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June 21, 2010

RESS, EMAIL & COURIER

Ontario Energy Board
P.O. Box 2319, 27th Floor
2300 Yonge Street
Toronto ON M4P 1E4

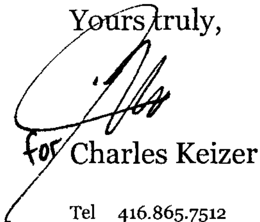
Attention: Ms. K. Walli, Board Secretary

Dear Ms. Walli:

Re: Great Lakes Power Transmission LP - 2010 Rates (EB-2009-0408) - Reply Argument

We are counsel to Great Lakes Power Transmission LP ("GLPT"), applicant in the above-referenced proceeding. Attached, please find GLPT's Reply Argument, which has been filed this afternoon on RESS.

Yours truly,



for Charles Keizer

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Intervenors
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ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an application by Great Lakes Power Transmission Inc. on behalf of Great Lakes Power Transmission LP for an Order or Orders pursuant to section 78 of the *Ontario Energy Board Act, 1998* for 2010 transmission rates and related matters.

EB-2009-0408

Applicant Reply Submissions

Great Lakes Power Transmission Inc.

on behalf of Great Lakes Power Transmission LP

June 21, 2010

These are the reply submissions of Great Lakes Power Transmission LP ("**GLPT**") in response to the submissions of School Energy Coalition ("**SEC**"), the Vulnerable Energy Consumers Coalition ("**VECC**") (together, the "**Intervenors**") and Board Staff. A Book of Authorities in support of these reply submissions is attached.[1]

A. GLPT's Position

GLPT submits that, based upon the facts and upon regulatory precedent, the Board should grant the full tax allowance requested. After accounting for the Board-approved Settlement Agreement, the full amount of the requested tax allowance is $1,729,806. With this tax allowance, GLPT's revenue requirement is $35,148,818.

In the submissions of the Intervenors and Board Staff, attempts have been made to summarize GLPT's position. In each case, GLPT's position has been mischaracterized. In summary, GLPT's position is as follows:

- GLPT is a limited partnership with a structure that is simple and straight forward. The focus for regulatory purposes is the limited partnership.
- The partners of GLPT, Great Lakes Power Transmission Inc. ("**GLP Inc.**") and Brookfield Infrastructure Holdings (Canada) Inc. ("**BIH Inc.**"), are taxable Canadian corporations. GLP Inc. and BIH Inc. bear the burden of the tax liability that arises from the income earned from the transmission business. Both of these taxpayers file tax returns annually to report their taxable income and both are subject to audit by the Canada Revenue Agency. As a result, the Board's inquiry with respect to the tax condition, tax liability and tax burden should rest with BIH Inc. and GLP Inc. as the partners of GLPT.
- BIH Inc. is a holding company formed for the purposes of holding the Canadian investments of Brookfield Infrastructure Partners LP ("**BIP**"). Currently, BIP's Canadian

[1] The materials provided at Tabs D and E of the Book of Authorities are not being provided as legal authorities but, rather, are being provided for the convenience of the Board.

investments are its investments in GLPT and Island Timberlands LP ("**Timberlands**"). It is assumed for purposes of this reply argument that, for the 2010 test year, in accordance with the *Income Tax Act*, tax losses will be allocated to BIH Inc. from Timberlands. It is further assumed that these tax losses, or tax losses from prior years, will offset the taxable income derived from GLPT in the test year. Notwithstanding this, BIH Inc. continues to incur a tax liability from the inclusion in its income of profit from the regulated business of GLPT. The income from GLPT has the effect of reducing tax losses that would otherwise be available in the future to offset taxable income arising from Timberlands. A tax liability is incurred.

- Because BIH Inc. has two sources of income, one regulated and one not regulated, GLPT invokes the stand alone principle to establish that the income from the timber business is not relevant to the determination of a tax allowance specifically related to the regulated transmission business. The costs that give rise to the tax losses are not costs that are borne by the ratepayers. Ratepayers are not entitled to receive the benefit of using the tax losses because the benefit is associated with costs that the ratepayers have not borne and will not bear.[2]

- The tax allowance provision included in GLPT's rate application relates to income taxes arising directly from the provision of transmission services in Ontario on a stand alone basis, with the tax burden borne by GLP Inc. and BIH Inc. The circumstance for BIH Inc. is analogous to a corporation that has both regulated and unregulated divisions. The Board has previously considered such an analogous circumstance, where the applicant

[2] See Robert. L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities,* (Newark, NJ: Matthew Bender & Company, Inc./LexisNexis Group, 2009), Part V, Chapter 17, Section 17.05[2]: "Income tax normalization is consistent with a fundamental principle of the cost of service approach to ratemaking; the principle that consumers should bear only the costs for which they are responsible. Under this principle, there is a well reasoned, and widely recognized, postulate that taxes follow the events they give rise to. Thus, if ratepayers are held responsible for costs, they are entitled to the tax benefits associated with the costs. If ratepayers do not bear the costs, they are not entitled to the tax benefits associated with the costs."

itself was not the direct taxpayer, in a rate application on behalf of Great Lakes Power Limited's distribution division. In this circumstance, the full tax allowance was allowed.[3]

B. Summary of GLPT's Reply

Intervenors and Board Staff have shown no basis in fact as to why the requested tax allowance should not be granted and have shown no basis in fact or law as to why the stand alone principle should not be applied.

In this proceeding, there have been two rounds of interrogatories, a technical conference, a motion and an oral hearing. During each of these stages in the proceeding, consideration has been given to the tax allowance issue. No evidence has been filed at any stage of this proceeding by either of the Intervenors or Board Staff. Moreover, in their final arguments, no evidence is cited by SEC, VECC or Board Staff to support their respective positions. As a result, one must conclude that there is no factual basis for their assertions - their submissions are purely conjecture. Furthermore, in their final arguments SEC and Board Staff misinterpret the legal precedents that they refer to. The Intervenors and Board Staff have no basis in law for their respective positions.

Of particular importance is that the Intervenors and Board Staff also fail to consider the fundamental tenet of the stand alone principle that the "benefit should follow the cost". At no time do they address the consideration that the ratepayers bear none of the expense giving rise to the tax loss and, as such, should not have the benefit of the tax loss.

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3 See *Great Lakes Power Limited*, EB-2007-0744, Decision and Order, October 30, 2008, pp. 40-41: "The Board finds that the 2007 test year tax provision should be calculated without regard for corporate tax loss carry-forwards that arose due to losses in GLPL's nondistribution businesses. The Board agrees with GLPL that it has been the Board's policy to apply the standalone principle when assessing the tax provisions of regulated businesses. In the Board's view, fairness in ratemaking requires adherence to the principle that a party who bears a cost should be entitled to any related tax savings or benefits . . . The principle that the Board relied on in accepting the 2006 DRH treatment of disallowed expenses is equally applicable in this case. The pre-2007 expenses and losses of GLPL's unregulated businesses were borne by GLPL's shareholder, not ratepayers. It would be fundamentally unfair to take such tax losses into account when setting rates for regulated service. To abandon the stand-alone principle in this case would give rise to the inappropriate result that rates for regulated service would be affected by the income or loss of a non-regulated business."

C. The Correct Statement of Facts

The Intervenors and Board Staff have mischaracterized and ignored the facts in certain key areas. To address this, a summary of the correct facts found in evidence is set out below.

1. GLPT's Structure and its Rationale

GLPT's structure is not complex. GLPT is a limited partnership that has as its general partner, holding a 0.01% interest, GLP Inc., and as its limited partner, holding a 99.99% interest, BIH Inc.[4] The figure presented at page 5 of Exhibit 1, Tab 1, Schedule 12 further shows that the holdings of BIH Inc. also includes Timberlands, which is a large, non-regulated timber business situated in British Columbia and which is structured as a limited partnership that has as its limited partner BIH Inc.

As described in the evidence, the formation of a partnership does not create a separate or distinct legal entity. As a result, partnerships are not distinct legal persons. For this reason, GLPT cannot be distinguished from GLP Inc. and BIH Inc. for tax purposes. In these circumstances, the *Income Tax Act* dictates that the individual partners pay tax on the basis of their respective shares of the income or losses of the partnership.[5] The evidence is clear that both of the partners - GLP Inc. and BIH Inc. - are taxable Canadian corporations.[6]

As explained by Mr. Grosman during cross-examination by counsel for SEC, the structure of GLPT as described above was selected based on a number of factors. To understand the rationale for using the structure, it is important first to recognize that BIH Inc. is indirectly controlled by BIP, which is a publicly traded entity that owns many significant assets in many jurisdictions around the world. To hold these assets, the approach that BIP takes in the jurisdictions where it owns assets is to set up as few entities and as few corporations as possible.[7] Consistent with this widely used BIP approach, BIH Inc. was established for the purpose of

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[4] Exhibit 1, Tab 1, Schedule 12, p. 5.
[5] Response to Board Staff Supplemental Interrogatory #11.
[6] Response to Board Staff Interrogatory 49(ii).
[7] Hearing Transcript, p. 37, line 21.

holding BIP's Canadian assets, which at present consists of the regulated transmission business of GLPT and the non-regulated timber business of Timberlands.[8]

Another consideration that has influenced the structure is that for administrative purposes it is preferable to be able to file one tax return and, furthermore, that the preferred approach to achieving this outcome is to establish partnerships held by the single corporation.[9] In fact, when Mr. Grosman was asked about the primary motivation for the structure, it was this aspect - to allow for the filing of a single tax return - that was cited most prominently by GLPT's witness.[10]

Other considerations for structuring GLPT in the form of a partnership include that BIH Inc. already held its investment in Timberlands in the form of a partnership,[11] that partnerships have the benefit of providing limited liability,[12] as well as that the partnership structure can simplify any potential future reorganization involving the relevant business.[13] In light of these reasons supporting the use of a partnership structure for GLPT and the significant experience by BIP in using similar structures to hold numerous investments around the world, GLPT indicated that the partnership structure was regarded by BIH Inc. as the preferred structure for GLPT from the outset and that there was no formal analysis performed for purposes of selecting this structure.[14]

2. *Basis for the Tax Losses of Timberlands*

To understand the basis for the tax losses recently incurred by Timberlands, it is necessary to first understand the scope and nature of the business that has given rise to these tax losses. Timberlands is a large and complex business.[15] Timberlands paid approximately $1 billion to acquire its assets[16] in 2005 from Weyerhauser Company, which had acquired the assets in the

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[8] Hearing Transcript, p. 37, line 23 - p. 38, line 3.
[9] Hearing Transcript, p. 38, lines 4-13.
[10] Hearing Transcript, p. 39, lines 3-26.
[11] Response to Board Staff Supplemental Interrogatory 10.
[12] Hearing Transcript, p. 40, line 23.
[13] Response to Board Staff Supplemental Interrogatory 10.
[14] Response to Board Staff Supplemental Interrogatory 10.
[15] Hearing Transcript, p. 28, line 28.
[16] Hearing Transcipt, p. 34, line 18.

late 1990s through its purchase of MacMillan Bloedel Limited.[17] Timberlands has operations on and in the vicinity of Vancouver Island, with head offices in Nanaimo, British Columbia. The company owns and manages approximately 634,000 acres of freehold timber lands primarily on Vancouver Island, but also along the mainland coast of B.C. and on the Queen Charlotte Islands.[18]

Operational costs for Timberlands are driven in part by its focus on sustainable forest management practices and good forest stewardship, which includes such activities as fire prevention, pest and insect management, and erosion protection.[19] In addition to forest management, costs arise from business operations that include activities associated with the harvesting of trees, the sale of forest products,[20] reforestation/tree planting and the transport of products to customers. All of these activities take place within a company that places a high level of importance on worker and public safety, as well as sustainable forest management practices and community engagement.[21] Aside from its operational costs, the company incurs interest expenses on the approximately $450 million in debt that was used to acquire the business.[22] In summary, there are significant and ongoing operational and other expenditures that must be incurred to maintain and support the future success of the Timberlands business.

However, there are a number of significant variables in the operation of the timber business that are out of the control of Timberlands' management and which can and do significantly affect its fortunes. These include the price of lumber in the marketplace, foreign exchange rates, shipping costs and mill capacity, among others.[23] Unfortunately for Timberlands, market conditions have recently been very poor for the forest products sector. In particular, the demand for timber products is down because of the very significant slow-down in home building in the United

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[17] See www.islandtimberlands.com
[18] SEC Motion Record, Tab 7, Supplemental Information Filing of Brookfield Infrastructure Partners L.P., p. 12.
[19] Hearing Transcript, p. 28, lines 18-22.
[20] Hearing Transcript, p. 29, lines 1-2.
[21] See www.islandtimberlands.com
[22] Hearing Transcript, p. 20, lines 23-35.
[23] Hearing Transcript, p. 28, lines 23-27.

States.[24] Concurrently with this slow-down in demand, there has been a flooding of the market due to the harvesting of trees subject to pine beetle infestations.[25] As a result, Timberlands revenues over the last several years have dropped by 35% and operating income is down 75% over the same period.[26] Compounding the problems for Timberlands has been the rise in the value of the Canadian dollar over this period, which Mr. Grosman testified has had a dramatic impact on Timberlands.[27]

Together, the factors described here have contributed to the tax losses and, it is assumed for purposes of this reply argument, will contribute to further tax losses in the test year. It is these tax losses that, in the hands of BIH Inc. (which files a single tax return accounting for all of its holdings), are assumed will have the effect of offsetting the taxable income earned by the regulated business of GLPT in 2010. To the extent that there are more tax losses from Timberlands in a given year than can be used to offset taxable income earned by GLPT or any other businesses held by BIH Inc. in such year, those incremental tax losses are accumulated and carried forward so that they can be used by BIH Inc. in future years to offset net income derived from any business that it then holds, including from Timberlands and/or GLPT.

3. Expectation to Pay Tax

During cross-examination by SEC counsel, Mr. Grosman testified that Timberlands is indeed in business to make money and was not established for the purpose of generating losses.[28] He further testified that, despite its recent performance, Timberlands is expected to be profitable and to generate taxable income.[29] This is supported by statements made in recent public filings associated with Timberlands, namely the Form 20-F/A filed by BIP with the U.S. Securities and Exchange Commission in September 2009, as well as the Supplemental Information Filing of BIP for the year 2009, each of which was filed as part of SEC's Motion Record.

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[24] Hearing Transcript, p. 18, lines 11-14 and p. 29, lines 8-9.
[25] Hearing Transcript, p. 29, lines 10-12.
[26] Hearing Transcript, p. 29, lines 12-13.
[27] Hearing Transcript, p. 18, line 15 - p. 19, line 22.
[28] Hearing Transcript, p. 52, lines 16-18.
[29] Hearing Transcript, p. 76, lines 4-5.

As described in Form 20-F/A, "the Partnership expects to continue to meet all of its debt covenants and remains well positioned for a market turnaround."[30] The Supplemental Information Filing goes more in-depth on this matter and states as follows:

> Our timber operations consist of high quality timberlands . . . predominantly comprised of premium species and are expected to provide attractive risk adjusted returns on capital employed over the long-term . . .
>
> . . . While timber market conditions continue to be poor, prices have improved steadily since the second quarter of 2009. Seasonally adjusted, annualized U.S. housing starts fell 5% from the third quarter to 554,000. While an improvement from the lows of the first quarter, this level is approximately one third of long-term trend levels. The inventory of new homes in the U.S. declined to 234,000 units while existing home inventories declined to 3.29 million units or a 7.2 month supply, both these statistics suggesting an increasingly balanced market. Despite these seemingly positive statistics, recovery of U.S. housing starts is expected to remain weak through 2010 and into 2011 as a result of the significant amount of vacant and foreclosed homes which we anticipate will continue to add to the inventory of existing homes for sale. Despite this difficult outlook, strong supply-side management has resulted in very low inventories of sawlogs and finished wood products across North America. Prices for most products have increased over 20% from their second quarter lows. Log prices in the Japanese market were stable through the quarter, and demand for whitewood in the Korean market remained strong, with realized pricing, net of transportation, at levels close to five-year averages.
>
> Consistent with our focus on optimizing the long-term value of our business, we continued to harvest at sharply curtailed levels. We continue to adapt our plan as necessary to pursue market opportunities that arise . . .
>
> . . . One of the key attributes of our timber business is operating flexibility that allows us to adapt our harvest levels to market conditions to maximize the value of our business. Until we believe that sustainable demand will support meaningfully higher prices, we plan to harvest at minimum levels required to service our key customers and protect key distribution channels while capitalizing on market opportunities that do arise. Based on current conditions, we expect harvest levels at our Canadian and U.S. operations in 2010 to be similar to 2009 levels. Prices need to increase at least 20% from current levels before we would expect to return to target harvest levels. We currently do not expect this magnitude of price increases before late 2010 or early 2011.

