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December 7, 2007

Via E-mail and Courier

Ontario Energy Board
2300 Yonge Street
Suite 2700, P.O. Box 2319
Toronto, Ontario M4P 1E4

Attention: Ms. Kirsten Walli, Board Secretary

Dear MS. Walli:

Re: PUC Distribution Inc.
Application to Amend 2007 Distribution Rates (Recovery of 2007 PILs Expense)
Board File No. EB-2007-0723

We are counsel to PUC Distribution Inc. ("PUC Distribution") with respect to the above-stated matter. In accordance with Procedural Order No. 2, please find enclosed PUC Distribution's submission.

Please do not hesitate to contact the writer should you have any questions or concerns regarding the material filed.

Yours very truly,

BORDEN LADNER GERVAIS LLP

ORIGINAL SIGNED BY CHRISTINE E. LONG

Christine E. Long

CEL/ac
Enclosures
cc: Terry Greco, PUC Distribution Inc.
Michael Buonaguro, Counsel for VECC
Bill Harper, Consultant for VECC

PUC Distribution Inc.
Application to Amend 2007 Distribution Rates
(Recovery of 2007 PILs Expense) (the "Application")
Board File No. EB-2007-0723

1.0 Introduction

1.1 In accordance with Procedural Order #2 in the above-stated matter, please find attached the submission of PUC Distribution Inc. ("PUC Distribution"). The submission responds to the filing of the Ontario Energy Board Staff ("Board Staff") on November 29, 2007 and the Vulnerable Energy Consumers Coalition ("VECC") filed on November 26, 2007.

1.2 PUC Distribution will address the issues raised in these submissions in turn.

Board Staff Submission

2.0 Model Used

2.1 Board Staff has stated that the model used by PUC Distribution is a modification of the model issued by the Ontario Energy Board (the "Board") for 2007 rate setting purposes and appears to have been used in order to provide a "work-around" to accommodate requested changes. The Board model was used because it provided a familiar format and good basis with which to work, plus it incorporated the ability to easily calculate the impact to customers' bills for the rate change contemplated. PUC Distribution took the view that given the specific changes it was requesting, use of the Board model was appropriate.

3.0 Regulatory Asset Figure

3.1 Board Staff states that the figure used by PUC Distribution of $1,450,000 is not consistent with the regulatory asset figure of $1,217,901 available for recovery at the end of 2006 according to PUC Distribution's financial statements. The $1,450,000 number was calculated as the estimated regulatory asset recovery in 2007 based on approved rates and estimated consumption. As such, while the $1,450,000 number is different from the figure calculated on the 2006 financial statements, it does represent an accurate estimation based on ratepayer consumption.

4.0 CCA used in PUC Distribution's PILs Calculation

4.1 Board Staff states that PUC Distribution's calculation uses only class 1 assets (at a 4% rate) and that the use of further CCA classes with higher CCA rates could have resulted in a lesser PILs burden. PUC Distribution submits that many of the classes with higher CCA rates do not apply to the assets owned by PUC Distribution. PUC Distribution has completed a calculation in which the CCA rates for distribution assets increases from 4% to 8%. It is anticipated that this change would lead to a decreased tax amount of $40,000 per full year. PUC Distribution has made the appropriate changes to the CCA calculation in its 2008 Rate Application. PUC Distribution also advises the Board that PUC Distribution did not calculate CCA in respect of land rights but that this item does not represent a significant change in Payment in Lieu of Taxes ("PILs") liability. PUC Distribution has determined that this additional CCA calculation would lead to an estimated tax decrease of $1,300 per year.

5.0 Regulatory Asset Accounts

5.1 The Board Staff submission states that the regulatory asset recovery amount as applied for is not supported by Board policy. PUC Distribution disagrees. Board Staff bases its view on the premise that a PILs or tax provision is not needed for the recovery of deferred regulatory asset costs because such costs would have been deducted when calculating taxable income in tax returns. PUC Distribution advises that it did not follow the described treatment upon which Board Staff bases its position. Attached at Schedule "A" in chart form is the PILs accounting which PUC Distribution undertook and has previously described, indicating regulatory assets were deducted from accounting income in years 2002-2004 and were not included in taxable income on tax returns, when PILs were calculated. In years 2005-2007, the regulatory asset amount collected ("Regulatory Assets Receivable") was added into accounting income, and therefore taxable income on tax returns, creating an increased PILs liability. The steps taken were recommended by PUC Distribution's tax consultants at KPMG as being appropriate treatment. In August 2007, the Ministry of Finance conducted an audit of PUC Distribution's years 2001-2004 regarding the manner in which regulatory assets were treated. The Ministry of Finance has not raised any issues with PUC Distribution with regard to its treatment of regulatory assets. PUC Distribution also provides further detail on this issue in response to VECC-Issue 10.0.

