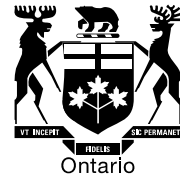


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By E-mail

November 23, 2007

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

Dear Ms. Walli:

**Re: Welland Hydro-Electric Services Inc.
2007 Electricity Distribution Rates Amendment (Recovery Of 2007
Pils Expense)
Board File No. EB-2007-0663**

In accordance with Procedural Order No. 2, please find enclosed Board staff's submission with respect to Welland Hydro-Electric Services Inc.'s application and evidence.

Yours truly,

Original signed by

Keith C. Ritchie
Project Advisor - Applications

Enclosures

cc: Mr. Wayne Armstrong, Welland Hydro-Electric Systems Inc.
Mr. J. Sidlofsky, Borden Ladner Gervais
Intervenors of Record



ONTARIO ENERGY BOARD

STAFF SUBMISSION

**2007 ELECTRICITY DISTRIBUTION RATES
AMENDMENT (RECOVERY OF 2007 PILs
EXPENSE)**

WELLAND HYDRO-ELECTRIC SERVICES INC.

EB-2007-0663

November 23, 2007

INTRODUCTION

The purpose of this document is to provide the Ontario Energy Board (the “Board”) with the submissions of Board staff after its review of the evidence filed in the 2007 electricity distribution rates application by Welland Hydro-Electric Systems Inc. (“Welland Hydro”) to amend its approved distribution rates, effective October 1, 2007, for the purpose of recovering its reasonable taxes/PILs expenses (“PILs expense”) for 2007 on a going-forward basis.

This submission of Board staff will address Welland Hydro’s application in two parts. First, Board staff will comment on the soundness of Welland Hydro’s proposal that, since its Board-approved 2006 distribution rates reflect a lower PILs expense recovery because of the use of a then-available loss carry forward, use of those rates as the starting point for the 2007 IRM adjustment would then under-recover a “normal” tax or PILs liability when the loss carry forward has been used up. Second, staff will make submissions on how Welland Hydro’s application supports its position that the loss carry forward has been used up and its proposal for distribution rates in 2007 to recover a “normal” level of PILs expense.

WELLAND HYDRO’S RATE AMENDMENT PROPOSAL

Welland Hydro applied for and was approved distribution rates effective May 1, 2007 in accordance with the 2nd Generation Rate Adjustment “price cap” mechanism as documented in the Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation Mechanism for Ontario’s Electricity Distributors (the “Board Report”), issued December 20, 2006. Its 2007 distribution rates were considered in the IRM proceeding under Board file No. EB-2007-0586.

The IRM approach is a formulaic adjustment to the prior year’s rates to allow for inflationary adjustments to the costs of inputs (labour, material and capital) less expected annual improvements in productivity through technological advances, management expertise, and cost management. The IRM formulaic approach does not reflect material changes in individual cost components.

Welland Hydro filed its submission on the basis that its 2006 approved rates were inadequate and inappropriate for fully recovering its expected 2007 taxes/PILs since the

2006 rates incorporated a reduced PILs expense due to use of a loss carry-forward to reduce its tax/PILs liability in that year, but which is now used up. As a result, Welland Hydro expects to pay a more “normal” level of PILs in 2007.

Welland Hydro’s approach is two-step:

- 1) Calculate “pro forma” 2006 rates using the 2006 EDR and PILs models corresponding to Welland Hydro’s approved 2006 EDR rates, as considered in RP-2005-0020/EB-2005-0428, but eliminating the loss carry-forward used in the original 2006 EDR application. These “pro forma” 2006 rates would reflect recovery of a normal level of PILs expense in the absence of historical loss carry forwards; and
- 2) Flow these “pro forma” 2006 rates through the 2007 IRM model used to determine 2007 rates. The 2007 IRM model used reflects all other adjustments (such as Welland’s Smart Meter rate adder) as approved for Welland Hydro’s May 1, 2007 rates in the Board’s Decision and Order EB-2007-0586.