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[30] Motion Record of the School Energy Coalition, Tab 6, p. 13.

We believe operating results for our timber segment will improve following recovery in U.S. new home construction. Although it is difficult to predict the timing and amount, we believe that we will achieve increases in ANOI and net income from this segment of our business for the following reasons:

- Improved pricing upon market recovery
- Increased harvest levels
    - The estimated long-run sustainable yield of our Canadian operations is approximately 0.7 million m3 on a proportionate basis. Due to a surplus of merchantable inventory, we expect to achieve an elevated harvest level of approximately 0.9 million m3 on a proportionate basis for a period of 10 years before returning to the long-run sustainable yield level.
    - As a result of a substantial surplus of merchantable inventory at our U.S. operations, we expect to increase harvest levels to approximately 0.9 million m3 on a proportionate basis and sustain this higher level for a period of 10 years before returning to a long-run sustainable yield of approximately 0.8 million m3.
- Increased margins
    - As the product mix in our Canadian operations evolves to a greater percentage of second growth harvest relative to primary growth harvest, we expect our margins to increase due to the lower harvesting costs of this product.

In addition, over the mid-to-long term, we expect that our timber operations will be positively impacted by a number of fundamental factors affecting the supply of timber in the markets that we serve:

- The mountain pine beetle infestation, which is having a significant impact on the supply of timber from the interior of British Columbia, Alberta and the U.S. Inland;
- Increasing demand from both Asian markets and the rapidly expanding bio-fuel industry; and
- Continuing withdrawals of timberlands for conservation and alternate uses. (emphasis added)[31]

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[31] BIP Supplemental Information Filing for 2009, SEC Motion Record, Tab 7, pp. 12-14.

In summary, it is anticipated that the various factors affecting Timberlands business performance will change course: the U.S. housing market is expected to pick up; the impact of the pine beetle on supply in the marketplace is expected to subside; shipping costs could fluctuate; and the value of the Canadian dollar could return to its historic levels. When Timberlands is able to sell more lumber, it will be well positioned to make a lot of money.[32]

Having set out an accurate statement of the facts which have been established by evidence in this proceeding, first in respect of GLPT's structure and the rationale for the structure, second in respect of the basis for the tax losses from Timberlands, and third in respect of the expectation that BIH Inc. will be in a position where it will have to pay tax, the section that follows addresses each of the significant aspects of the evidence which have been mischaracterized by the Intervenors and Board Staff.

D. How the Facts Have Been Mischaracterized

Based on the foregoing summary of facts established by the evidence in this proceeding, Intervenors and Board Staff have mischaracterized the facts in relation to the (a) the basis for the GLPT structure, (b) the tax liability incurred, and (c) the expense incurred. Each of these is dealt with in turn.

1. The Basis for the GLPT Structure

SEC incorrectly states that GLPT has "set up a complex and aggressive structure to stream taxable income and tax losses from separate activities" in order to obtain a net tax benefit.[33] Similarly, Board Staff incorrectly asserts that GLPT has chosen the structure it did only "to maximize the utility of the losses from Island Timberlands".[34] At the hearing of SEC's motion and during the hearing itself, SEC and Board Staff spent an inordinate amount of time asserting and suggesting some conspired activity by BIH Inc., Timberlands, and/or GLPT to deliberately and purposely obtain the benefit for the tax loss through its structure. There are no facts in this

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[32] Hearing Transcript, p. 47, lines 18-21.
[33] Final Argument of SEC, para. 19.
[34] Board Staff Submissions, p. 5.

proceeding that support these assertions and, indeed, none were cited by the Intervenors or Board Staff in their respective submissions. Rather, the facts demonstrate otherwise.

As noted, the tax losses arising from Timberlands are because of a number of factors beyond the control of Timberlands or BIH Inc. Timberlands cannot control the market or manipulate its taxable income/loss in order to achieve a benefit relative to the income generated by GLPT.[35] The evidence clearly demonstrates that Timberlands was not acquired for purposes of obtaining a "loss creating vehicle" but rather was acquired because profits were and continue to be expected.

With respect, Board Staff and Intervenors are "looking into the wrong-end of the telescope". These assertions are completely implausible. Based upon the facts, it would be implausible that $1 billion would be spent to acquire assets such as those acquired by Timberlands just so Timberlands' tax losses could be combined with GLPT net income to obtain $1.7 million per year. It is equally implausible that Brookfield Timberlands Management would, in years like 2009, make a repayment of management fees to Timberlands of $35 million, just so Timberlands tax losses could be combined with GLPT's net income to obtain $1.7 million per year.[36] When seen in its proper context, it is clear the assertions made by the Intervenors and Board Staff have no economic credibility, are entirely without merit and fail to acknowledge the true rationale for establishing the GLPT structure, which as explained was primarily to maintain a holding company structure similar to that used by BIP internationally.

2. The Tax Liability Incurred

At various points in their submissions, the Intervenors and Board Staff assert that the tax liability is a "phantom cost" or is not real. The evidence shows that the tax liability exists and that a tax liability is a real cost. It is important to recognize and not lose sight of the fact that, despite GLPT not being a taxable entity, the net income earned by GLPT is taxable. This taxable net income is derived from regulated activities within the regulated business. The net income is what attracts the tax liability, not the entity that generates that income. Support for the

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[35] Hearing Transcript, p. 26-27.
[36] Hearing Transcript, p. 52.

proposition that such a tax liability is a "real cost" may be found in BP West Coast Products, LLC v. FERC.[37] In this decision, the U.S. Court of Appeal commented that FERC was correct in stating that a tax liability of a regulated company is a real cost of providing service.[38] The net income from the regulated business of GLPT therefore carries with it an obligation to pay the relevant quantum of income tax. As described in the evidence, the *Income Tax Act (Canada)* requires a partnership to calculate its taxable income annually as though it were a taxpayer, but then to allocate that income (or loss, as the case may be) to its partners.[39] As a result, there is a real tax cost that arises from the regulated activity of GLPT. The allocations of partnership income to each of GLP Inc. and BIH Inc. are subject to federal and provincial taxation. GLPT's proposed tax allowance is based on this tax liability that is allocated to its partners.[40]

The income of GLPT forms part of the income of BIH Inc. which is a fully taxable corporation. The income from GLPT is offset by the tax loss from Timberlands, if any. However, to the extent that there are tax losses available to offset income from GLPT and Timberlands in future years, such tax losses are reduced as a result of the allocation of net income from GLPT to BIH Inc. for the test year. There is a tax consequence to the income from GLPT.

3. The Expense Incurred

The Intervenors and Board Staff also ignore a critical and central fact which is that an expense is incurred to generate the tax losses in question. This expense is incurred by Timberlands, and in turn BIH Inc., through the cost of operations and the cost of the asset. These costs are described in the statement of facts set out above. Neither Board Staff nor the Intervenors have provided a justification as to why the ratepayer should get the benefit of the tax loss and not have to incur

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[37] 374 F. 3d 1263 (2004), as filed at Tab A of SEC's Final Argument.

[38] See *BP West Coast Products, LLC v. FERC*, 374 F. 3d 1263 (2004) in SEC Final Argument, Tab A, p. 16 of 35: "... **the Commission stated, no doubt correctly**, that in the case of a jurisdictional corporate subsidiary of a corporate group, "**the allowed equity return generates an actual tax liability for the pipeline that must be paid to the IRS, either in cash or through the use of another member's deductions....[E]ither way, the tax liability of the jurisdictional company is a real cost of providing service.**"" (emphasis added) Note: Although the decision in BP West Coast Products is generally no longer applicable, neither this comment from the Court nor the underlying statement from FERC appears to have been subsequently challenged or reconsidered.

[39] Exhibit 4, Tab 3, Schedule 2, p. 2. See also section 96(1)(a) and (f) of the *Income Tax Act*.

[40] Exhibit 4, Tab 3, Schedule 2, p. 3.

the expense associated with that tax loss. The evidence shows that Timberlands is a large and complex operation that is operated to make a profit. It is not a prop or a means to avoid tax or, as SEC often asserted without any basis, a tax shelter in its effect. At the end of the day, no evidence was established by SEC or Board Staff in this regard. The facts are otherwise. The expenses associated with the tax losses are legitimate and as a key element in the stand alone principle they must be recognized. To not do so would produce unjust and unreasonable rates with the ratepayer being unfairly subsidized.

SEC's Final Argument notes "if that principle – the standalone principle – is not consistent with "just and reasonable" on these facts, then it must in law be limited, and cannot be applied here. If that principle is consistent with "just and reasonable" in this situation, then absent a compelling reason to the contrary, the Board should apply it to the extent that it is otherwise applicable".[41] The facts in this case are consistent with just and reasonable rates. Neither the Intervenors nor Board Staff have produced any fact or compelling reason to the contrary.

E. Responses to Specific Intervenor and Board Staff Submissions

1. SEC Submissions

(a) Discussion of the U.S. Tax Regime and FERC is Not Based in Evidence

SEC challenges the application of the stand alone principle based upon SEC's interpretation of US tax policy and regulatory practice. From page 6 to 14 of SEC's Submission, SEC's counsel provides an extensive narrative on the US tax regime and FERC's historical approach to that regime. He cites no authority for the discussion. In fact, the submissions take the form of evidence. However, in this proceeding SEC chose not to present evidence. The statements made by SEC are not authoritative nor have they been tested by cross-examination. At most, they are conjecture and GLPT submits that the Board should give them no weight.

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[41] SEC Final Argument, p. 4.

(b) Consolidation of Partnership Income Under Canadian Tax Law is Analogous to Corporate Income Consolidation Under U.S. Tax Law

With respect to SEC's actual submissions, SEC attempts to draw some distinction between the US and Canadian tax regimes with respect to the calculation of tax on a consolidated basis. GLPT acknowledges that, in the US, the results of independent and separate businesses (in regulated and non-regulated business) may be consolidated for tax purposes (and only for tax purposes) under US tax law. In the case of BIH Inc., the exact same effect occurs whereby the results of two independent and separate businesses are consolidated for tax purposes under Canadian law with income being taxed in the hands of BIH Inc. As noted, this is because the *Income Tax Act* requires each partnership to calculate its annual taxable income as though it were a taxpayer, but then to allocate that income or loss to its partners in proportion to their respective interests in the partnership.[42] Both situations give rise to the exact same need for the stand alone principle to apply. The structure is legitimate from a tax and regulatory perspective. As a result, SEC's commentary in respect of US tax policy provides no compelling basis for the Board to abandon its application of the stand alone principle.

(c) Decision in BP West Coast is of Limited Value

SEC provides a review of two US Court of Appeal decisions which deal with FERC's policy related to the calculation of tax allowances for limited partnerships. SEC goes to great lengths to describe the Court of Appeal's decision in BP West Coast. However, as acknowledged by SEC, this decision was in respect of a former policy of FERC and is no longer applicable in light of the Court of Appeal's decision in Exxon Mobil Corporation v. FERC.[43] It is important to recognize that the Court of Appeal in Exxon stated, in reference to its decision in BP West Coast, that "we granted the shippers' petition for review in that case primarily because of the Commission's inadequately justified differential treatment of individual partners and corporate partners . . . BP West Coast did not pass upon the specific question at issue in the instant case - whether FERC may grant an (income tax allowance) to limited partnerships for the income taxes paid by all

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[42] Exhibit 4, Tab 3, Schedule 2, p. 2.
[43] 487 F. 3d 973 (2007).

partners on the income they receive from the partnership".[44] In other words, the Court granted the petition not based on the merits of the arguments advanced by the parties, but rather because it found FERC to have issued a poorly reasoned decision. There is no greater meaning to be offered from the BP West Coast decision.

(d) Decision in Exxon Endorses FERC Policy Statement

In its brief discussion of Exxon, SEC acknowledges that in this decision the US Court of Appeal upholds the revised FERC Policy Statement on Income Tax Allowances (the "**FERC Policy Statement**"). The FERC Policy Statement sets out the Commission's conclusion, after an extensive consultation process, that it should permit an income tax allowance for all entities owning public utility assets, provided that the entity has an actual or potential income tax liability to be paid on that income from those assets. Thus, a partnership would be permitted an income tax allowance on the income imputed to the partners provided that the partners have an actual or potential income tax liability on that public utility income.[45] Though SEC remarks that "the response of the Court to the FERC policy is, at best, tepid",[46] this comment is not a fair observation because it disregards the Court's comment that policy choices about ratemaking are the responsibility of FERC rather than of the Court and that the Court's role is limited to ensuring that FERC's decision-making is reasoned, principled and based upon the record.[47]

It is also important to note that the FERC Policy Supports the application of the tax allowance to a limited partnership. The FERC Policy Statement does not pre-empt the application of the stand alone principle in the event that there is a tax loss due to unregulated business activity in the entity to which the tax allowance would apply. As explained in the FERC Policy Statement,

> like a Subchapter C (i.e. taxable) corporation, <u>partners may have deductions or losses that offset the income from a specific public utility asset or which may neutralize the operating income from the asset itself. But this does not preclude</u>

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[44] *Exxon Mobil Corporation v. FERC*, 487 F. 3d 973 (2007) in SEC Final Argument, Tab B, p. 7 of 19.

[45] FERC, Policy Statement on Income Tax Allowances, May 4, 2005 (Docket No. PL05-5-000) as filed in Board Staff Factum, Tab 7.

[46] SEC Final Argument, p. 9.

[47] *Exxon Mobil Corporation v. FERC*, 487 F. 3d 973 (2007) in SEC Final Argument, Tab B, p. 6 of 19.

> such a corporation from obtaining an income tax allowance under the Commission's stand-alone doctrine. Just as there are no rational grounds for granting an income tax allowance on partnership interests owned by a corporation and denying one to those owned by individuals, there are no rational grounds for reaching a different conclusion for the deductions and offsets for taxpaying partners or LLC members.[48] (emphasis added)

As a result, the FERC Policy Statement is informative to the Board on the basis that a limited partnership is eligible for a tax allowance, including where the partners of the partnership have deductions or tax losses that offset the regulated income. The FERC Policy Statement in no way contradicts or diminishes the application of the stand alone principle.

(e) The Tax Allowance is a Real Cost

According to SEC, the tax allowance sought by the applicant is not a true cost and the applicant has not demonstrated that the tax costs will be paid now or in the future.[49] However, the evidence clearly shows otherwise. As indicated in evidence, the tax paying entities responsible for paying tax, based on their proportionate interests in GLPT, are BIH Inc. (99.99%) and GLP Inc. (0.01%), each of which is a taxable Canadian corporation. Although for 2007, 2008 and 2009 there were tax losses sufficient to result in no tax being paid by BIH Inc., and the assumption for purposes of this reply argument is that there will also be sufficient tax losses to result in no tax being paid by BIH Inc. in 2010, the evidence shows that there is a reasonable and credible expectation that Timberlands and therefore BIH Inc. will, with the economic turnaround, make a profit and therefore have taxable income. This evidence is described above in the statement of facts.

