP-2002-0075; EB-2002-0084); Gravenhurst Hydro Electric Inc. (Interim Order effective June 1, 2002 (made final by the operation of Bill 210) (RP-2002-0060; EB-2001-0069); Brock Hydro (RP-2002-0099; EB-2002-0108); Port Hope Hydro (RP-2002-0076; EB-2002-0085); Belleville (RP-2002-0074; EB-2002-0083); and Scugog Hydro Energy Corporation RP-2002-0065; RP-2002-0074)); and EnWin Powerlines Ltd. RP-2002-0013;EB-2002-0022).

- included an allowance for the 2001 Board-Approved PILs amount in base distribution rates;
- were final in nature; and
- remained in effect until changed by subsequent rate orders.

12. These orders, like many of the decisions made by the OEB in the period 2000-2001, were made on the assumption that the Board would continue to have general uninterrupted rate setting authority for distributors. When the 2002 rates were set, the Board and the sector expected that there would be several adjustments to revenue requirements in future rate orders, the first of which would have been effective in 2003. These adjustments would have included the determination of a new PILs amount and the third instalment of the market adjusted revenue requirement ("MARR").

13. The Bill 210 rate freeze prevented these adjustments from taking place as planned. Electricity distributors experienced considerable financial detriment because rates that were expected to be in place only for the 2002 rates year were in place for a longer period than that – the foregone revenue adjustment representing the third MARRs instalment totalled approximately $80 million for CLD members and EnWin alone. However, the law does not allow the Board to go back and readjust the gains and losses of distributors and ratepayers to reflect what the expectations would have been if the Board did have the power to set new rates during the Rate Freeze Period. As a corollary of this, the Board cannot selectively go back and "cherry pick" which gains and losses it would like to readjust.

14. Under the Board's statutory jurisdiction, historic gains and losses incurred pursuant to final rate orders cannot be revisited in subsequent orders. This restriction follows from two unambiguous principles of law that apply to rate orders:

    1. Final rate orders remain in place until changed by subsequent rate orders; and
    2. Subsequent rate orders can only operate on a prospective basis.

    Each of these principles will be addressed in turn.

1. Final Rate Orders Remain in Effect until Changed by Subsequent Rate Orders

15. The 2002 rate orders were final orders, not interim orders. As a result, the rates they approved remained in place, and could not be changed, until replaced by a subsequent order. The fact that the Board's inability to make such an order was legally restricted by Bill 210 does not take away from the finality of the 2002 rate orders that it did make. Regardless of what expectations are when a final order is made, rates approved by that order remain in place until changed by a subsequent order.

16. In *Northwestern Utilities Ltd.* v. *Edmonton*,[4], the Supreme Court of Canada approved of the following statement of the Alberta Court of Appeal in *City of Calgary and Home Oil Co.* v. *Madison Natural Gas Co*. (1959), 19 D.L.R. (2d) 655 (at 661): "The powers of the Natural Gas Utilities Board have been quoted above and the Board's function was to determine 'the just and reasonable price' or prices to be paid. It was to deal with rates prospectively and having done so, so far as that particular application is concerned, it ceased to have any further control. To give the Board retrospective control would require clear language and there is here a complete absence of any intention to so empower the Board" (emphasis added).

17. It is this finality that distinguishes a final order (such as the 2002 rate orders) from an interim order. As the Supreme Court of Canada stated in *Bell Canada* v. *CRTC*[5], "one of the differences between interim and final orders must be that interim decisions may be reviewed and modified in a retrospective manner by a final decision….It is the interim nature of the order which makes it subject to further retrospective directions" (emphasis added).

18. The Board has recognized and applied the legal distinction between final and interim orders and has noted that, when obtaining a final order, "A party…would have the certainty that a final order will not be reviewed later by the Board."[6]

[4] [1979] 1 S.C.R. 684
[5] [1989] 1 S.C.R. 1722
[6] Notice of Proceeding in RP-2004-0203, October 5, 2004.

19. More recently, in setting rates for Barrie Hydro Distribution Inc. effective 2009, the Board agreed that changes in PILs calculations that occurred during the year in which a final rates order governed (2008), could not be taken into account for the period covered by that rate order: "the additional amounts Barrie collected in the 2008 rate year should remain with Barrie, as it appropriately reflected the Board Decision (EB-2007-0746) for that rate year."[7]

20. Similarly, in setting an order fixing Enersource Hydro Mississauga Inc.'s 2009 distribution rates, the Board agreed with Board staff's submission that "once the Board issues its final rate order in this case, the proceeding is over and the current panel does not have the power to declare these same rates interim at a later date."[8]

2. Subsequent Rate Orders Only Operate on a Prospective Basis

21. A rate order may only be prospective in nature. It cannot be used to seek to "recapture" over or under earnings during a period in which a previous rate order was in place. Applying that here, the Board is not in a position today to seek to recover any "over earnings" (or conversely to compensate distributors for "under earnings") during the period that the 2002 rate orders were in place.

