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December 5, 2007

Delivered by Courier and Email

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, Suite 2700
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

**Re: EB-2007-0663 Welland Hydro-Electric System Corp. 2007 Electricity
Distribution Rate Application – Reply Submission**

We are counsel to Welland Hydro-Electric System Corp. (“Welland Hydro”) with respect to the above-captioned matter. Please find accompanying this letter 2 copies of Welland Hydro’s Reply Submission on its 2007 EDR Application, together with an electronic version of same. Mr. Armstrong, of Welland Hydro, will also be submitting an electronic copy through the OEB’s web portal pursuant to its E-Filing Guidelines.

Should you have any questions or require further information, please do not hesitate to contact me.

Yours very truly,

BORDEN LADNER GERSAIS LLP

Original Signed by James C. Sidlofsky

James C. Sidlofsky
JCS/dp

Encls.

cc: Wayne Armstrong, Welland Hydro
Ross Peever, Welland Hydro
John De Vellis, Shibley Righton LLP
Keith C. Ritchie, OEB

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

AND IN THE MATTER OF an Application by Welland
Hydro-Electric System Corp. for an Order or Orders approving
or fixing just and reasonable rates and other charges for the
transmission of electricity commencing October 1, 2007.

**REPLY SUBMISSION OF THE APPLICANT,
WELLAND HYDRO-ELECTRIC SYSTEM CORP.**

FILED: DECEMBER 5, 2007

Introduction:

1. Welland Hydro-Electric System Corp. (“Welland Hydro”) has applied for an adjustment to its OEB-approved electricity distribution rates to reflect a significantly increased PILs liability after using its remaining loss carry-forwards in 2006 (the “Application”). Specifically, Welland Hydro’s actual 2006 PILs expense was \$688,265, over seven times the \$97,286 PILs expense approved by the OEB in Welland Hydro’s 2006 electricity distribution rate order.

2. Welland Hydro is in receipt of two submissions in response to its Application – those of Board Staff, and those of the School Energy Coalition (“SEC”). Welland Hydro repeats and relies upon the submissions contained in its Application, and offers the following comments with respect to the Board Staff and SEC submissions.

The Board Staff Submission

3. In their submission of November 23, 2007, Board Staff wrote (at pages 3 and 4):

“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?

Board staff has analyzed the rate application models for 2006 and 2007 that Welland Hydro has filed in support of the proposed rates. Board 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 recover 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.”

4. Board Staff concluded with the following 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.”

5. With Board Staff having concluded that Welland Hydro’s request is supported by the evidence and that its approach is a reasonable means of reflecting normal taxation/PILs in 2007 rates, Welland Hydro will not be replying to the Board Staff submission. It would simply request that the OEB implement the Staff findings by granting the relief requested in this Application.

6. Welland Hydro does note, though, that the notion of establishing a normal level of recovery of PILs through rates is consistent with the OEB’s rate making process. For example, Tier 1 adjustments in the 2006 electricity distribution rate making process were intended “...to move the 2004 results closer to a typical year of capital investments, operations, and revenues, to the extent possible.”¹ Similarly, the OEB has adjusted the PILs proxy calculation periodically to ensure that the PILs recovery in rates is more closely aligned with distributors’ actual PILs liability. For example, in the recent 2008 Incentive Regulation Mechanism distribution rate adjustment applications, there was an adjustment for the transition to the common deemed capital structure (i.e. the “K” factor). This adjustment not only adjusted the revenue requirement for the movement in capital structure but also adjusted for the change in PILs associated with the capital structure movement. In light of the non-recurring nature of the loss carry-forwards and the significant difference between Welland Hydro’s “normal” taxation level and the temporarily reduced level incorporated into its 2006 distribution rates, Welland Hydro submits that it is reasonable and appropriate that the requested adjustment be made to reflect a tax liability that corresponds much more closely to its actual ongoing tax liability.

¹ See page 11 of the OEB’s 2006 Electricity Distribution Rate Handbook
http://www.oeb.gov.on.ca/documents/edr_final_ratehandbook_110505.pdf

The SEC Submission

7. Welland Hydro has divided its submissions according to a number of matters raised in the SEC submission.

Rate and Bill Impacts

8. SEC writes of “large increases” of 5.1-5.3% increase in monthly service charges and 5.3-6.3% increase in volumetric distribution rate under the proposed adjustments. While those values are accurate, Welland Hydro submits that the OEB must consider the impacts of these proposed adjustments on customers’ total bills in order to fairly determine the significance of these proposed adjustments. This information may be found in the spreadsheet accompanying the Application.