At such time that Timberlands becomes profitable, either tax will be paid by BIH Inc. or, if there are tax losses from Timberlands that have been accumulated from prior years, such prior year tax losses could be used as an offset to net income in the hands of BIH Inc. However, the total value of the tax losses from Timberlands that BIH Inc. will have accumulated by such time will have

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[48] FERC, Policy Statement on Income Tax Allowances, May 4, 2005 (Docket No. PL05-5-000) as filed in Board Staff Factum, Tab 7, pp. 16-17.

[49] SEC Final Argument, p. 14.

been diminished as a direct result of the application of tax losses, through the filing of annual tax returns during the intervening period, to offset the annual income arising from the regulated activities of GLPT during the intervening period. As a result, BIH Inc. will have to pay more income taxes than it otherwise would have. Both the Intervenors and Board Staff seem to equate zero tax being paid in the test year with tax never being paid. This is a false presumption, is not based on fact and it should therefore not be adopted by the Board. Furthermore, as noted, the U.S. Court of Appeal has agreed with FERC that a tax liability of a regulated company is a real cost of providing service.[50]

(f) There is no Affiliate Transaction

Again, based on conjecture, SEC asserts that there is an affiliate transaction occurring between GLPT and BIH Inc. There is no affiliate transaction. The two businesses in question operate autonomously and there is no sharing of resources, costs, revenues or management. Under the *Income Tax Act*, the requirement for BIH Inc. to file a single tax return accounting for the net income or losses from all partnerships in which it is a partner[51] gives rise to the netting of taxable income and tax losses. This is the product of the tax rules applying and not any actual transaction between two separate and independent businesses. The stand alone principle is a workable and objective tool that operates properly regardless of whether Timberlands has losses or income. In effect, what SEC is suggesting is that the stand alone principle should be replaced with a mechanism that produces different results depending on whether Timberlands has losses or taxable income. One flaw, among others, in SEC's reasoning is that SEC fails to deal with the circumstance where Timberlands causes there to be taxable income in BIH Inc. Under SEC's proposal, in this circumstance, BIH Inc. should be fully taxed based on the portion of GLPT net income allocated to it, but only receive a tax allowance for half of the amount it would be required to pay to the Canada Revenue Agency in respect of GLPT's net income. SEC's approach is logically inconsistent and continues to perpetuate the subsidization of ratepayers, which does not produce a just and reasonable result.

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[50] See *BP West Coast Products, LLC v. FERC*, 374 F. 3d 1263 (2004) in SEC Final Argument, Tab A, p. 16 of 35.

[51] Exhibit 4, Tab 3, Schedule 2, p. 2.

The analogous transactions proposed by SEC[52] are in fact not analogous. The fundamental aspect underlying SEC's example is that both parties would incur the cost of a finance department. Because both parties would incur the cost of the finance department, the combined department would produce economies of scale which would result in a lower cost. Typically, the costs of a shared department would be allocated based upon some accepted parameter, such as use, to accurately reflect expenses that would have been incurred to provide that service to the regulated entity. In fact, under the Affiliate Relationships Code this would not even be considered an affiliate transaction, but rather would be considered the sharing of corporate services on a cost basis.[53]

As noted above, and in GLPT's Argument-in-Chief, for there to be a "transaction" an expense needs to be incurred to acquire the benefit. None of the expenses associated with the tax loss that gives rise to the tax benefit is incurred by GLPT or the ratepayers. The circumstance that gives rise to the benefit occurs because of the mechanics of filing income tax returns for partnerships in accordance with the *Income Tax Act* and not because of some deliberate intention to carry out an affiliate transaction. There has been no evidence produced in this proceeding to establish such a transaction.

(g) Upholding the Stand Alone Principle Will Not Spur Utilities to Establish Limited Partnerships

SEC asserts that if the Board accepts the long established stand alone principle it will somehow encourage other utilities to embark upon aggressive tax planning.[54] As noted above, the structure that GLPT has is a very simple one and does not arise from aggressive tax planning. It is merely a limited partnership to which a tax allowance is applicable. Limited partnerships are acceptable from a regulatory perspective. The Board has issued licenses to limited partnerships and has considered limited partnerships in the context of MAAD applications, including the MAAD

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[52] SEC Final Argument, p. 18.

[53] Ontario Energy Board, *Affiliate Relationships Code*, section 2.3.5.

[54] SEC Final Argument, pp. 20-21.

application associated with GLPT.[55] There is nothing about the structure of GLPT that should limit the application of the stand alone principle. Furthermore, there is nothing about the structure of GLPT that would either encourage or discourage parties to establish limited partnerships. The evidence shows that GLPT is like any other business that has associated with it both regulated and unregulated taxable income or losses arising from the operation of an unregulated business. Nothing has been established by the intervenors or Board Staff to the contrary. As a result, GLPT submits that the affirmation of the stand alone principle in this proceeding will not alter the behavior of regulated utilities in Ontario. Contrary to the views of SEC, the Board reaffirmed the stand alone principle in its *2006 Distribution Rate Handbook* proceeding. The findings in that proceeding were of general application and did not lead to any change in industry practice. Nothing new has been established by the intervenors or Board Staff in the rehearing of this issue in this proceeding that would change either the determination of the Board or the impact on the industry.

2. Board Staff Submissions

(a) The Basis for the GLPT Structure

In its Submissions, Board Staff asserts that the structure of the applicant was chosen for no other purpose than to maximize the utility of the losses of Timberlands.[56] As noted above, there is no evidence to support this assertion and the evidence indicates otherwise. Board Staff seems to base its assertion on two aspects.

Although not clearly stated, it appears that this assertion is based on the fact that BIH Inc. is part of the bigger structure involving BIP. However, Board Staff appears to treat BIH Inc. as a pass through entity. As noted on a number of occasions, BIH Inc. is not a pass through entity. It is a taxable Canadian corporation and is subject to tax. As a result, its relationship with the remainder of the entities in the BIP structure is irrelevant for regulatory and tax purposes. In addition, Board Staff tries to draw the inference that because the witnesses did not have

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[55] See EB-2007-0647.

[56] Board Staff Submission, p. 5.

information about elaborate tax planning schemes, the structure is solely related to extracting the tax allowance from the regulated utility. However, the evidence clearly indicates that no formal analysis was performed in establishing a limited partnership structure since it was created similar to other BIP holdings around the world, consistent with the BIP practice of establishing a holding company in each jurisdiction.[57] Moreover, the evidence is clear that another key driver was the attempt to provide a simplified structure whereby only one tax return is filed in respect of the operating entities. In order to permit consolidation under one tax return, the limited partnership structure was established.[58] The evidence does not support the inference drawn by Board Staff.

(b) The Divisional Analogy is Misinterpreted

Board Staff also makes a series of submissions with respect to the analogy between a division and a limited partnership with respect to the recovery of a tax allowance and the application of the stand alone principle.[59] Board Staff submits that the analogy should not stand because of section 71 of the *Ontario Energy Board Act*. However, Board Staff misunderstands the purpose of the analogy drawn between the divisional relationship of Great Lakes Power Limited and the limited partnership of GLPT. A parallel was drawn strictly for the purpose of demonstrating that the Board on previous occasions has awarded a full tax allowance in a circumstance where the applicant before the Board (in that case Great Lakes Power Limited's Distribution Division) was not itself a tax-paying entity. GLPT submits that Board Staff's reference to section 71 is irrelevant.

(c) The AltaLink Decision is Incorrectly Characterized

In its Submissions, Board Staff relies on the Alberta Energy Utility Board's ("AEUB") decision in AltaLink.[60] Board Staff notes two aspects of the AltaLink decision. In respect of the first aspect, Board Staff correctly states that the AEUB looked through the corporate structure until it

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[57] Response to Board Staff Supplemental Interrogatory 10.
[58] Hearing Transcript, p. 38, lines 4-13.
[59] Board Staff Submission, pp. 4-8.
[60] Board Staff Submission, p. 8 and Board Staff Factum on SEC Motion, Tabs 4-6.

found an entity paying corporate tax on which to base its decision to allow a tax allowance in the utility.

However, Board Staff incorrectly states the second aspect. Board Staff states that the tax allowance recovered from utility customers was conditionally based on estimated taxes paid by the taxable corporations subject to check based on actual amounts paid or payable.[61] In fact, the AEUB did not estimate the taxes paid by the taxable corporations and confirm those estimations based on the actual amounts paid or payable. Rather, upon determining that three of the four partners were taxable entities in Canada, the AEUB approved a deemed income tax allowance for the three partners on a conditional basis. AltaLink was directed to calculate the appropriate amount of the tax allowance and include it in a re-filing. In this regard, the AEUB ordered AltaLink to provide the AEUB as soon as possible all relevant information related to the capital structure of the four limited partners' investment, excluding the premium, in the utility partnership. Upon the receipt of this information, the AEUB would determine whether an adjustment to the deemed income tax allowance for the period in question was necessary. The reasons for the AEUB's concern about the capital structure and its relationship to the tax allowance was as follows:

> "**One of the costs, which is deducted from revenue, is the interest or carrying charges on the deemed debt portion of the utility's capital structure.** The capital structure is, of course, set on a stand alone basis, focusing only on the regulated utility operations in question. Both the percentage of debt and the accompanying interest rate that will be allowed (as well as the percentage of equity and return thereon) are determined by the Board. **The amount of interest associated with the debt constitutes a significant expense to the utility and provides a significant deduction from revenue with the effect of lowering taxable income and reducing the income tax that would otherwise be payable.**
>
> Where the stand alone utility under scrutiny relies, for example, on a parent corporation or other related entity to arrange its debt financing because of the parent's greater overall assets and financial security, the carrying charges or interest on this actual debt may be less than the approved interest charge on the deemed debt portion of the stand alone utility. . .

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[61] Board Staff Submission, p. 9.

> In the present case, the Board is unable to conduct this type of review because this is the initial rate application by AltaLink and there is no regulatory history to provide context for the Board. Further, no evidence was presented to show the actual capital structure of the limited partners as it relates to their respective investment, excluding the premium, in the utility. **The Board will determine the deemed capital structure for the utility on a stand alone basis and in doing so will use the deemed interest charge on the debt portion of capital in the calculation of the income tax allowance. However, until it is able to review the actual capital structure of the limited partners, the Board is not in a position to assess how the actual interest cost of each partner compares to the deemed interest cost in terms of an acceptable range of variation.**"[62] (emphasis added)

The AEUB then went on to deal with its second issue in the proceeding, which was whether the partnership structure was eligible for an income tax allowance. As a result, it is incorrect to characterize the AltaLink case as applying an analysis of actual tax paid. The purpose of the information requested by the AEUB was to ensure the tax allowance calculated was appropriate and not to compare actual and estimated tax.

Board Staff queries as to whether the Board should look beyond the taxable Canadian corporation of BIH Inc. to other taxpaying entities within the structure of Brookfield Infrastructure Partners.[63] As indicated repeatedly, BIH Inc. and GLP Inc. are taxable corporate entities, file tax returns, are responsible for paying the tax and are subject to audit by the Canada Revenue Agency. The Board should not look beyond these entities with respect to responsibility for tax liability generated from GLPT's income.

GLPT submits that, based upon the AltaLink decision and having regard to the fact that BIH Inc. and GLP Inc. are taxable Canadian corporate entities, GLPT as a limited partnership ought to be found eligible for a full tax allowance.

Board Staff is once again incorrect when it states that the AEUB was not satisfied to grant the tax provision merely because it found entities in the tax ownership hierarchy that were taxable Canadian corporate entities, but required the entities to provide independent evidence of actual

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62 *AltaLink Management Ltd. and TransAlta Utilities Corporation*, AEUB Decision 2003-061, August 3, 2003, pp. 82-83.

63 Board Staff Submission, pp. 9-10.

taxes paid.[64] As noted, this is an incorrect interpretation of the case. The AEUB required independent evidence of the capital structure in order to achieve a level of comfort with respect to the tax allowance calculated for the prospective rate year.

Board Staff states at page 10 of it's Submission that there is no reference to any case that goes beyond the AltaLink situation where the owners of a limited partnership have been granted a tax allowance in rates when losses from unregulated business have been applied such there is no tax expected to be payable in the test year. The AltaLink case stands for the proposition that the stand alone principle extends to limited partnerships. The AEUB did not consider the circumstance where there was a tax loss offsetting income from the regulated utility. However, it is reasonable to conclude that once the stand alone principle applies, appropriate ratemaking principles with respect to the "benefits following the costs" and the avoidance of subsidization of the ratepayer would be applicable. In fact, the AEUB acknowledged that "efficient tax planning imperatives can lead to discrepancy between a utility company and its partners' net tax liability".[65]

(d) Tax Policy is Beyond the Board's Jurisdiction

In it's Submissions, Board Staff presents an option where the tax allowance would be approved. However, Board Staff encourages the Board to take into account tax policy with respect to tax leakages and location of taxable revenue.[66] GLPT respectfully submits that the jurisdiction of the Board is to establish rates that are just and reasonable, which in this case includes the tax allowance sought. It is not the jurisdiction of the Board to establish tax policy, especially where tax consequences are arising by virtue of structures which are accepted and fully permitted under the *Income Tax Act*.

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[64] Board Staff Submission, p. 10.

[65] *AltaLink Management Ltd.*, Review and Variance of Decision 2003-061 (Decision 2005-011), Alberta Energy Utilities Board, February 16, 2005, p. 8 as filed in Tab 6 of Board Staff Factum on the SEC Motion, May 25, 2010.

[66] Board Staff Submission, pp. 11-12.

(e) Statements Made in Argument Should Not be Taken as Evidence

In it's Submissions, Board Staff sets out an option under which the tax allowance would be shared between GLPT and ratepayers. In support of its notion that the Board may wish to consider whether ratepayers are entitled to some benefit, Board Staff relies solely on SEC's submissions made during the hearing of SEC's motion. GLPT respectfully submits that these are mere assertions by SEC without any evidentiary base. They are not evidence and are in the form of argument. As a result, it is inappropriate for Board Staff to rely on those submissions as a basis for the sharing of any benefit arising from the application of a taxable loss.

3. VECC Submissions

(a) GLPT Should Be Viewed as a Separate Entity for Regulatory Purposes Only

VECC notes that, from a regulatory perspective, GLPT has a separate identity. On this basis, VECC proceeds to argue that the requirement that the Board view GLPT as a separate entity means that it must ensure that GLPT obtains the tax losses of Timberlands at fair market value, as though GLPT had gone into the market to obtain those losses from a third party.[67] VECC's submissions in this respect are flawed. GLPT is not a distinct identity for tax purposes. Rather, for tax purposes, it is not only appropriate but necessary for the Board to look beyond GLPT. This is because of the requirement under the *Income Tax Act* for the taxable income or loss of a partnership be determined initially as though it were a taxpayer, but then for such income or loss to be allocated among the partners in the partnership.[68]

Conclusions

It is appropriate for GLPT to receive the full tax allowance it has been requested because the income it earns for providing transmission service is taxable income. Although GLPT as a partnership is not recognized as a taxable entity under Canadian tax law, the tax law is clear that GLPT is required to determine its taxable income as though it were a taxable entity and then to

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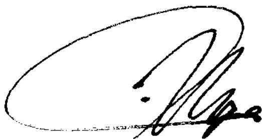
[67] VECC Final Argument, p. 5.

[68] Exhibit 4, Tab 3, Schedule 2, p. 2.

allocate such income to its partners. Both of GLPT's partners, BIH Inc. and GLP Inc., are taxable Canadian corporations. As such, they each file income tax returns that account for their respective shares of taxable income from GLPT. GLPT has demonstrated based on the evidence that the tax liability incurred by GLPT is a real cost of service. In filing its return, BIH Inc. also accounts for other income or losses that it incurs through its other holdings. To the extent there are tax losses arising from its investment in Timberlands, these have the effect of offsetting taxable income from GLPT. As explained, it is instructive that FERC and the U.S. Court of Appeal have considered and agreed that it does not matter whether a tax liability is paid by cash to a government tax authority or through the use of deductions derived from another holding of the entity that files the tax return - in either scenario there is a real cost. Finally, ratepayers are not entitled to receive the benefit of using the tax losses because the benefit is associated with costs that the ratepayers have not borne, that is, the costs of the investment in and the operation of the Timberlands business.