22. This proposition was unequivocally put forward by a majority of the Supreme Court of Canada in *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board):*[9]

> "From my discussion above regarding the property interest, the Board was in no position to proceed with an implicit refund by allocating to ratepayers the profits from the asset sale because it considered ratepayers had paid excessive rates for services in the past. As such, the City's first argument must fail. The Board was seeking to rectify what it perceived as a historic over-compensation to the utility by ratepayers. There is no power granted in the various statutes for the Board to execute such a refund in respect of an erroneous perception of past compensation. It is well established throughout the various provinces that utilities boards do not have the authority to retroactively change rates (*Northwestern, 1979*, p. 691; *Re Coseka Resources Ltd. and Saratoga Processing Co.* (1981), 126 D.L.R. (3d) at p. 715, leave to appeal refused, [1981] 2 S.C.R. vii; *Re Dow Chemical Canada Inc.*

[7] EB-2008-0160, p. 4.
[8] EB-2008-0171, p. 6.
[9] [2006] S.C.J. No. 4, at para. 71.

(C.A.), at pp. 734-735). But more importantly, it cannot even be said that there was over-compensation: the rate-setting process is a speculative procedure in which both the ratepayers and the shareholders jointly carry their share of the risk related to the business of the utility (See MacAvoy and Sidak, at pp. 238-39)." (Emphasis added)

23. As a result, although the Board and the parties expected that rates approved in the 2002 rate orders would be revisited for new orders effective for the 2003 rate year, that expectation does not provide jurisdiction to go back now and change orders that approved those rates.

3. The Relevance of Deferral Accounts

24. The Board staff submission spends considerable time on the fact that Account 1562 is a deferral account. It is therefore necessary to address what deferral accounts are generally and how Account 1562 operated in this case.

25. The Board has defined deferral accounts as "accounting devices intended to allow an entity to capture and record in an identifiable location an aspect of operations, the final quantum and disposition of which is dependent on some future unknown event." [10]

26. From a legal perspective, deferral accounts are administrative devices. They are not orders – in fact the Board can, and has created deferral accounts without making an order. Deferral accounts cannot create, take away, or alter legal rights and obligations. As described above, rights created by a final order can only be altered by a subsequent order, and this alteration of rights can only be made by a new order on a prospective basis.

27. This is an important point because the Board staff submission contains the statements that deferral accounts are "an exception to [the restrictions against] retroactive ratemaking" (p.6), and "are interim orders and not retroactive ratemaking." (p. 8). It is not clear what turns on these specific propositions. However, if the Board were to adopt them, it would be making a dramatic departure from Canadian legal authority in this area. The cases that are said to support these propositions should therefore be very closely considered.

[10] See: Order setting 2007 and 2008 Transmission Rates for Hydro One, August 16, 2007 (EB-2006-0501), p. 5.

28. In support of the proposition that deferral accounts are "an exception to [the restrictions against] retroactive ratemaking", Board staff relies on the Supreme Court of Canada's decision in *Bell Canada v. Bell Aliant Regional Communications*.[11] However, that decision did not create an exception to restrictions to retroactive rate making. Specifically, it did not authorize the reconsideration of amounts approved in previous orders. Rather, it addressed the CRTC's authority to order the disposition of the *difference between* amounts approved in previous orders and the amounts actually recovered. The Supreme Court of Canada put it as follows:

> "In my view, the credits ordered out of the deferral accounts in the case before us are neither retroactive nor retrospective. They do not vary the original rate as approved, which included the deferral accounts, nor do they seek to remedy a deficiency in the rate order through later measures, since these credits or reductions were contemplated as a possible disposition of the deferral account balances from the beginning."[12]

29. As a result, the *Bell Aliant* decision does not create an exception to the rule against retroactivity. To the contrary, in that decision, the Court looked to the original order authorizing rate recovery to determine the rights and obligations of the utility. The deferral account simply recorded the revenues or costs that the original rate order determined to be contingent and therefore subject to future disposition.

30. In the context of Account 1562, none of the orders approving the recovery of the 2001 Board-approved PILs amounts suggested that the entitlement to recovery of those amounts was contingent upon a future event.