9. Specifically:

- a typical Residential consumer (1,000 kWh per month) will see a bill increase of 1.2%, or \$1.42 per month on a current bill of \$120.20 (summer) or \$116.39 (winter);
- a typical General Service < 50 kW customer (5,000 kWh per month) will see a bill increase of 0.6%, or \$3.14 per month on a current bill of \$531.39;
- a typical General Service 50-4,999 kW customer (40,000 kWh/500 kW per month) will see a bill increase of 0.5%, or \$31.60 per month on a current bill of \$6,000.59;
- a typical Large Use customer (2,400,000 kWh/5,400 kW per month) will see a bill increase of 0.3%, or \$778.80 per month on a current bill of \$226,069.79;
- unmetered scattered load customers will see a bill increase of 1.3%, or 73 cents per connection per month on a current bill of \$56.86;
- sentinel light customers will see a bill increase of 0.4%, or 11 cents per connection per month on a current bill of \$26.79; and
- street lighting customers will see a bill increase of 0.5%, or 5 cents per connection per month on a current bill of \$10.26.

10. Welland Hydro submits that by any reasonable measure, these are not the “large impacts” suggested by SEC. Rather, Welland Hydro submits that when considered reasonably, these impacts are not significant, and they should not prevent the OEB from normalizing Welland Hydro’s PILs recovery.

Cost of Service Application vs. Single Issue Rate Making

11. SEC suggests that the Application should be rejected because it constitutes “single-issue rate making”. Welland Hydro respectfully disagrees. The request that is the subject of its Application is no more a matter of single issue rate making than are the Z factor adjustments that are contemplated in both the cost of service and IRM rate making processes. The OEB rightly recognizes that there will be circumstances that arise that are beyond the distributor’s control, and that will warrant rate adjustments without revisiting the distributor’s entire revenue requirement. Welland Hydro noted in its Application that were it not for the OEB’s restrictive approach to Z factors, this incremental PILs expense would have qualified for a Z factor adjustment in Welland Hydro’s 2007 distribution rates. In any event, even if the OEB is not prepared to consider it a Z factor item, Welland Hydro submits that an adjustment to correct a PILs calculation that is so fundamentally inconsistent with its actual PILs liability through no fault of its own is warranted in these circumstances as a stand-alone adjustment.

12. Second, Welland Hydro submits that the maintenance of this “one time” tax loss carry forward that distorts “normal” PILs recoveries going forward, by an inflexible reliance on the Z factor rules, in itself represents single issue rate setting.

13. Third, while Welland Hydro does not accept the SEC position, even if it were necessary to consider other potential adjustments to the revenue requirement, those proposed by SEC are simply incorrect, for the reasons discussed below.

Bad Debt Recovery

14. In its 2006 EDR Rate filing, Welland Hydro declared bad debt expenses of \$324,741 in 2003 and \$265,139 in 2004 primarily from a group of related companies that had filed for bankruptcy. Instead of requesting a rate rider to recover the full amount of the write off, Welland Hydro asked that \$265,139 (2004 levels) be included as bad debt expense (less than 50%) when setting 2006 rates.

15. In its Decision and Order the OEB reduced the level of bad debt expense included in determining 2006 rates to \$36,000 or approximately equal to the level incurred in 2002. The

OEB was not prepared to set prospective rates based on “exceptional” amounts nor permit a prospective allowance for bad debt which serves to recapture bad debt losses from a prior period.

16. As a result, the exceptional bad debt expense incurred in 2003/4 was borne solely by Welland Hydro’s shareholder. The amounts received from bankruptcy trustees in 2006 represent a recovery of previous losses and is not a “windfall” as suggested by SEC.

Capital Cost Allowance

17. The SEC has identified a difference of \$230,062 in the actual amount of Capital Cost Allowance deducted in 2006 when compared to the 2006 OEB Tax Model. However, it has failed to identify variances in other additions/deductions which adversely affect taxable income. One such item included in the 2006 OEB Tax Model is “deductible expenses capitalized for accounting” in the amount of \$72,682 for which no deduction was made in the actual 2006 income tax return.