For the foregoing reasons, GLPT submits that the Board should grant the full tax allowance requested. Intervenors and Board Staff have shown no basis in fact as to why the tax allowance should not be granted and have shown no basis in fact or law as to why the stand alone principle should not be applied.

All of which is respectfully submitted by:



for Charles Keizer, Torys LLP

Counsel for Great Lakes Power Transmission LP

June 21, 2010

BOOK OF AUTHORITIES

on behalf of

GREAT LAKES POWER TRANSMISSION LP

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TAB	DESCRIPTION
A	Robert. L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities,* (Newark, NJ: Matthew Bender & Company, Inc./LexisNexis Group, 2009), Part V, Chapter 17, Section 17.05[2] (as filed at Tab J of GLPT Factum in response to the SEC Motion).
B	*Great Lakes Power Limited*, EB-2007-0744, Decision and Order, October 30, 2008, pp. 40-41 (as filed at Tab H of GLPT Factum in response to the SEC Motion).
C	*Income Tax Act* (Canada), ss. 89(1), 96(1)(a) and (f) (as filed in part at Tab B of GLPT Factum in response to the SEC Motion).
D	*US Securities and Exchange Commission Form 20-F/A of Brookfield Infrastructure Partners L.P.*, dated September 17, 2009, p. 13 (as filed at Tab 6 of SEC Motion Record).
E	*Supplemental Information Filing of Brookfield Infrastructure Partners L.P. for 2009*, pp. 12-14 (as filed at Tab 7 of SEC Motion Record).
F	*BP West Coast Products, LLC v. Federal Energy Regulatory Commission, et al.*, 374 F. 3d 1263 (2004), U.S. Court of Appeals, District of Columbia Circuit, p. 16 (as filed at Tab A of SEC Final Argument).
G	*ExxonMobil Oil Corporation v. Federal Energy Regulatory Commission*, et. al. (2007), U.S. Court of Appeals, District of Columbia Circuit, pp. 6-7 (as filed at Tab B of SEC Final Argument).
H	Federal Energy Regulatory Commission, *Policy Statement on Income Tax Allowances*, May 4, 2005 (Docket No. PL05-5-000), pp. 16-17 (as filed at Tab 7 of Board Staff Factum on SEC Motion).
I	Ontario Energy Board, *Affiliate Relationships Code*, s. 2.3.5.
J	*AltaLink Management Ltd. and TransAlta Utilities Corporation*, AEUB Decision 2003-061, August 3, 2003, pp. 82-83 (as filed at Tab 4 of Board Staff Factum on SEC Motion).
K	*AltaLink Management Ltd.*, Review and Variance of Decision 2003-061 (Decision 2005-011), Alberta Energy Utilities Board, February 16, 2005, p. 8 (as filed at Tab 6 of Board Staff Factum on the SEC Motion).

Tab 'A'

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§ 17.05 Intercompany Tax Allocation

This section provides a general discussion of the concept of consolidated tax returns and reviews the effect of non-utility subsidiaries' operations in the determination of consolidated income tax expense, including its treatment in the ratemaking process. Finally, it provides a brief analysis of the FERC policy and methodology for income tax allocation.

[1] Consolidated Tax Returns

The IRC provides that a group of affiliated companies may elect to file a consolidated federal income tax return.[n61] The consolidated income tax return reports the combined income and expense items of the consolidated group. Many utility companies have affiliates involved in unregulated operations. These affiliates generate income or losses that are usually combined with the parent utility in the filing of the consolidated federal income tax return. Intercompany transactions are eliminated for purposes of consolidation.

Once the election is made to file a consolidated tax return, the affiliated group must continue to file on a consolidated basis in subsequent tax years. The election to file a consolidated tax return makes the parent corporation the agent of all corporations included in the affiliated group. This agency relationship includes, but is not limited to, the duties to file proper and timely consolidated tax returns, to receive deficiency notices, to file refund claims, to execute waivers of the statute of limitations, to respond to IRS audits, and to conduct proceedings in the courts.[n62]

The parent company should specify its tax responsibility with its subsidiaries in the form of a tax-sharing agreement. The agreement should cover the method of allocating the tax liability or tax savings generated by the subsidiaries. In addition, the parent company should establish the accounting procedures for collecting the respective tax liability and for reimbursing the tax savings. However, it should be recognized that the parent and each subsidiary are both jointly and severally liable for the tax liability. The regulations provide that the tax liability cannot be reduced by means of an intercompany agreement among the members of the group.

The objective of the consolidated tax return, therefore, is to calculate the separate taxable incomes of the members and to consolidate those amounts to arrive at a consolidated taxable income. The consolidated tax is computed on the consolidated taxable income. Because each member of the group has contributed to the consolidated tax liability, the tax liability must be allocated among the members of the consolidated group.

[2] Ratemaking Considerations

Non-utility affiliates that file a consolidated tax return with a utility normally are allocated the tax liability and/or savings generated within the group under either a "separate return" method (i.e., current and deferred tax expense or benefit for the period is determined for each member of a consolidated group by applying the requirements of SFAS 109 (ASC 740) as if that group member was filing a separate tax return) or a "stand alone" method (i.e., consolidated tax expense is allocated to members through recognition of the benefits/burdens contributed by each member). A non-utility affiliate retains its tax savings generated from a net operating loss. Similarly, if the affiliate is profitable, the tax on its taxable income is an obligation or liability of the affiliate to the group and the IRS.

The losses of a nonregulated affiliate generate tax savings in a consolidated tax return and, thus, lower the consolidated tax liability. The parent normally reimburses the affiliate for the tax savings realized on the consolidated return. The application in ratemaking of tax savings resulting from losses of nonregulated affiliates would, therefore, create a windfall benefit to the utility consumer by transferring to the consumer the benefit of the tax relief intended for the owners of the losing affiliate. If a utility corporation enters into arm's length transactions with its affiliate, the utility would be in the same position as if it had dealt with an independent third party. Assuming that the investment in the affiliate has been financed by investor-provided capital, it would be inequitable to deprive the investor of the tax savings generated by the affiliate's operations. The shifting of the tax savings to the regulated company for ratemaking considerations based on the principle of tax consolidation creates an unwarranted and unfair financial detriment to the investor.

The allocation of tax savings presents other tax planning problems when various companies are in the consolidated group--some with profits and others with losses. The system for allocating the tax savings of a nonregulated subsidiary to the regulated parent is referred to as the "consolidated effective tax rate" method by the FERC (see § 17.05 [3]) as well as by some state commissions. The use of the rate, developed by dividing actual taxes paid by the total of the pre-tax income amounts of the subsidiaries with taxable income, not only results in a lower rate for determination of income tax expense for cost of service, but also reflects a flow-through of the tax savings to the ratepayers. The effect of the consolidated effective tax rate formula is to pass to the ratepayers tax deductions and/or tax credits available to the nonregulated entity.

The following simplified table shows how these events develop at a 35-percent statutory tax rate. In the first year, the utility has taxable income that is used to absorb its affiliate's tax losses under "effective tax rate" assumptions. Under these conditions, the utility operation is assessed with a tax liability that reflects a 17.5-percent tax rate. In the second year, both operations have taxable income and the 35-percent rate applies equally. When the two years are combined as shown in the last computation, however, the distortion becomes obvious. Even though the consolidated results are consis-

tently reflected at actual tax rate of 35 percent, the accumulated taxes assigned to the utility operation reflect a 23.3-percent tax rate while the affiliate's accumulated taxes reflect a 70-percent tax rate.

Year 1:

	UTILITY	AFFILIATE	CONSOLIDATED
Revenues	1000	1000	2000
Expenses	800	1100	1900
Taxable income (loss)	200	(100)	100
Taxes	35	0	35
Effective rate	17 .5%	35	%

Year 2:

	UTILITY	AFFILIATE	CONSOLIDATED
Revenues	1000	1000	2000
Expenses	900	800	1700
Taxable income	100	200	300
Taxes	35	70	105
Effective rate	35 %	35 %	35 %

Cumulative results:

	UTILITY	AFFILIATE	CONSOLIDATED
Revenues	2000	2000	4000
Expenses	1700	1900	3600
Taxable income	300	100	400
Taxes	70	70	140
Effective rate	23 .3%	70 %	35 %

The significant feature of the normalization process is the recognition that tax costs of a given period are not by payments to the U.S. Treasury, any more than the expenditures (payments made) to build a generating plant are a measure of the plant costs for the period. In the latter example, the plant costs are measured through depreciation over time. Similarly, the tax deductions of the depreciation provisions are tracked through the normalization process. Neither the depreciation costs, nor the related tax effects, reflect payments of cash.

Income tax normalization is consistent with a fundamental principle of the cost of service approach to ratemaking; the principle that consumers should bear only the costs for which they are responsible. Under this principle, there is a well-reasoned, and widely recognized, postulate that taxes follow the events they give rise to. Thus, if ratepayers are held responsible for costs, they are entitled to the tax benefits associated with the costs. If ratepayers do not bear the costs, they are not entitled to the tax benefits associated with the costs.

Regulators have long used a ratemaking procedure that explicitly embraces this principle. The procedure is to identify utility activities (revenues and costs) and compute taxes directly related to the utility activities.

Non-utility operations involve financial risks that are different from a utility's regulated operations. When these risks are not borne by the ratepayers, it is unfair to make use of the business losses generated in those nonregulated entities to reduce the utility's cost in determining the rates to be charged for utility services. By the same token, when a company's nonjurisdictional activities are profitable, the ratepayers have no right to share in those profits, but neither are they required to pay any of the income taxes that arise as a result of those profits. Thus, a separate return method (as opposed to an allocation method or a consolidated effective tax rate method) for computing the income tax expense component of cost of service is the proper and equitable method to be followed for ratemaking purposes.

[3] FERC Tax Allocation Policy

A basic principle of regulation is the separation of regulated utility operations from nonregulated operations. Historically, regulatory commissions have segregated utility operations from non-utility operations in determining rate base and utility operating revenues and expenses for ratemaking purposes. This fundamental ratemaking principle was set forth in *Panhandle Eastern Pipeline Co. v. Federal Power Commission.* [n63] in which the Supreme Court stated:

> "We agree that the Commission must make a separation of the regulated and unregulated business when it fixes the interstate wholesale rates of a company whose activities embrace both. Otherwise the profits or losses, as the case may be, of the unregulated business would be assigned to regulated business and the Commission would transgress the jurisdictional lines which Congress wrote into the Act."[n64]

In *Federal Power Commission v. United Gas Pipeline Co.,* [n65] 22 years later, the Supreme Court considered the issue of allocation and application of tax savings in the ratemaking process. This case addressed the issue of whether the tax cost of a regulated utility filing consolidated returns should be reduced by the tax savings resulting from losses incurred by the nonregulated subsidiaries of the group. (This methodology was proposed as a means of reducing the tax expense allowance and revenue requirements of the regulated utility for ratemaking purposes, even though the regulated utility had not generated the losses or tax savings.) By using the losses of nonregulated affiliates in computing the utility's allowance for tax expense in cost of service, the FPC had deviated from the *Panhandle Eastern* principle of fully segregating regulated and nonregulated business operations for the purpose of allocating costs between the utility's jurisdictional and nonjurisdictional sales. The Supreme Court remanded the case for reconsideration of whether the allowance should be computed separately on the utility's income from regulated and nonregulated (i.e., jurisdictional and nonjurisdictional) activities. The court noted, however, that under the proper circumstances, the FPC would have the power to reduce cost of service, and hence rates, based on the application of nonjurisdictional losses to jurisdictional income.

In *Florida Gas Transmission Co.,*[n66] however, the FPC reversed its position, changing back to a policy of computing the tax expense allowance for cost of service on a "stand alone" basis (e.g., excluding the tax savings of the nonregulated companies). The FPC explained the change in its position, stating that:

> "At the present time, we seek to avoid a determination that will tend to defeat efforts to acquire additional gas supplies or constitute a disincentive to exploration and development. Since 1968, all major industry data indicate that gas is being consumed at a greater rate than it is being discovered, and a number of pipelines have had to file plans for curtailment of service to their customers under our Order No. 431. Therefore, if a case were before us where an affiliated, regulated or nonregulated, producer of oil or gas showed a tax loss, and this loss company were joined in a consolidated return with a pipeline, the United or Cities Service cases, in our opinion, would no longer be persuasive authority, for to reduce the rates of a regulated pipeline because of such affiliated exploration and development activities would be discouraging to the very enterprise we now want to encourage. Furthermore, there has been an increasing tendency for pipeline affiliates to diversify and to engage in activities completely unrelated to gas pipeline operations or the gas business at all, so that determining a tax allowance for the pipelines' jurisdictional business on the basis of the activities of a far-flung conglomerate bears less and less relationship to the operations in which we are properly interested."[n67]

The FPC went on to state that a utility should be regulated on its own merits as an independent entity and not on those of its affiliates. The FPC reasoned that the tax losses generated by nonregulated affiliates should therefore not be used to reduce the return of *Florida Gas.* Thus, the FPC avoided regulating one company on the basis of the activities of others in the affiliated group.

FERC Opinion No. 173[n68] contains possibly the most comprehensive discussion of the fundamental principles underlying tax allocations. Significant findings of the FERC in that opinion are quoted and paraphrased as follows:

> (1) "Taxes are no different from other expenses included in the cost of service." The principles should not differ, "and we make no distinction. In both cases we limit the allowance charged to ratepayers to an amount equal to the costs the company incurs in serving them."
>
> (2) "... the test is whether the expenses that generate the deduction are used to determine the jurisdictional service's rates. Put more simply, the test is whether the expenses are included in the relevant cost of service. If they are, the associated deductions and their tax reducing benefits will be taken into account in calculating the tax allowance for that cost of service. If the expenses are not, the deductions will not be taken into account. In this way the tax allowance will reflect the profit the ratepayers contribute to the group's consolidated taxable income."
>
> (3) The use of an effective tax rate is found to be inconsistent with the use of income tax normalization. The order states that "Once a normalization policy is adopted for dealing with tax and ratemaking timing differences, a policy on consolidated taxes that ignores the source of the loss makes no sense."

The FERC concluded that the use of consolidated or effective tax rates "... would result in giving ... ratepayers the tax savings twice."

[4] Tax Allocation and Normalization Requirements

Controversy has arisen between utilities and regulatory commissions as to whether the use of "consolidated effective tax rates" or "consolidated savings" as applied to current tax expense is a violation of the normalization requirements of the IRC. The IRS initially took a strong position in favor of the stand alone tax allocation concept. In several rulings, the IRS rejected various ratemaking proposals involving the use of the tax losses of nonregulated subsidiaries to reduce current or deferred income tax expense in cost of service for ratemaking purposes, on the grounds that these proposals would violate the normalization requirements under the IRC.[n69] The IRS based this determination on a thorough examination of the language of IRC Sections 167(l) and 168(i)(9), as well as on the U.S. Treasury regulations.

In 1989, the IRS announced a regulation project intended to resolve the uncertainties surrounding the use of consolidated effective tax rates and consolidated tax adjustments.[n70] On November 20, 1990, the IRS released proposed regulations regarding the application of the normalization requirements of the IRC to companies filing consolidated tax returns. These proposed regulations concluded that it is a violation of the normalization requirements to directly adjust a utility's ratemaking tax expense, either current or deferred, by a "consolidated tax savings adjustment" or through the use of an "effective tax rate" that takes into account the losses of any other corporation. However, the IRS also concluded that reducing rate base by the utility's share of the cumulative net tax savings, or treating such savings as cost-free capital in determining rate of return, does not violate the normalization requirements for rate orders that become final determinations after the effective date of the final regulations or, if sooner, by January 1, 1992.