31. Further, the Board (and Board staff) have described the nature of Account 1562 on several occasions. They have always recognized that Account 1562 recorded differences between amounts approved in rates and actual amounts recovered from customers. A limited number of items, specifically identified in Board documents, were subject to a true-up. At no point was it ever suggested that Account 1562 would be somehow used to reduce the amount of the 2001 Board-approved PILs amounts that were already approved for recovery in base distribution rates.

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[11] 2009 SCC 40.

32. For example, the April 2003 "Accounting Procedures Handbook Frequently Asked Questions" states:[13]

> "The Deferred Payments in Lieu of Taxes Variance Account 1562 is established to track and record the variances that results from the difference between the Board approved PILs amount and the actual billings that relates to the recovery of PILs."

33. Similarly, the Staff Discussion Paper accompanying this proceeding described Account 1562 as follows:[14]

- "Entries to Account 1562 are designed to track and record:
- The variances resulting from the difference between the Board-approved PILs amount and the amount of actual billings that relate to the recovery of PILs."

34. An account that tracks differences in amounts approved in rates and actual amounts recovered from customers cannot be used to change amounts that were approved in base distribution rates.

35. The Board staff submission also contains the statement that deferral accounts "are interim orders and not retroactive ratemaking". This seems to be different from the proposition that deferral accounts are "exceptions" to the rule against retroactivity, but, frankly, the legal proposition is difficult to follow – especially given that deferral accounts are not orders at all.

36. In this regard, the Board staff submission refer to the Alberta Court of Appeal's refusal to grant leave to appeal an Alberta Energy and Utilities Board decision addressing the disposition of a deferral account recording the differences between actual and forecasted commodity costs. The staff submissions quote from the Alberta Court of Appeal's description of the submissions of the parties, which is somewhat brief and unclear. The

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[12] At paragraph 63.
[13] April 2003 "Accounting Procedures Handbook Frequently Asked Questions", p. 1 (emphasis added).
[14] 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*, EB-2007-0820 (the "Staff Paper), at p. 5 (emphasis added). See also p. 3, where the Staff Paper states that the purpose of the account is to track "The total difference between the expected amount included in rates and the amount collected." (emphasis added).

Court of Appeal listed a number of submissions and ultimately concluded that, "Given the strong factual component that underlies this ground of appeal, the inconsistency and logistical difficulties associated with EPCOR's positions, and the applicable standard of review, the first ground does not meet the test for leave."

37. This decision cannot be relied upon for the proposition that rules against retroactive rate making do not apply.

38. The Board staff submission also puts great emphasis on the Board's approach in the *GLPL* decision. That case addressed whether GLPL was entitled to recover $2.8 million from a deferral account. The account was approved in an interim order that was made prior to the passage of Bill 210 (and that therefore became a final order as a result of Bill 210). The $2.8 million figure represented an amount that GLPL claimed to have foregone as a result of a voluntary rate mitigation plan. Although GLPL's initial rate application included a proposed revenue requirement of $12.7 million, which included the $2.8 million figure, the revenue requirement that was approved by the Board was for $9.8 million – which did not include $2.8 million. According to the Board, the fact that the order establishing the deferral account did not include a final revenue requirement was fatal to GLPL's case: "The GLPL distribution rates approved by the Board and attached as Appendix A to its May 13, 2002 Interim Decision and Order <u>did not reflect a revenue requirement of $12.7 million</u>."[15] The Court of Appeal agreed. It stated: "It is of significance that the 2002 order was interim in nature and approved the rates proposed by GLPL necessary to recover the $9.8 million."[16]

39. As a result, in the *GLPL* case the OEB refused recovery of amounts that were recorded in deferral accounts in an interim order and which were never included in a final rate order. It did not address the recovery of amounts approved in rates in a final rate order, which is the relevant situation respecting the 2001 Board-approved PILs amount.

[15] Great Lakes Power Limited Application for 2007 Rates (EB-2007-0744), October 30, 2008.
[16] Great Lakes Power Limited v. Ontario Energy Board (Court File No. 610/08), July 21, 2009, paragraph 37.

PART III: Prudence and Entries to Account 1562

40. As indicated, Board staff's submission is that the Board should conduct a prudence review of the entries to Account 1562. Subject to the forgoing submissions that the Board cannot, as part of this review, seek to retroactively change the 2001 Board-approved PILs amount, the CLD and EnWin largely agree with this basic proposition. The real issue at this stage of the proceeding is for the Board to set out how it will apply the test for prudence in this context.