Welland Hydro proposed that the adjusted 2007 rates be effective October 1, 2007. Welland Hydro’s rates from May 1 to September 30, 2007 will under-recover its PILs expense, but Welland Hydro has proposed that this will be borne by the shareholder.

Welland noted that, based on this approach, the estimated PILs under-recovery for 2007 would be \$352,832. Based on its proposal to adjust rates from October 1 onwards, the incremental amount of PILs to be recovered would be around \$206,000.

STAFF SUBMISSION ON WELLAND HYDRO’S EVIDENCE

Board staff submits that the test to be met is: Has Welland Hydro adequately demonstrated that it has used all historical loss carry forwards by December 31, 2006? If that is the case, then the next question is: Have 2007 distribution rates been derived using a “normal” PILs expense amount?

Staff has analyzed the rate application models for 2006 and 2007 that Welland Hydro has filed in support of the proposed rates. Staff is satisfied that the models provided correspond with the Board Decisions and approved rates for Welland Hydro for 2006

and 2007, with the sole change being that of “zeroing out” the loss carry forward in 2006. This change has the effect of calculating “pro forma” 2006 rates with a “normal” level of PILs expense recovery, which are then used as the starting rates adjusted in the 2007 IRM model to derive adjusted 2007 rates that also would recovery a “normal” level of taxes or PILs. Staff is satisfied that the two-stage approach by Welland Hydro is a reasonable way of calculating adjusted 2007 rates reflecting a “normal” level of taxes/PILs based on the nature of rate-setting in 2006 and 2007.

In response to interrogatories posed by Board staff, Welland Hydro filed copies of its Federal and Provincial tax returns, associated schedules, and Notices of Assessment, for the years 2005 and 2006. Staff notes that Welland Hydro’s tax returns shows that its actual use of loss carry-forwards to reduce taxes/PILs in 2005 and 2006 differed from the estimated use of Loss Carry Forwards as documented in the PILs model at the time of Welland Hydro’s 2006 EDR application. However, both the PILs model in 2006 and the tax returns do support Welland Hydro’s position that available historical loss carry-forwards were eliminated by December 31, 2006, and hence that Welland Hydro is subject to a “normal” level of taxes/PILs in 2007.

	2006 EDR PILs Model	Actual (from 2005 and 2006 tax returns)
Loss Carry-Forward Available - Dec. 31/04	\$ 805,523	\$ 1,142,157
Lass Carry-Forward Used - 2005	<u>\$ 71,895</u>	<u>\$ 756,385</u>
Loss Carry-Forward Available - Dec. 31/05	\$ 733,628	\$ 385,772
Loss Carry-Forward Used - 2006	<u>\$ 733,628</u>	<u>\$ 385,772</u>
Loss Carry-Forward Available - Dec. 31/06	\$ -	\$ -

In response to an interrogatory posed to it by the School Energy Coalition, Welland Hydro provided an analysis showing that its actual PILs payments in 2006 were \$688,265, in contrast to the \$97,286 PILs expense approved in Welland Hydro’s 2006 EDR application. However, use of much of the available Loss Carry-Forward in 2005, rather than in 2006 as filed by Welland Hydro in its 2006 EDR application, would be a major factor explaining why its actual PILs was higher than forecast. However, this just shifts the year that Welland Hydro benefited from the PILs reduction.

IMPLEMENTATION OF RATE CHANGES

Board staff notes Welland Hydro's proposal that the adjusted 2007 rates reflecting a normal level of tax/PILs expense recovery only come into effect on October 1, 2007, which implies that any tax/PILs under-recovery from May 1 to September 30, 2007 will be borne by Welland Hydro's shareholder(s).

SUMMARY

In conclusion, Board staff submits that Welland Hydro's request for the adjustment to 2007 rates to reflect the elimination of historical loss-carry forwards by December 31, 2006 has been supported by Welland Hydro's evidence. Board staff also submits that these adjusted 2007 rates reflect a "normal" level of PILs.

All of which is respectfully submitted this 23rd day of November, 2007