In 1991, the Treasury withdrew the proposed regulations and closed the project. The withdrawal notice stated, "Upon consideration of the comments received, the Service has decided to withdraw those proposed regulations and to close the related regulations project pending congressional guidance (PS-107-88)."

On September 11, 1991, the Subcommittee on Select Revenue Measures of the House Ways and Means Committee held public hearings on the treatment of consolidated tax savings under the normalization requirements of the IRC. Testimony was given by the U.S. Treasury, public utility representatives, regulatory commissioners and other interested parties. The hearing ended with no clear indication as to what the Subcommittee intends to do.

Comment:

> As a result of the IRS's actions, some regulators may assume that the actual taxes paid application is appropriate for ratemaking. This assumption is misplaced, however, because tax guidance is not intended to address the fairness or equity of a particular ratemaking practice. Sound regulatory principles oppose use of actual taxes paid for ratemaking.

FOOTNOTES:

(n1) Footnote 61. The consolidated filing requirements are codified at IRC §§ 1501 through 1505. Generally, in order to file a consolidated return, a parent company must own at least 80 percent (measured in terms of value and of voting power) of the stock of each subsidiary included in the consolidated group.

(n2) Footnote 62. See Treas. Reg. § 1.1502-77.

(n3) Footnote 63. 324 US 635 (1945) .

(n4) Footnote 64. *Id* at 643 .

(n5) Footnote 65. 386 US 237 (1967) .

(n6) Footnote 66. FPC Opinion 611, 93 PUR3d 477 (1972) , *modified by* FPC Opinion 611A, 98 PUR3d 221 (1973) .

(n7) Footnote 67. *Id* at 495 .

(n8) Footnote 68. Dkt No RP75-106-006 (June 22, 1983).

(n9) Footnote 69. See, eg, Ltr Ruls 8801041 , 8711050 , 8643052 , 8525156 .

(n10) Footnote 70. See Notice 89-63, 1989-1 CB 720 . In connection with the regulation project, the Service also revoked Ltr Rul 8711050 via Ltr Rul 8935009 , and Ltr Rul 8643052 via Ltr Rul 8935010 .

Tab 'B'

- Cross subsidization would occur because rates would be based on a tax expense that would be lower than it would have been absent the non-distribution businesses;
- There would be retroactive altering of the conditions assumed by the investor at the time investments were made in the non-utility operations; and
- Shareholders of GLPL would be denied the same treatment available to other shareholders under the *Income Tax Act*.

Board Findings

The Board finds that the 2007 test year tax provision should be calculated without regard for corporate tax loss carry-forwards that arose due to losses in GLPL's non-distribution businesses.

The Board agrees with GLPL that it has been the Board's policy to apply the stand-alone principle when assessing the tax provisions of regulated businesses. In the Board's view, fairness in ratemaking requires adherence to the principle that a party who bears a cost should be entitled to any related tax savings or benefits.

Prior to release of the *2006 Electricity Distribution Rate Handbook* ("2006 DRH"), the Board considered arguments related to a somewhat similar question – Who should benefit from the tax deductions for expenses that are not included in the determination of a distributor's rates? The Report of the Board on the Handbook states that:

> *... the Board rejects the proposal by Schools, and concludes that tax savings arising from disallowed expenses, including purchased goodwill and charitable donations, will not be allocated to ratepayers. Ratepayers have not paid for the expense through rates, and therefore are not entitled to the tax benefit.*[25]

The principle that the Board relied on in accepting the 2006 DRH treatment of disallowed expenses is equally applicable in this case. The pre-2007 expenses and losses of GLPL's unregulated businesses were borne by GLPL's shareholder, not ratepayers. It would be fundamentally unfair to take such tax losses into account when

[25] RP-2004-0188, May 11, 2005, p. 55.

setting rates for regulated service. To abandon the stand-alone principle in this case would give rise to the inappropriate result that rates for regulated service would be affected by the income or loss of a non-regulated business.

Benefit of pre-2007 tax losses in GLPL's regulated business

As noted earlier, GLPL's evidence is that there are no pre-2007 loss carry forwards in the distribution business on a stand-alone basis. The reason for that result appears to be that, in years before 2007, GLPL included in its calculation of taxable income the annual increase in deferral account 1574. Board staff submitted that "if the values accumulated in account 1574 are not permitted for recovery in rates, it appears the GLPL distribution division would have incurred operating losses in years prior to the test year." In the staff's opinion, the existence of such prior year regulatory tax losses would make it unnecessary for a tax allowance to be recovered from customers in 2007. [26]

The second tax issue raised by staff is whether, in the event the Board disallows recovery of a deferral account balance, the regulated distribution business itself would have pre-2007 losses that should be used to eliminate any 2007 tax provision.

GLPL argued that, in the event the Board disallows recovery of the balance in account 1574, loss carry-forwards arising pre-2007 should be for the benefit of GLPL's shareholder. GLPL noted that any pre-2007 losses that arise in the event of the Board's denial of recovery of account 1574 must be due to variations in load or expenses compared to the amounts on which GLPL's then existing rates were based. Ratepayers would not have paid any amount due to unfavourable variations in load or expenses. Based on the stand-alone principle, GLPL argued that ratepayers should not be entitled to any benefit of those losses and that applying such pre-2007 losses to reduce the 2007 regulatory tax provision would constitute retroactive ratemaking. Board staff did not comment in its submission on whether the reason for the pre-2007 losses is relevant to whether the losses should be used to eliminate 2007 taxes.

[26] In its submission, Board staff also argued that GLPL has overstated its regulatory tax provisions in 2006 and earlier years by voluntarily including the annual increase in account 1574 in taxable income. Staff submitted that GLPL's action of recognizing the increase in account 1574 as taxable income in 2006 and earlier years is not something a stand-alone business would consider necessary or would consider to be prudent tax management. In effect, the staff seemed to be arguing that GLPL should be considered to have loss carry-forwards for regulatory purposes whether or not the Board disallows recovery of account 1574. Because the Board has determined that GLPL will not be permitted to recover the balance in account 1574, it is not necessary to consider and make a finding on this alternative staff argument.

Tab 'C'

so designated it complied with the conditions referred to in subparagraph (i),

and where a corporation has, on or before its filing-due date for its first taxation year, become a public corporation, it is, if it so elects in its return of income for the year, deemed to have been a public corporation from the beginning of the year until the time when it so became a public corporation;

"taxable Canadian corporation" « *société canadienne imposable* »

"taxable Canadian corporation" means a corporation that, at the time the expression is relevant,

(*a*) was a Canadian corporation, and

(*b*) was not, by virtue of a statutory provision, exempt from tax under this Part;

"taxable dividend" « *dividende imposable* »

"taxable dividend" means a dividend other than

(*a*) a dividend in respect of which the corporation paying the dividend has elected in accordance with subsection 83(1) as it read prior to 1979 or in accordance with subsection 83(2), and

(*b*) a qualifying dividend paid by a public corporation to shareholders of a prescribed class of tax-deferred preferred shares of the corporation within the meaning of subsection 83(1).

trentième jour précédant le jour comprenant le moment donné, remplit la condition énoncée au sous-alinéa (ii):

(i) elle a choisi, selon les modalités réglementaires, d'être une société publique et, au moment de ce choix, remplissait les conditions réglementaires concernant le nombre de ses actionnaires, la répartition de la propriété de ses actions et le commerce public de celles-ci,

(ii) elle a été désignée par le ministre, par avis écrit adressé à son intention, comme étant une société publique et remplissait, au moment de cette désignation, les conditions mentionnées au sous-alinéa (i);

n'est pas une société publique aux termes du présent alinéa la société qui, après le choix ou la désignation, selon le cas, et avant le moment donné, a cessé d'être une société publique par l'effet du choix ou de la désignation prévu à l'alinéa *c*);

c) une société, sauf une société à capital de risque de travailleurs visée par règlement, qui réside au Canada au moment donné et qui était une société publique après le 18 juin 1971 et avant le moment donné; n'est pas une société publique aux termes du présent alinéa, la société qui, après qu'elle est devenue la dernière fois une société publique et avant le moment donné, remplit la condition énoncée au sous-alinéa (i) ou qui, après qu'elle est devenue la dernière fois une société publique et avant le trentième jour précédant le jour comprenant le moment donné, remplit la condition énoncée au sous-alinéa (ii):

(i) elle a choisi, selon les modalités réglementaires, de ne pas être une société publique et, au moment de ce choix, remplissait les conditions réglementaires concernant le nombre de ses actionnaires, la répartition de la propriété de ses actions et le commerce public de celles-ci,

(ii) elle a été désignée par le ministre, par avis écrit adressé à son intention, comme n'étant pas une société publique et, au moment de cette désignation, remplissait les conditions mentionnées au sous-alinéa (i).

Par ailleurs, la société qui est devenue une société publique à la date d'échéance de produc-

(*b*) where a person or partnership acquires or disposes of shares of the capital stock of a corporation or interests in a partnership, either directly or indirectly, and it can reasonably be considered that the principal purpose for the acquisition or disposition is to permit a person to avoid, reduce or defer the payment of tax or any other amount that would otherwise be payable under this Act, that acquisition or disposition is deemed not to have taken place, and where the shares or partnership interests were unissued by the corporation or partnership immediately before the acquisition, those shares or partnership interests, as the case may be, are deemed not to have been issued.

le cas, sont réputées appartenir à la personne ou à la société de personnes;

b) dans le cas où une personne ou une société de personnes acquiert des actions du capital-actions d'une société ou des participations dans une société de personnes, ou en dispose, directement ou indirectement et où il est raisonnable de considérer que la principale raison de l'acquisition ou de la disposition est de permettre à une personne d'éviter, de réduire ou de reporter le paiement d'un impôt ou d'un autre montant qui serait payable par ailleurs en vertu de la présente loi, les actions ou les participations sont réputées ne pas avoir été acquises ou ne pas avoir fait l'objet d'une disposition et, dans le cas où elles n'avaient pas été émises par la société ou la société de personnes immédiatement avant l'acquisition, ne pas avoir été émises.

Stock dividends from foreign affiliates

(7) For the purposes of this subdivision and subsection 52(3), the amount of any stock dividend paid by a foreign affiliate of a corporation resident in Canada shall, in respect of the corporation, be deemed to be nil.

NOTE: Application provisions are not included in the consolidated text; see relevant amending Acts. R.S., 1985, c. 1 (5th Supp.), s. 95; 1994, c. 7, Sch. II, s. 71, c. 21, s. 43; 1995, c. 21, ss. 32, 46, 78; 1998, c. 19, ss. 122, 305; 1999, c. 22, s. 25; 2001, c. 17, s. 73; 2007, c. 35, s. 26; 2009, c. 2, s. 25.

Dividendes en actions payés par une société étrangère affiliée

(7) Pour l'application de la présente sous-section et du paragraphe 52(3), le montant de tout dividende en actions payé par une société étrangère affiliée d'une société résidant au Canada est, à l'égard de cette dernière société, réputé être nul.

NOTE : Les dispositions d'application ne sont pas incluses dans la présente codification; voir les lois modificatives appropriées. L.R. (1985), ch. 1 (5e suppl.), art. 95; 1994, ch. 7, ann. II, art. 71, ch. 21, art. 43; 1995, ch. 21, art. 32, 46 et 78; 1998, ch. 19, art. 122 et 305; 1999, ch. 22, art. 25; 2001, ch. 17, art. 73; 2007, ch. 35, art. 26; 2009, ch. 2, art. 25.

Subdivision j

Partnerships and their Members

General Rules

96. (1) Where a taxpayer is a member of a partnership, the taxpayer's income, non-capital loss, net capital loss, restricted farm loss and farm loss, if any, for a taxation year, or the taxpayer's taxable income earned in Canada for a taxation year, as the case may be, shall be computed as if

(*a*) the partnership were a separate person resident in Canada;

(*b*) the taxation year of the partnership were its fiscal period;

(*c*) each partnership activity (including the ownership of property) were carried on by the partnership as a separate person, and a computation were made of the amount of

Sous-section j

Les sociétés de personnes et leurs associés

Règles générales

96. (1) Lorsqu'un contribuable est un associé d'une société de personnes, son revenu, le montant de sa perte autre qu'une perte en capital, de sa perte en capital nette, de sa perte agricole restreinte et de sa perte agricole, pour une année d'imposition, ou son revenu imposable gagné au Canada pour une année d'imposition, selon le cas, est calculé comme si :

a) la société de personnes était une personne distincte résidant au Canada;

b) l'année d'imposition de la société de personnes correspondait à son exercice;

c) chaque activité de la société de personnes (y compris une activité relative à la propriété de biens) était exercée par celle-ci en tant

(i) each taxable capital gain and allowable capital loss of the partnership from the disposition of property, and

(ii) each income and loss of the partnership from each other source or from sources in a particular place,

for each taxation year of the partnership;

(*d*) each income or loss of the partnership for a taxation year were computed as if

(i) this Act were read without reference to section 34.1, subsection 59(1), paragraph 59(3.2)(*c.1*) and subsections 66.1(1), 66.2(1) and 66.4(1), and

(ii) no deduction were permitted under any of section 29 of the *Income Tax Application Rules*, subsections 34.2(4) and 65(1) and sections 66, 66.1, 66.2, 66.21 and 66.4;

(*e*) each gain of the partnership from the disposition of land used in a farming business of the partnership were computed as if this Act were read without reference to paragraph 53(1)(*i*);

(*e.1*) the amount, if any, by which

(i) the total of all amounts determined under paragraphs 37(1)(*a*) to 37(1)(*c.1*) in respect of the partnership at the end of the taxation year

exceeds

(ii) the total of all amounts determined under paragraphs 37(1)(*d*) to 37(1)(*g*) in respect of the partnership at the end of the year

were deducted under subsection 37(1) by the partnership in computing its income for the year;

(*f*) the amount of the income of the partnership for a taxation year from any source or from sources in a particular place were the income of the taxpayer from that source or from sources in that particular place, as the case may be, for the taxation year of the taxpayer in which the partnership's taxation year ends, to the extent of the taxpayer's share thereof; and

(*g*) the amount, if any, by which

que personne distincte, et comme si était établi le montant :

(i) de chaque gain en capital imposable et de chaque perte en capital déductible de la société de personnes, découlant de la disposition de biens,

(ii) de chaque revenu et perte de la société de personnes afférents à chacune des autres sources ou à des sources situées dans un endroit donné,

pour chaque année d'imposition de la société de personnes;

d) chaque revenu ou perte de la société de personnes pour une année d'imposition était calculé comme si :

(i) d'une part, il n'était pas tenu compte de l'article 34.1, du paragraphe 59(1), de l'alinéa 59(3.2)*c.1*) ni des paragraphes 66.1(1), 66.2(1) et 66.4(1),

(ii) d'autre part, aucune déduction n'était permise par les paragraphes 34.2(4) et 65(1) et les articles 66, 66.1, 66.2, 66.21 et 66.4 ni par l'article 29 des *Règles concernant l'application de l'impôt sur le revenu*;

e) chaque gain de la société de personnes résultant de la disposition de fonds de terre utilisés dans une entreprise agricole de la société de personnes était calculé compte non tenu de l'alinéa 53(1)*i*);

e.1) était déduit, en application du paragraphe 37(1), par la société de personnes dans le calcul de son revenu pour l'année l'excédent éventuel du total visé au sous-alinéa (i) sur le total visé au sous-alinéa (ii):

(i) le total des montants déterminés aux alinéas 37(1)*a*) à *c.1*) quant à la société de personnes à la fin d'une année d'imposition,

(ii) le total des montants déterminés aux alinéas 37(1)*d*) à *g*) quant à la société de personnes à la fin de l'année;

f) le montant du revenu de la société de personnes, pour une année d'imposition, tiré d'une source quelconque ou de sources situées dans un endroit donné, constituait le revenu du contribuable tiré de cette source ou de sources situées dans cet endroit donné, se-

Tab 'D'

Capital disclosures, Section 1535

CICA Handbook Section 1535, Capital Disclosures, requires additional disclosures with respect to the Partnership's management of capital. Adoption of the CICA recommendations had no impact on the Partnership's financial statements. The Partnership is expected to adopt this new standard effective January 1, 2009.