41. The test for prudence that has been approved by the Board and the Ontario Court of Appeal is as follows:[17]

"The Board agrees that a review of prudence involves the following:

- Decisions made by the utility's management should be generally presumed to be prudent unless challenged on reasonable grounds.
- To be prudent, a decision must have been reasonable under the circumstances that were known or ought to have been known to the utility at the time the decision was made.
- Hindsight should not be used in determining prudence, although consideration of the outcome of the decision may legitimately be used to overcome the presumption of prudence.
- Prudence must be determined in a retrospective factual inquiry, in that the evidence must be concerned with the time the decision was made and must be based on facts about the elements that could or did enter into the decision at the time."

42. The presumption of prudence can be overcome, but a party seeking to do so must demonstrate that there is a reason why the presumption should not apply. As the OEB stated in the same decision: "a party challenging the prudence of a decision made by the utility has an obligation to raise reasonable grounds for undertaking such a review."[18]

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[17] *Enbridge Gas Distribution Inc.*, v. *Ontario Energy Board*, [2006] O.J. No. 1355, April 7, 2006, para. 10 Ont. C.A. (Quoting from OEB Decision setting EGD Rates for 2002 Fiscal Year, December 13, 2002 (RP-2001-0032), at p. 62.

[18] (RP-2001-0032), at pp. 62-63.

> "A party can raise reasonable grounds through such means as an examination of the outcome of the decision, the inherent conflict of interest of related parties to a transaction and relevant industry practices at the time the decision was made."

43. Applying that here, Board staff's requested prudence review involves a two-staged approach. First, the Board must apply the presumption of prudence. In this case, that means applying the presumption that the 2004 Audited Amounts (including their methodology and balances) were prudently incurred. That presumption may be overcome on the basis of evidence that demonstrates reasonable grounds for undertaking a review of specific components of the 2004 Audited Amounts – not a blanket request.

44. The second stage in determining prudence arises only if the Board determines that the presumption of prudence can be overcome and that there are reasonable grounds for undertaking a review. In that case, the Board may determine whether the entries, methodologies and final balances were prudent given the circumstances that were known or ought to have been known to distributors at the time the entries were made. These circumstances include, but are not limited to, direction that was provided by the Board and guidance provided by Board staff through materials such as letters from the Board Secretary, the Accounting Procedures Handbook and associated Frequently Asked Questions posted on the Board's web-site, the various annual Spreadsheet Implementation Models for Payments in Lieu of Taxes (the "SIMPIL"), and other information provided to utilities by Board staff with respect to the treatment of those accounts.

45. It is important to emphasize that the Board should not engage in an attempt to measure a utility's entry by reference to any current theories or constructs put forward to justify accounts or create new methodologies. Rather, the Board's measurement of prudence should be by reference to the circumstances of the time.

PART IV: Conclusion

46. In conclusion, the CLD and EnWin submit that the limitation on the Board's ability to make rate orders during the Rate Freeze Period impacts these proceedings in two ways.

47. The first impact is jurisdictional. For the reasons set out in Part II, the Board does not have the jurisdiction to retroactively seek to deny recovery of Board-approved PILs amounts for 2001. Board staff submissions do not contradict this position.

48. The second type of impact of the rate freeze relates to Board staff's submission that the Board is authorized to conduct a "full prudence review" of those amounts, including reviewing the "methodology" applied by distributors to determine these amounts and the final balances of the account for the period from October 1, 2001 to April 30, 2006. The CLD and EnWin do not disagree with this proposition as a general matter, and suggest that the important point at this stage of the proceeding is to clarify the application of the "prudence review" in this context.

49. For the reasons set out in Part III, a prudence review involves applying the presumption that management decisions were prudently made. That presumption can be overcome if it is demonstrated that there are reasonable grounds for undertaking a review. In that case, the Board may determine whether the entries, methodologies and final balances were prudent given the circumstances that were known or ought to have been known to distributors at the time the entries were made.

50. The CLD and EnWin respectfully submit that the next step of these proceedings should be to make it clear that the Board will not be engaging in any review of the Board-approved PILs amounts that were included in 2002 base distribution rates and that the Board will approach its review of the entries, methodologies and final balances of Account 1562 through the prudence framework.

All of Which is Respectfully Submitted

Date: November 20, 2009

George Vegh
McCarthy Tétrault LLP
Telephone 416-601-7709
Email: gvegh@mccarthy.ca

Counsel for the Coalition of Large Distributors and EnWin Utilities Ltd.