18. In order to determine whether or not Welland Hydro is recovering a “normal” PILs amount in current rates, the total effect of additions/deductions in determining taxable income must be evaluated. Below is a comparison of net additions and deletions between Welland Hydro’s 2006 OEB Tax Model and 2006 Actual Tax Return. The actual figures must be adjusted to reflect the reversal of a regulatory asset provision in 2006 which increased Net Income before taxes but had no effect on Taxable Income.

	2006 OEB Tax Model	2006 Actual Tax Return
Additions	\$2,321,916	\$6,580,725
Reversal Regulatory Asset Provision	-	1,161,290
Deletions	<u>(2,492,440)</u>	<u>(7,050,730)</u>
Net Additions/(Deductions)	(\$ 170,524)	\$691,285

19. The net effect of additions/deletions was to increase taxable income by \$861,809 in 2006 compared to the 2006 OEB Tax Model. The majority of this amount is represented by \$815,645

in Regulatory Asset Recovery during 2006. The following table shows a comparison between the tax model and the actual 2006 tax return removing the Regulatory Asset Recovery:

	2006 OEB Tax Model	2006 Actual Tax Return
Net Additions/ (Deductions)Prior to Regulatory Asset Recovery	(\$170,524)	\$691,285
Regulatory Asset Recovery	<u>=====</u>	<u>(815,645)</u>
Net Additions/(Deductions)	(\$170,524)	(\$124,360)

20. As a result, 2006 actual additions/deductions to net income excluding Regulatory Asset Recovery reflect the 2006 OEB Tax Model and therefore current rates. No adjustment to specific line items within additions/deductions needs to be made as proposed by the SEC.

Calculation of Revenue Shortfall

21. The SEC states that if the Board accepts Welland Hydro's argument to recalculate its EDR Model, it should be recalculated using the actual 2006 non-capital losses of \$385,772, and not with the non-capital loss adjustment eliminated completely. To be clear, this amount represents the balance of the loss carry forward available to Welland Hydro after a portion of Welland Hydro's loss carry forward was used to fully offset 2005 taxable income. As pointed out by Board Staff in their submissions of November 23, 2007, use of the loss carry forward in 2005 reduced the amount available for 2006, and reflects simply a shift in the year that Welland Hydro benefited from the PILs reduction.

22. The relevant issue here is that the reduction in PILs payable as a result of the loss carry forward was passed on to Welland Hydro's customers in 2006 rates. This loss carry forward has been fully used and is no longer available and current rates do not reflect the "normal" PILs payable going forward.

23. As a result, the loss carry forward must be eliminated in its entirety in the revised 2006 EDR Model and not be artificially set at \$385,772 as proposed by the SEC. In addition, one

could make the argument that the loss carry forward was primarily made up of Regulatory Asset amounts expensed for tax purposes in prior years and should not have been shared with Welland Hydro's customers as PILs become payable as they are recovered. This contributed to the increased actual PILs payments in 2006 and will continue to result in increased PILs payable for 2007 and 2008 when Regulatory Asset Recovery is completed.

Conclusion

24. Welland Hydro submits that, as acknowledged by OEB Staff, it has filed an accurate calculation of the adjustment necessary to recover its "normal" PILs expenses through distribution rates. The evidence, which OEB Staff confirm supports the request, illustrates that Welland Hydro's actual Net Income Before Taxes is in line with the 2006 EDR submission when Bad Debt Recovery and Reversal of the Regulatory Asset Provision are excluded. The evidence also shows that the net effect of Additions/Deletions to Net Income is comparable when Regulatory Asset Recovery is excluded. The only item at issue is the Tax Loss Carry Forward included in current rates but no longer available for tax purposes.

25. Because of the lack of a current adjustment mechanism to normalize its PILs, Welland Hydro has borne this increased cost from May 1st to September 30th 2007. Welland Hydro respectfully submits that it is not appropriate to continue to impose this liability on it and ultimately on its shareholder.

26. For all of the foregoing reasons, Welland Hydro respectfully requests that the OEB approve its Application as filed, for implementation effective October 1, 2007.

27. With respect to the SEC claim for costs, Welland Hydro intends to respond to the claim when it is filed. Welland Hydro understands that the OEB's Rules of Practice and Procedure provide applicants with that opportunity.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 5TH DAY OF DECEMBER, 2007.

Original Signed by James C. Sidlofsky
James C. Sidlofsky
Counsel to Welland Hydro-Electric System Corp.