3. Changes in accounting policies

(a) Inventories, Section 3031

Effective January 1, 2008, the Partnership adopted, on a prospective basis, the recommendations of the CICA Handbook Section 3031, Inventories. This section provides an expanded definition of cost and requires that inventory be measured at the lower of cost and net realizable value. Additionally, there are increased guidelines on the grouping of inventories along with disclosure requirements regarding accounting policies, carrying values, and the treatment of any inventory write downs.

Under the new standard, logs from harvesting operations are valued at the lower of 12 month moving average cost and net realizable value on a product basis. Since the costs of each product are not separately identifiable, they are allocated between the products based on the relative sales value of each product. Purchased logs are measured at the lower of actual cost and net realizable value. Boomsticks are valued at net realizable value to reflect degradation that occurs from use.

The adoption of this standard did not have a significant impact on the financial statements of the Partnership.

(b) Financial Instruments, Section 3862 and 3863

As new financial instruments standards will be included in the proposed GAAP standards for private enterprises currently under development by the CICA, it has been decided by the CICA that private enterprises will not be required to apply the CICA Handbook Sections 3862 and 3863 which would have otherwise applied to the financial statements of the Partnership for the year ended December 31, 2008. The Partnership has elected to use this exemption but will continue to apply the requirements of CICA Sections 1530, 3855 and 3865.

(c) Assessing Going Concern, Section 1400

In June 2007, Section 1400 of the CICA Handbook was amended to require management to assess and disclose an entity's ability to continue as a going concern. This section applies for interim and annual periods beginning on or after January 1, 2008. Island adopted this Section on January 1, 2008.

The North American forest products industry is currently experiencing a very challenging economic environment. Demand for most products has weakened substantially, especially in domestic and US markets. Island has forecasted financial results and cash flows for 2009 using the Partnership's best estimates of market and operating conditions. These forecasts indicate that the Partnership will be able to maintain current liquidity. The Partnership expects to continue to meet all of its debt covenants and remains well positioned for a market turnaround. The Partnership sees no immediate impediments to its ability to continue as a viable going concern.

4. Management fee—performance bonus

Pursuant to the terms of the Management Agreement (the "Agreement") between Island and BTM, management fees are payable to BTM as compensation for the services provided by BTM on behalf of Island. These fees are comprised of a base management fee which is payable quarterly, and a performance fee which becomes payable annually upon the achievement of specified performance thresholds.

Tab 'E'

WestNet Rail is a 5,100 kilometre rail network in Western Australia. WestNet Rail provides access to its rail network to companies with trains that ship primarily bulk commodities (iron ore, alumina, coal, minerals, grain) to ports along the west coast of Australia. Due to the high costs and inefficiency of road transportation, our rail network often provides the sole economic access to the export market for our customers. In 2009, over 50 million tonnes of freight was shipped across WestNet Rail's network. With the recovery in the capital markets and the renewed demand for commodities, particularly from China, several large-scale iron ore mining developments in proximity to our rail network have progressed and are proposed to be brought into production in 2011. The engineering and financing analysis to support the necessary upgrades to WestNet Rail's network to accommodate these projects will begin in 2010. Based on our preliminary analysis, these upgrade projects will require capital expenditure in excess of $200 million.

In January 2010, WestNet Rail received a notice for stamp duty assessed in respect of the 2006 acquisition of the ARG Group. Our Partnership's share of the amount of the assessment is A$18.5 million (Prime's A$46.4 million). We believe that the assessment is incorrect at law and Prime intends to vigorously challenge it. Prime will fund the assessment from its cash resources while the matter is still pending.

Timber Operations

Our timber operations consist of high quality timberlands located in the coastal region of British Columbia, Canada and the Pacific Northwest region of the U.S. These operations are predominantly comprised of premium species and are expected to provide attractive risk adjusted returns on capital employed over the long-term.

Our timber segment is comprised of the following businesses:

Longview: Owns approximately 651,000 acres of freehold timberlands in Oregon and Washington. Longview has an estimated merchantable inventory of 25.5 million m^3 of timber, which is primarily comprised of high value Douglas-fir and hemlock trees.

Island Timberlands: Owns approximately 634,000 acres of freehold timberlands located principally on Vancouver Island, British Columbia. Island Timberlands has an estimated merchantable inventory of 58.0 million m^3 of timber, which is primarily comprised of high value Douglas-fir, hemlock and cedar trees. Island Timberlands' land holdings include approximately 33,000 acres of "higher and better use" ("HBU") lands, which may have greater value if used for real estate development or conservation.

The following table presents our timber segment's proportionate share of financial results.

	Years Ended December 31	
MILLIONS, UNAUDITED	**2009**	2008
Revenue	**$ 77.4**	$ 124.8
Cost attributed to revenues	**(56.2)**	(81.8)
Net operating income	**21.2**	43.0
Other income (expense)	**1.7**	(0.5)
Interest expense	**(25.7)**	(29.0)
Cash taxes	**0.2**	(0.7)
Adjusted net operating income (ANOI)	**(2.6)**	12.8
Depreciation, depletion and amortization	**(26.3)**	(36.7)
Performance fee	**5.4**	13.4
Unrealized loss on investment	**(11.9)**	—
Deferred taxes and other items	**9.4**	17.2
Net (loss) income	**$ (26.0)**	$ 6.7

For the year ended December 31, 2009, our timber operations' net operating income and ANOI totaled $21.2 million and negative $2.6 million, respectively, compared to $43.0 million and $12.8 million, for the same period in the prior year.

While timber market conditions continue to be poor, prices have improved steadily since the second quarter of 2009. Seasonally adjusted, annualized U.S. housing starts fell 5% from the third quarter to 554,000. While an improvement from the lows of the first quarter, this level is approximately one third of long-term trend levels. The inventory of new homes in the U.S. declined to 234,000 units while existing home inventories declined to 3.29 million units or a 7.2 month supply, both these statistics suggesting an increasingly balanced market. Despite these seemingly positive statistics, recovery of U.S. housing starts is expected to remain weak through 2010 and into 2011 as a result of the significant amount of vacant and foreclosed homes which we anticipate will continue to add to the inventory of existing homes for sale. Despite this difficult outlook, strong supply-side management has resulted in very low inventories of sawlogs and finished wood products across North America. Prices for most products have increased over 20% from their second quarter lows. Log prices in the Japanese market were stable through the quarter, and demand for whitewood in the Korean market remained strong, with realized pricing, net of transportation, at levels close to five-year averages.

Consistent with our focus on optimizing the long-term value of our business, we continued to harvest at sharply curtailed levels. We continue to adapt our plan as necessary to pursue market opportunities that arise.

The following table summarizes our proportionate share of operating metrics for our timber operations:

	Year Ended December 31, 2009				Year Ended December 31, 2008			
UNAUDITED	**Harvest (000's m³)**	**Sales (000's m³)**	**Revenue/m³**	**Revenue ($ millions)**	Harvest (000's m³)	Sales (000's m³)	Revenue/m³	Revenue ($ millions)
Douglas-fir	**502**	**538**	**$ 78**	**$ 42.0**	773	793	$ 88	$ 70.0
Whitewood	**237**	**258**	**61**	**15.7**	403	419	60	25.0
Other species	**235**	**261**	**70**	**18.3**	246	233	109	25.5
	974	**1,057**	**$ 72**	**$ 76.0**	1,422	1,445	$ 83	$ 120.5
HBU and other sales				**1.4**				4.3
Total				**$ 77.4**				$ 124.8

In 2009, sales volumes of Douglas-fir and whitewood declined by 32% and 38%, respectively, versus 2008 due to difficult market conditions in the North American structural lumber market. Sales volumes of other species increased 12% year-over-year, as a result of better relative market conditions for pulp logs and cedar through the first nine months of the year. To mitigate the impact of weak North American markets, we continued to increase our proportion of export quality timber from our harvest to take advantage of significantly better prices, net of transportation costs, available in the off-shore markets. Export volumes represented 42% of shipments in 2009, compared to 35% in 2008. Harvest volumes in our timber operations decreased 32% over 2008 as a result of our decision to reduce near-term harvest levels to preserve value.

Our operating margins declined to 28% for the year versus 34% in the prior year due to lower prices offset partially by lower costs per unit. The average realized price for Douglas-fir decreased by 11% compared to the prior year as declines in prices of products sold to the domestic market were partially offset by a significant percentage of high value appearance and export grade products sold to off-shore markets in our product mix. This compares favorably to the 15% decline in prices of indicative Douglas-fir logs during the same time period. The average selling price of whitewood increased modestly verus 2008, reflecting strong pricing realized on shipments to the Korean market. The significant change in the average realized price for other species is mostly attributable to a change in the mix of products included in that category.

Harvest and delivery costs per unit decreased 6% compared to 2008 primarily due to aggressive efforts to manage fixed costs and an increase in the proportion of harvesting rates determined through bid processes. This was partially offset by the impact of foreign exchange on Canadian dollar denominated costs in our Canadian operations.

Our share of revenue from HBU land and other sales totalled $1.4 million for the year compared to $4.3 million for 2008.

For the years ended December 31, 2009 and 2008, depreciation, depletion and amortization was $26.2 million and $36.7 million, respectively. The decrease is due to reduced harvest levels.

The unrealized loss on investment relates to our 7% indirect interest in our U.S. timber operations that is held through a private fund and is carried at fair value with changes to the carrying value recorded in income. Also, during the year, our Canadian timber operations recorded a reversal of a performance fee payable in 2011 as a result of a decline in the valuation of their HBU lands. We record this accrual below ANOI as it is a non-cash accrual that is subject to a claw-back prior to the determination of the payment amount in 2011.

Business Development and Outlook – Timber

One of the key attributes of our timber business is operating flexibility that allows us to adapt our harvest levels to market conditions to maximize the value of our business. Until we believe that sustainable demand will support meaningfully higher prices, we plan to harvest at minimum levels required to service our key customers and protect key distribution channels while capitalizing on market opportunities that do arise. Based on current conditions, we expect harvest levels at our Canadian and U.S. operations in 2010 to be similar to 2009 levels. Prices need to increase at least 20% from current levels before we would expect to return to target harvest levels. We currently do not expect this magnitude of price increases before late 2010 or early 2011.

We believe operating results for our timber segment will improve following recovery in U.S. new home construction. Although it is difficult to predict the timing and amount, we believe that we will achieve increases in ANOI and net income from this segment of our business for the following reasons:

- Improved pricing upon market recovery
- Increased harvest levels
  - The estimated long-run sustainable yield of our Canadian operations is approximately 0.7 million m^3 on a proportionate basis. Due to a surplus of merchantable inventory, we expect to achieve an elevated harvest level of approximately 0.9 million m^3 on a proportionate basis for a period of 10 years before returning to the long-run sustainable yield level.
  - As a result of a substantial surplus of merchantable inventory at our U.S. operations, we expect to increase harvest levels to approximately 0.9 million m^3 on a proportionate basis and sustain this higher level for a period of 10 years before returning to a long-run sustainable yield of approximately 0.8 million m^3.
- Increased margins
  - As the product mix in our Canadian operations evolves to a greater percentage of second growth harvest relative to primary growth harvest, we expect our margins to increase due to the lower harvesting costs of this product.

In addition, over the mid-to-long term, we expect that our timber operations will be positively impacted by a number of fundamental factors affecting the supply of timber in the markets that we serve:

- The mountain pine beetle infestation, which is having a significant impact on the supply of timber from the interior of British Columbia, Alberta and the U.S. Inland;
- Increasing demand from both Asian markets and the rapidly expanding bio-fuel industry; and
- Continuing withdrawals of timberlands for conservation and alternate uses.

CORPORATE AND OTHER

The following table presents the components of Corporate and other for the years ended December 31, 2009 and 2008:

	Years Ended December 31	
MILLIONS, UNAUDITED	**2009**	2008
General and administrative costs	**$ (7.8)**	$ (7.0)
Base management fee	**(10.2)**	(7.0)
Financing costs	**(5.0)**	(3.1)
Corporate expenses	**(23.0)**	(17.1)
Contribution from social infrastructure investments	**1.7**	—
Corporate and other	**$ (21.3)**	$ (17.1)

General and administrative costs were higher in 2009 compared to the prior year as a result of transaction costs that were incurred in conjunction with our investment in Prime, DBCT and PD Ports.

Pursuant to the Master Services Agreement, we pay a base management fee to the Manager on a quarterly basis, based on our market value. The fee increased over the prior year due to the approximately $940 million equity offering that was completed in November of 2009.

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words, a tax allowance is "no different from the allowance for any other costs." *Id.* Presumably whatever tax rate was applicable to a tax-paying regulated entity would be included in the cost-of-service analysis, nor does anything said by the Commission in *Lakehead* or in the opinions before us dispute that presumption. From this line of "reasoning," FERC proceeded to conclude that the limited partnership operating a jurisdictional pipeline "is entitled to an income tax allowance with respect to income attributable to its corporate partners." *Id.* The only further explanation that FERC offers for this conclusion is "when partnership interests are held by corporations, the partnership is entitled to a tax allowance in its cost-of-service for those corporate interests because the tax costs will be passed *1289 on to the corporate owners who must pay corporate income taxes on their allocated share of income directly on their tax returns." *Id.*

The Commission then goes on to "conclude[] that [the limited partnership pipeline] should not receive an income tax allowance with respect to income attributable to the limited partnership interests held by individuals ... because those individuals do not pay a corporate income tax." *Id.* at 62,315. Presumably, however, the individual owners pay individual income taxes. Also, presumably many owners (shareholders) of corporate holders of limited partnership interests will not be paying taxes on dividends as corporations often do not generate dividends.[7] In the original *Lakehead* opinion, the Commission had little further to say about why it distinguished between the corporate taxes of corporate unit holders and the individual income taxes of individual unit holders. In *Lakehead II,* and in the opinions we review today, the Commission did offer some attempt to explain the distinction.

In *Lakehead II,* FERC considered the argument of the *Lakehead* limited partnership that the Commission's refusal to grant a tax allowance reflecting the tax liabilities of all limited partnership unit holders, whether or not each holder was a subchapter C corporation, did not comport with the Commission's own "actual taxes paid" rationale, because the Commission, under the "stand-alone" tax policy discussed above, would permit "a regulated entity to collect a fair tax allowance even where no actual tax liability is incurred." *Lakehead II,* 75 FERC at 61,594. *Lakehead II* went on to argue that under this rationale, even if the jurisdictional entity is a non-taxed limited partnership, "rate payers should be responsible for the tax liability otherwise associated with the revenue generated from the jurisdictional activities, without regard to any actual amount paid to the IRS." *Id.* In rejecting the argument, the Commission stated, no doubt correctly, that in the case of a jurisdictional corporate subsidiary of a corporate group, "the allowed equity return generates an actual tax liability for the pipeline that must be paid to the IRS, either in cash or through the use of another member's deductions.... [E]ither way, the tax liability of the jurisdictional company is a real cost of providing service." *Id.* at 61,595 (citing *Northern Border Pipeline Co.,* 67 FERC ¶ 61,194, 61,110-11, 1994 WL 196221 (1994)). As applied to tax liability generating corporate subsidiaries engaged in jurisdictional activities, the Commission's statement is again quite defensible, when such a subsidiary does not itself incur a tax liability but generates one that might appear on a consolidated return of the corporate group. The difficulty arose when the Commission attempted to take the next step and explain why this reasoning applied to an entity that is a non-taxable limited partnership and to justify discriminating between allowances for the tax liability of corporate unit holders and the tax liability of those unit holders who are individuals or otherwise not subchapter C corporations. The Commission's reasoning on that point extends for two more paragraphs, but is summarized in the following statement immediately following the last quoted language from *Lakehead II*:

1290

> In contrast, there is no corporate tax liability associated with individual partners' equity return and therefore it is *1290 not appropriate to allow Lakehead to collect for such amounts in its cost-of-service.

Id. This does not supply reasoning for differentiating between individual and corporate tax liability. It is merely restating the proposition that the Commission is so differentiating. Otherwise stated, the Commission is once again simply declaring: we are including a tax allowance for corporate tax liability; we are not allowing a deduction for individual income tax liability. To re-phrase a proposition is not the same as supplying supporting reasoning. In short, the Commission's opinions in *Lakehead* do not evidence reasoned decisionmaking for

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whether that amount is actually distributed to him."). Based on this aspect of partnership law, FERC concluded that income taxes paid by investors in a limited partnership are "first-tier" taxes that may be allocated to the regulated entity's cost-of-service. The shipper petitioners argue that these taxes are ultimately paid by individual investors — not the pipeline — and thus it was improper for FERC to grant an ITA to the regulated entity. However, the Commission reasonably addressed this concern, explaining:

> Because public utility income of pass-through entities is attributed directly to the owners of such entities and the owners have an actual or potential income tax liability on that income, the Commission concludes that its rationale here does not violate the court's concern that the Commission had created a tax allowance to compensate for an income tax cost that is not actually paid by the regulated utility.

Policy Statement, 111 FERC at 61,742.

FERC also emphasized that "the return to the owners of pass-through entities will be reduced below that of a corporation investing in the same asset if such entities are not afforded an income tax allowance on their public utility income." *Id.* The Commission determined that "termination of the allowance would clearly act as a disincentive for the use of the partnership format," because it would lower the returns of partnerships vis-a-vis corporations, and because it would prevent certain investors from realizing the benefits of a consolidated income tax return. *Id.* We cannot hold that these conclusions were unreasonable. It has long been established that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks." *Hope Natural Gas*, 320 U.S. at 603. In the Policy Statement, FERC concluded that it would be inequitable to grant a full income tax allowance to corporations while denying a similar allowance to limited partnerships. 111 FERC at 61,740, 61,742. For example, if the corporate tax rate is 35%, then a pipeline that operates as a corporation is permitted to charge a rate of $154 in order to earn after-tax income of $100. As several commenters pointed out, "if an income tax allowance is not allowed the partnership, then the partners must pay a $35 income tax on $100 of utility income, leaving them with only an after-tax return of $65." *Id.* Based on these comments, the Commission determined that pipelines operating as limited partnerships should receive a full income tax allowance in order to maintain parity with pipelines that operate as corporations. This conclusion was not unreasonable, and we defer to FERC's expert judgment about the best way to equalize after-tax returns for partnerships and corporations.

In sum, policy choices about ratemaking are the responsibility of the Commission — not this Court. *See AT&T Corp. v. FCC*, 220 F.3d 607, 631 (D.C. Cir. 2000) (noting that "policy judgment[s]" are "for the agency — not this court — to make"). Our role as a reviewing court is limited to ensuring that "the Commission's decisionmaking is reasoned, principled, and based upon the record." *So. Cal. Edison Co. v. FERC*, 443 F.3d 94, 98 (D.C. Cir. 2006) (quoting *Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d 54, 60 (D.C. Cir. 1999)). Here, the conclusions reached in the Policy Statement and the Remand Order were within the scope of the Commission's discretion with respect to ratemaking issues. We held in *City of Charlottesville* that regulated entities are entitled to recover all "proper" costs from their ratepayers. 774 F.2d at 1207. Obviously, "proper" is not a self-defining term, and the Commission thus has broad discretion to determine which costs may be recovered through a pipeline's rates. Here, FERC has reasonably explained why income taxes paid on partnership income are properly allocated to the regulated entity for ratemaking purposes, and the shipper petitioners have offered no compelling reason to second-guess the agency's policy choices.

* * *

Petitioners argue that regardless of whether FERC's new ITA policy is reasonable, the Remand Order must be set aside because it is inconsistent with our opinion in *BP West Coast*. We disagree.

At the outset, we note that *BP West Coast* did not categorically prohibit the Commission from

granting income tax allowances to pipelines that operate as limited partnerships. We granted the shippers' petition for review in that case primarily because of the Commission's inadequately justified differential treatment of individual partners and corporate partners. As we explained, "the Commission's opinions in *Lakehead* do not evidence reasoned decisionmaking for their inclusion in cost of service of corporate tax allowances for corporate unit holders, but denial of individual tax allowances reflecting the liability of individual unit holders." BP West Coast, 374 F.3d at 1290. The Commission has now chosen to treat all income taxes alike, regardless of whether they are incurred by individual partners or corporate partners. *See* Remand Order, 111 FERC at 62,455 (conceding that "*Lakehead* mistakenly focused on who pays the taxes rather than on the more fundamental cost allocation principle of what costs, including tax costs, are attributable to regulated service, and therefore properly included in a regulated cost of service"). *BP West Coast* did not pass upon the specific question at issue in the instant case — whether FERC may grant an ITA to limited partnerships for the income taxes paid by *all* partners on the income they receive from the partnership. It is a basic tenet of administrative law that when an agency action is found to be arbitrary and capricious because of a failure to exercise reasoned decisionmaking, the agency is free to adopt a new policy on remand, provided it supplies a reasoned explanation for its actions. *See* SEC v. Chenery Corp., 332 U.S. 194, 200-01 (1947) (holding that when a court sets aside an agency order as "unsupportable for the reasons supplied by that agency," the agency is "bound to deal with the problem afresh" on remand).

Petitioners also argue that limited partnerships do not pay entity-level income taxes, and thus FERC's new ITA policy disregards our statement in *BP West Coast* that "the regulator cannot create a phantom tax in order to create an allowance to pass through to the rate payer." 374 F.3d at 1291. While not without force, this argument cannot ultimately prevail, for two reasons. First, as FERC explained in the Policy Statement and the Remand Order, the income taxes for which SFPP will receive an income tax allowance are real, albeit indirect. SFPP will be eligible for a tax allowance only to the extent it can demonstrate — in a rate proceeding — that its partners incur "actual or potential" income tax liability on their respective shares of the partnership income. Remand Order, 111 FERC at 62,456. Second, when we used the term "phantom tax" in *BP West Coast,* we were reviewing a very different set of orders than the ones at issue here. In *BP West Coast,* we vacated the *Lakehead* policy because the Commission had offered *no* reasoning to support its distinction between corporate partners and individual partners. 374 F.3d at 1290 ("This does not supply reasoning for differentiating between individual and corporate tax liability. It is merely restating the proposition that the Commission is so differentiating."). However, in the instant case FERC has gone to great lengths to explain why the taxes in question are not "phantom" and are properly attributed to the regulated entity. And there is at least one aspect of partnership law that supports FERC's conclusion but was not advanced by the Commission in *BP West Coast* — investors in a limited partnership are required to pay tax on their distributive shares of the partnership income, even if they do not receive a cash distribution. *See* Basye, 410 U.S. at 454. As explained above, this supports FERC's determination that taxes on the income received from a limited partnership should be allocated to the pipeline and included in the regulated entity's cost-of-service. In this sense, petitioners' likening of partnership tax to shareholder dividend tax is inapposite because a shareholder of a corporation is generally taxed on the amount of the cash dividend actually received. In sum, in the Policy Statement and the Remand Order, FERC has reasonably explained why its new ITA policy does not result in the creation of "phantom" tax liability for regulated pipelines that operate as limited partnerships. The same cannot be said for the *Lakehead* policy that we vacated in *BP West Coast.*

Shipper petitioners also emphasize that in *BP West Coast* we rejected SFPP's argument that the Commission should have adopted a full income tax allowance for limited partnerships. Petitioners argue that this holding is now the "law of the case," because the instant case involves the same issue that was litigated — and resolved in the shippers' favor — in the earlier proceeding. Again, we disagree. In *BP West Coast,* SFPP cross-petitioned for review of the *Lakehead* policy. Like the shipper petitioners, SFPP argued that the Commission's distinction between corporate partners and individual partners was unsupportable. 374 F.3d at 1291. However, while the shipper petitioners argued that FERC should not have permitted *any* income tax allowance, SFPP argued that FERC should have granted a *full* ITA to pipelines

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order,[25] denying a tax allowance would significantly reduce the expected returns that were the basis for that badly needed investment. They provide lists of numerous publicly traded partnerships that have substantial amounts of equity, and assert that some of these partnerships have made significant additional investments in reliance on the income tax allowance.[26] For these reasons these commentors conclude that all entities investing in utility operations, and generating utility income, should be permitted an income tax allowance. As discussed in the WPPI and EEI comments, the size of the allowance would be determined by the weighted maximum tax rate of the partners involved. Any problems of over- or under recovery would be adjusted within the partnership structure to assure that the benefits of any income tax allowance would not flow to a partner that had no actual or potential income tax liability.

III. Discussion

31. The issue is under what circumstances, if any, an income tax allowance should be permitted on the public utility income earned by various public utilities regulated by the Commission. As stated earlier, while the court's decision in *BP West Coast* only addressed the particulars of a certain oil pipeline, the numerous comments submitted here indicate that partnerships or other pass-through entities are used pervasively in the gas pipeline and electric industries as well. Upon review of the comments, there appear to be four possible choices: (1) provide an income tax allowance only to corporations, but not partnerships; (2) give an income tax allowance to both corporations and partnerships; (3) permit an allowance for partnerships owned only by corporations; and (4) eliminate all income tax allowances and set rates based on a pre-tax rate of return.

32. Given these options, the Commission concludes that it should return to its pre-*Lakehead* policy and permit an income tax allowance for all entities or individuals owning public utility assets, provided that an entity or individual has an actual or potential income tax liability to be paid on that income from those assets. Thus a tax-paying corporation, a partnership, a limited liability corporation, or other pass-through entity would be permitted an income tax allowance on the income imputed to the corporation, or to the partners or the members of pass-through entities, provided that the corporation or the partners or the members, have an actual or potential income tax

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Trans-Elect ND-15; Tuscarora Gas Transmission Company; Saltville Gas Storage Company, L.L.C; and Shell Pipeline Company.

[25] *Trans-Elect NTS Path 15, LLC*, 109 FERC ¶ 61,249 (2004) (*Trans-Elect*).

[26] *See* comments of: Duke Energy Corporation at 9-10, 30; Enbridge Inc and Enbridge Energy Partners at 4-5; Gas Pipeline Partnerships at 2-4; Millennium Pipeline Company, L.P. at 2; Northern Border Pipeline Company at Appendix A; Publicly Traded Partnerships at 13-14.

liability on that public utility income. Given this important qualification, any pass-through entity seeking an income tax allowance in a specific rate proceeding must establish that its partners or members have an actual or potential income tax obligation on the entity's public utility income. To the extent that any of the partners or members do not have such an actual or potential income tax obligation, the amount of any income tax allowance will be reduced accordingly to reflect the weighted income tax liability of the entity's partners or members.[27]

33. In reaching this conclusion, the Commission expressly reverses the income tax allowance holdings of its earlier *Lakehead* orders. As stated in EEI's comments, *Lakehead* mistakenly focused on who pays the taxes rather than on the more fundamental cost allocation principle of what costs, including tax costs, are attributable to regulated service, and therefore properly included in a regulated cost of service.[28] Relying on *BP West Coast,* some commenters assert that because a pass-through entity pays no cash taxes itself, this results in a phantom tax on fictional public utility income. However, the comments summarized in sections A and D of Part II of this policy statement demonstrate that this assumption was incorrect. While the pass-through entity does not itself pay income taxes, the owners of a pass-through entity pay income taxes on the utility income generated by the assets they own via the device of the pass-through entity.[29] Therefore, the taxes paid by the owners of the pass-through entity are just as much a cost of acquiring and operating the assets of that entity as if the utility assets were owned by a

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[27] This is a technically complex issue that would be addressed in individual rate proceedings as suggested by EEI and WPPI.

[28] EEI comments at 8. In support of this point several commenters cite to *City of Charlottesville*, *supra*, note 12, for the proposition that a tax cost involves real taxes but not necessarily require that cash taxes be paid by the regulated entity. *See* EEI at 11-13; INGAA at 12-13; Joint Comments of the Interested Gas Pipeline Partnerships at 10-12; AOPL at 8-9.

[29] The comments and numerical examples submitted by the EEI, INGAA, and Northern Border demonstrate that under partnership law the partners, or members, of pass-through entities pay taxes on the public utility income of the operating entities that they control through the partnership or other pass-through entity. *See* EEI at 13-15; INGAA at 15-17; Northern Border at 5-8; Shell Pipeline Company LP at 4; and WPS Resources at 14-16.

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policy result here.[35] Moreover, the Commission emphasizes that the primary rationale for reaching the conclusion here is to recognize in the rates the actual or potential income tax liability ultimately attributable to regulated utility income. Having concluded that this will not result in phantom income taxes, it is then legitimate to conclude that the result here will facilitate important public utility investments such as that made by Trans-Elect NTD Path 15, LLC in the Path 15 upgrade.

38. In retrospect, it was the Commission's failure to distinguish between first and second tier income that lead to the double taxation rationale that the Commission incorrectly advanced in *Lakehead.* Dividends paid to the common stock investor and by the corporate investor in a pass-through entity are second tier income to such a common stock investor. As such, an income tax is paid by the investor in addition to the corporate tax that is due on the first tier income. In contrast, first tier income flows either to the

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[35] The partners of master limited partnerships have actual tax liability for any income recognized by the partnership. However, distributions may substantially exceed partnership book income. Such distributions do have an ultimate income tax liability depending on the status of the capital account of the individual partners. This matter can present complex allocation and timing issues that would be addressed in individual rate proceedings. However, a simple numerical example can illustrate the basic principles. For example, assume that an individual invests $100 in a partnership and obtains a ten percent interest in that partnership. This establishes a partnership account (or basis) for the individual of $100. During year one of that investment the partnership has $100 in income before depreciation and depreciation of $70. The partnership therefore has net income of $30 and also makes a distribution of $100. Since the individual partner owns ten percent of the partnership, that partner must declare $3 in income on the individual's 1040 tax form, but does not pay taxes on the $10 distribution made to that partner.

The capital account of the individual partner is adjusted as follows. Ten percent of the partnership income before depreciations (or $10) is allocated to the individual partner and is added to that partner's account. Ten percent of the partnership depreciation, or $7, is deducted from the account, as is the cash distribution. The individual's partnership account therefore stands at $93 ($100 + $10 - $10 - $7). In year two the partnership income is zero and no distributions are made, so the individual's partnership account is unchanged. However, that individual partner sells the partnership interest for $105. This difference is taxable as follows. Since $7 of the sale price is a gain above the year 2 partnership account level of $93, it will be taxed as income. This results in a tax on the cash that was distributed in the prior year but for which no income tax was paid at that time. Depending on the nature of the depreciation taken, the $7 may be taxed as ordinary income through the operation of various recapture provisions. The additional $5 is also income and is also taxed, most likely at the capital gains rate since it is gain in excess of the partner's original capital investment of $100.

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corporation, a corporate partner, or individual partners (or LLC members) and is taxed at that level. To the extent *Lakehead* either concluded or assumed that dividend payments and income, and partnership distributions and income, have the same ownership and income tax characteristics, this is simply incorrect as a matter of partnership and income tax law.[36] The court summarized this situation succinctly when it stated that presumably both corporate owners and individuals would pay taxes on public utility assets they control. Similarly, like a Subchapter C corporation, partners may have deductions or losses that offset the income from a specific public utility asset or which may neutralize the operating income from the asset itself. But this does not preclude such a corporation from obtaining an income tax allowance under the Commission's stand-alone doctrine.[37] Just as there are no rational grounds for granting an income tax allowance on partnership interests owned by a corporation and denying one to those owned by individuals, there are no rational grounds for reaching a different conclusion for the deductions and offsets for taxpaying partners or LLC members.

39. The Commission further concludes that the alternatives listed at the beginning of this Part III of this policy statement are not practical or are inconsistent with the court's remand. First the Commission agrees with the court's conclusion in *BP West Coast* that the Commission in *Lakehead* did not articulate a rational ground for concluding that there should be no tax allowance on partnership interests owned by individuals, but that there should be one for partnership interests owned by corporations. As the court stated, presumably individual partners pay taxes on their public utility income just as corporate partners pay income tax on theirs. The comments summarized in sections A and D of Parts II of this order affirm that common sense observation. The court's rejection of *Lakehead* likewise establishes why the Commission cannot simply limit income tax allowances to partnerships that are wholly owned by corporations, since doing so in effect denies a tax allowance to the partners of a partnership with no corporate ownership.

40. Similarly, there no rational reason to limit the income tax allowance to public utility income earned by a corporation. Public utility income controlled directly by an individual may also be taxed. The partnership entity is simply an intermediate ownership device that leads to the same tax result. Since both partners and Subchapter C corporations pay income taxes on their first tier income, the inconsistency that undermined *Lakehead* applies here as well. Finally, the comments rightly suggest that it would be difficult to establish rates based on a pre-tax rate of return. If the Commission were simply to raise the rates to equalize the pre-tax and after-tax returns, all this would do incorporate a presumed marginal income tax rate into the rate structure. The result is

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[36] *See* ATCLLC at 5.

[37] *See City of Charlottesville, supra,* note 12.

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"market price" means the price reached in an open and unrestricted market between informed and prudent parties, acting at arm's length and under no compulsion to act;

"qualifying facility" means a generation facility or an energy storage facility that meets the requirements set out in subsection 71(3) of the Act;

"rate" means a rate, charge or other consideration and includes a penalty for late payment;

"Rate Order" means an order of the Board that is in force at the relevant time which, among other things, regulates distribution and transmission rates to be charged by a utility;

"Services Agreement" means an agreement between a utility and its affiliate for the purpose of subsection 2.2 of this Code;

"shared corporate services" means business functions that provide shared strategic management and policy support to the corporate group of which the utility is a member, relating to legal, regulatory, procurement services, building or real estate support services, information management services, information technology services, corporate administration, finance, tax, treasury, pensions, risk management, audit services, corporate planning, human resources, health and safety, communications, investor relations, trustee, or public affairs;

"smart sub-metering provider" has the meaning given to it in the Smart Sub-metering Code;

"system planning information" means information pertaining to (i) the planning of a distribution system, including distribution system development or reinforcement plans, equipment acquisitions and work management plans, or (ii) the planning of systems involved in work management or of systems involved in the provision of customer service, including billing systems and call centre operations;

"transmission system" means a system for transmitting electricity , and includes any wires, structures, transformers, equipment or other things used for that purpose;

"transmit" means to convey electricity at voltages of more than 50 kilovolts;

"transmitter" means a person who owns or operates a transmission system;

2.3.4 Where No Market Exists

2.3.4.1 Where it can be established that a reasonably competitive market does not exist for a service, product, resource or use of asset that a utility acquires from an affiliate, the utility shall pay no more than the affiliate's fully-allocated cost to provide that service, product, resource or use of asset. The fully-allocated cost may include a return on the affiliate's invested capital. The return on invested capital shall be no higher than the utility's approved weighted average cost of capital.

2.3.4.2 Where a reasonably competitive market does not exist for a service, product, resource or use of asset that a utility sells to an affiliate, the utility shall charge no less than its fully-allocated cost to provide that service, product, resource or use of asset. The fully-allocated cost shall include a return on the utility's invested capital. The return on invested capital shall be no less than the utility's approved weighted average cost of capital.

2.3.4.3 Where a utility pays a cost-based price for a service, resource, product or use of asset that is obtained from an affiliate, the utility shall obtain from the affiliate, from time to time as required to keep the information current, a detailed breakdown of the affiliate's fully-allocated cost of providing the service, resource, product or use of asset.

2.3.4A Qualifying Facilities

2.3.4A.1 For a service, product, resource or use of asset that pertains exclusively to the ownership and operation of one or more qualifying facilities, fully-allocated cost-based pricing (as calculated in accordance with sections 2.3.4.1 and 2.3.4.2) may be applied between a utility that is a distributor and an affiliate in lieu of applying the transfer pricing provisions of section 2.3.3.1 or section 2.3.3.6, provided that the distributor complies with section 2.3.4.3.

2.3.5 Shared Corporate Services

2.3.5.1 For shared corporate services, fully-allocated cost-based pricing (as calculated in accordance with sections 2.3.4.1 and 2.3.4.2) may be applied between a utility and an affiliate in lieu of applying the transfer pricing provisions of section 2.3.3.1 or section 2.3.3.6, provided that the utility complies with section 2.3.4.3.

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IPCCAA/SPPA submitted that if the owners of a utility are not taxable due to their structure, then no tax should be included in the revenue requirement.

8.1.5 Views of ATCO Electric

ATCO urged the Board to issue a clear and unambiguous decision regarding the matter of deemed income tax for AltaLink because of the partnership structure. ATCO was concerned about a level playing field for the industry.

8.1.6 Views of the Board

In Alberta's cost of service jurisdiction where revenue and costs are forecast on a prospective basis, there must be a reasonable expectation that the quantum of costs, which are approved, would likely be incurred. At the end of the rate period the utility will have either incurred the costs exactly as approved or incurred actual costs that are higher or lower than those approved. In the latter two cases, the utility bears the incremental cost or gains the benefit of the lower cost, not the customer.

This is an acceptable consequence of setting rates on a prospective basis in a cost of service jurisdiction because this approach provides an incentive for a utility to keep costs under control, which in the long term should benefit customers. If the actual costs vary widely from the forecast costs, an opportunity is available in the next rate application to assess the accuracy or reasonableness of those applied for costs based on the experience from the previous rate period. Further, there may also be an opportunity for a review of a utility's rates during a rate period if they appear unjust or unreasonable under section 57 of the *Electric Utilities Act.*

The Board acknowledges that the existence of deferral accounts, which are routinely used and accepted by the Board, consumers and industry, do not strictly conform to the principles of prospective rate making because, generally, these accounts address costs which are not reasonably predicted or controllable. In most cases though, costs are usually predictable within an acceptable range of accuracy. It is because of this relatively narrow range of deviation between forecast and actual costs that a utility receives the benefit or is exposed to cost of the variance from the Board approved costs.

The calculation of an income tax component of revenue requirement should be determined on the same basis as other costs, that is, the utility is treated as a separate entity for regulatory purposes and it is the costs related to that utility's operations that are examined and approved on a prospective basis. The Board accepts that the underpinning of the stand-alone principle is that the regulated utility should not be subsidizing its non-utility operations or operations of members of its corporate family, neither should the non-regulated activities subsidize the utility operations.

Simply put, in calculating an income tax allowance for a utility, the utility's net income before income tax is adjusted to reflect the impact of permanent and timing differences to arrive at taxable income and the appropriate statutory income tax rate is applied. The result, adjusted by other tax amounts such as the Large Corporation Tax, is the income tax payable which then makes up part of the revenue requirement and which subsequently forms part of customer rates.

One of the costs, which is deducted from revenue, is the interest or carrying charges on the deemed debt portion of the utility's capital structure. The capital structure is, of course, set on a stand-alone basis, focusing only on the regulated utility operations in question. Both the

percentage of debt and the accompanying interest rate that will be allowed (as well as the percentage of equity and the return thereon) are determined by the Board. The amount of interest associated with the debt constitutes a significant expense to the utility and provides a significant deduction from revenue with the effect of lowering taxable income and reducing the income tax that would otherwise be payable.

Where the stand-alone utility under scrutiny relies, for example, on a parent corporation or other related entity to arrange its debt financing because of the parent's greater overall assets and financial security, the carrying charges or interest on this actual debt may be less than the approved interest charge on the deemed debt portion of the stand-alone utility. Similar to other costs, which are approved on a stand-alone prospective basis, the fact that the actual interest charges do not match the approved interest component does not offend the principles of rate making in a prospective cost of service jurisdiction provided that the actual cost is within an acceptable range of accuracy when compared to the approved cost. As discussed earlier, costs are examined for a new rate period, in part, within the context and experience of the previous rate period with access to actual costs for the previous period to assist in the assessment of the applied for costs. The existence of lengthy regulatory history with a particular utility also enhances the Board's understanding of the applied for costs and, in connection with the interest charges, the relationship between the deemed capital structure and the actual one.

In the present case, the Board is unable to conduct this type of review because this is the initial rate application by AltaLink and there is no regulatory history to provide context for the Board. Further, no evidence was presented to show the actual capital structure of the limited partners as it relates to their respective investment, excluding the premium, in the utility. The Board will determine the deemed capital structure for the utility on a stand-alone basis and in doing so will use the deemed interest charge on the debt portion of capital in the calculation of the income tax allowance. However, until it is able to review the actual capital structure of the limited partners, the Board is not in a position to assess how the actual interest cost of each partner compares to the deemed interest cost in terms of an acceptable range of variation.

The Board also finds that the partnership structure of this utility contributes to the difficulty in addressing the matter of an income tax allowance. Neither of the partnerships is liable to pay income tax, only the limited partners are taxable. Relevant information, apart from confirmation of the taxable status of the four limited partners, was not forthcoming during the hearing. AltaLink's position, generally, was that it did not possess the information, it was beyond its control to obtain such information, and was irrelevant in any event.

There is no other partnership structure which currently owns a regulated utility in Alberta nor has there been one in the past. The Board is concerned that the partnership structure utilized in this case may lead to the approval of an income tax allowance that will be significantly greater than the tax ultimately paid by the partners solely because of the corporate structure of the utility partnership and the opportunity for the four partners to establish a capital structure that deviates materially from the stand-alone one set by the Board for the operating utility.

The regulatory precedent cited by the applicant and the interveners is not binding on the Board. There is no regulatory precedent in Alberta for this issue. Some of the regulatory decisions regarding partnerships and income tax allowances are based on the unique circumstances and facts presented to the respective tribunals. Others, such as the NEB cases, do not provide any

Tab 'K'

3.3 Should OTPPB TEP Inc. be Treated Differently than its Partners

AltaLink also contends that, having found that OTPPB TEP Inc. is a taxable entity in Canada, the Board's decision to then disallow an income tax and LCT allowance to OTPPB Inc. was patently unreasonable and as such constitutes error of fact and law. In AltaLink's view, the Board's decision was unjustly discriminatory against OTTPB TEP Inc.

The Review Panel notes that in Decision 2004-007, as part of the Board's review of the AILP partners' capital structure information provided in AltaLink's 2002/2003 and 2003/2004 GTA Refiling, the Board stated in the views of the Board section as follows:

> The evidence before the Board in the GTA proceeding indicated that, at the time AltaLink filed its GTA, the OTPPB-TEP Inc. partner was a tax-exempt entity. However, by the time the hearing commenced or shortly thereafter, it had been reorganized into a taxable corporate entity. Since the Board received no persuasive reason or evidence for this change of tax status, it was not clear to the Board why this done. More importantly, what was also not clear was the impact of the OTPPB's tax-exempt status on the likelihood of incurring income tax expenses relative to its investment in ALP, notwithstanding the creation of a taxable subsidiary.
>
> The Board formed the view that, in a situation such as the OTPPB where a tax-exempt entity inexplicably creates a taxable subsidiary, it would be reasonable to assume that there is no likelihood of the OTPPB's incurring income tax expenses with respect to its investment in ALP. Hence, customers should not be expected to provide AltaLink with an income tax allowance with respect to the OTPPB's investment in ALP.
>
> With the filing of the owner's capital structure information and Commentaries, the Board now has some understanding of why the OTPPB chose to invest in ALP by way of a taxable subsidiary. However, it is still not completely clear to the Board why the OTPPB would see a need to make such a structural change to its organization for tax planning purpose since it is a tax-exempt entity.
>
> The inability of OTPPB-TEP Inc. to reduce income taxes for its *tax-exempt* parent (which cannot reduce its taxes below the zero level) suggests to the Board that OTPPB-TEP Inc. was created not as a tax-planning vehicle but solely to capture the tax allowance that might flow from ALP's revenue requirement and, thus, enhance the allowed return on its investment in ALP. The Board notes that OTPPB-TEP's capital structure consists of 0% debt, which is consistent with the tax-exempt status of its parent and is perhaps indicative of the OTPPB's lack of interest in tax shelters. The Board considers this to be further indication that the OTPPB's creation of a taxable subsidiary was designed to capture a tax allowance from its investment in ALP, thereby increasing its return on that investment, rather than a tax-saving strategy.
>
> As a general principle, the Board considers that it would not be fair to consumers to grant a deemed income tax allowance in a utility's revenue requirement for owners that have little to benefit from tax planning because of their tax-exempt status. The Board acknowledges that efficient tax planning imperatives can lead to a discrepancy between a utility company and its partners' net tax liability; however, when this happens for a tax-exempt owner such as OTPPB, the tax planning incentives become irrelevant.
>
> Based on the information before it, the Board concludes that the creation of OTPPB-TEP has little tax planning benefit because of the OTPPB's tax-exempt status. Consequently, it would not be fair to consumers to grant a deemed income tax expenses with respect to

> the income to be allocated to the OTPPB, or its taxable subsidiary, an income tax allowance in ALP's revenue requirement with respect to the OTPPB's investment. Moreover, the Board is still not convinced that there is a reasonable expectation of incurrence of income tax expenses by the OTPPB.

The Review Panel notes that the basis for the foregoing views of the Board was the AILP Partners' capital structure information and commentaries, which were also filed as part of this Application. The Review Panel has also reviewed this information and concurs with the Board's findings and conclusions as set out above.

In an effort to better understand why the generation of a tax liability, through the creation of an upstream entity such as OTPPB TEP Inc. by its non-taxable parent, the Ontario Teachers Pension Plan, might be considered prudent for establishing AltaLink's forecast revenue requirement, the Review Panel requested further information from AltaLink.[4] While AltaLink's submission was very expansive, the Review Panel considers that it was not responsive and, therefore, did not help in furthering understanding of this matter.

The Review Panel is not persuaded that the generation of a tax liability through the creation of an upstream entity such as OTPPB TEP Inc. by a non-taxable partner, should be considered a prudent cost of providing regulated service by AltaLink to be recovered through customer rates.

The Board's explanation of its determination respecting the Teachers' Income Tax Disallowance issue in Decision 2003-061 was arguably sparse. Nevertheless, based on the Review Panel's review of the Board's views in Decision 2004-007 and the additional information respecting this matter that was filed as part of this Proceeding, the Review Panel finds that the circumstances surrounding the OTPPB TEP Inc. are sufficiently different from its partners to warrant a different treatment in respect of an allowance for income taxes.

Accordingly, for all of the above reasons, the Review Panel considers that there is no need to vary the Board's determination of the Teachers' Income Tax Disallowance determination in Decision 2003-061.

For the reasons stated in Decision 2003-061[5], the Review Panel considers that its findings are equally applicable to the Board's LCT determinations in Decision 2003-061. Hence, there is no need to vary the Board's LCT determination in Decision 2003-061.

4 WHETHER TO VARY ALTALINK'S EQUITY RATIO ADJUSTMENT DETERMINATION

Having concluded that the Board's determination to disallow an income tax allowance in AltaLink's forecast revenue requirement with respect to the OTPPB TEP Inc.'s investment in AltaLink should not be varied, the Review Panel will now address whether the Board erred in using an average effective tax rate of 15% when it determined the impact of that disallowance on AltaLink's equity ratio at page 107 of Decision 2003-061.

[4] BR.AML-004 a-b, BR.AML-005 (b), and BR.AML-010 a-b IR No. 2

[5] Page 86, section 8.2.4 of Decision 2003-061