6.0 Effective Date of Rates and Rider

6.1 PUC Distribution's purpose in bringing this Application is to recover the amount it must in turn pay the Province in PILs. PUC Distribution seeks recovery in a way which will have the least impact on its ratepayers and yet allow it to recover the necessary amount in order to keep it whole, without experiencing a shortfall as a result of paying required PILs.

6.2 Given the concern with respect to retroactive rate orders, PUC Distribution proposes to the Board that a rate change could be made on a go-forward basis (effective at or shortly thereafter the time of the Board's decision) and any additional amounts be recovered through a deferral account mechanism. Therefore, if the Board were to make a decision in December, the change in rates could be effective as of January 1, 2008. PUC Distribution would be amenable to reaching any similar type arrangement.

7.0 Calculations and Gross-up

7.1 In its submission, Board Staff does not delineate exact amounts that it would allocate to the three factors which form the basis for PUC Distribution's request for PILs recovery; those being the amounts attributable to a reduction in loss carry-forwards, the treatment of Regulatory Assets Receivable and the interest expense change. Because these amounts are not delineated, it is difficult for PUC Distribution to discuss any calculations made by Board Staff. However, it would seem that the Board Staff submission does not account for a gross-up, but rather focuses on the tax amount deficiency as opposed to the required change to distribution rates. PUC Distribution's claim for relief seeks a gross-up to address the tax implications in distribution rates.

VECC Submission

PUC Distribution will address the issues raised in VECC's submission.

8.0 Departure from the 2007 IRM Model

8.1 In its submission, VECC questions the following adjustments made by PUC Distribution to the 2006 EDR Tax Model in order to derive a revised "base revenue requirement" for 2007.

These adjustments include:

- the adjustment to the loss carry forward value
- the inclusion of revenue from the recovery of regulatory assets as taxable income
- the calculation of taxable income on 2007 budgeted values for net income, depreciation, interest expense and CCA
- an adjustment to interest expense

8.2 VECC submits that only the adjustment to interest expense falls within the Z-factor definition. PUC Distribution submits that all three adjustments are appropriate given the circumstances.

8.3 VECC also takes the position that a forward test year application should have been filed. As previously described in addressing Board Staff's concern on this issue, PUC

Distribution took the view that the adjustments made were in keeping with the Board model and that to do a forward test year application would have resulted in a greater increase in rates for ratepayers.

9.0 Filing of Application August 15, 2007

9.1 VECC submits that PUC Distribution did not file the Application until well after the due date set for the Board for IRM based applications.

9.2 PUC Distribution delayed filing the Application because PUC Distribution was awaiting regulations being enacted which would address specifics related to the debt/equity structure of local distribution companies mandated in the Ontario Government's Budget. PUC Distribution anticipated that regulations would be issued shortly after the provincial budget which could have provided further clarity. Eventually PUC Distribution decided that it could no longer wait for the regulations and filed the Application. PUC Distribution was also waiting to see if the Board would address the PILs issue on a more global scale as PUC Distribution understood that other LDCs may have had similar issues which could be dealt with on an LDC-wide basis.

10.0 Inclusion of revenues from Regulatory Assets in PILS payable

10.1 VECC submits that revenue from regulatory assets should not be included in PILs payable.

10.2 In its answer to Board Staff Interrogatory 6[1], and VECC Interrogatory 4[2], PUC Distribution explained its reasoning for including the amount collected for Regulatory Assets Receivable in PILs payable.

10.3 As previously explained, on the advice of its tax consultants, PUC Distribution deducted the regulatory asset amount from taxable income on its PILs return. PILs were not calculated on the regulatory asset amount and consequently what would have been the corresponding PILs payable amount was not applied for in the PILs amount claimed in distribution rates. When PUC Distribution collected the Regulatory Assets Receivable, that Regulatory Assets Receivable amount was included as taxable income in the PILs tax return and PILs was calculated based on that taxable income number.

10.4 PUC Distribution has now been required to pay the PILs amount on the basis of the Regulatory Assets Receivable, but PUC Distribution has not been able to collect the PILs payable amount as that amount had not previously been calculated in the PILs component in distribution rates. PUC Distribution's method of accounting has not led to double recovery of the PILs payable amount. PUC Distribution seeks to recover from distribution rates the amount which it in turn is required to pay the Province for PILs.

[1] PUC Distribution Inc. Answers to Board Staff Interrogatories filed October 24, 2007, page 6 of 6
[2] PUC Distribution Inc. Answers to VECC Interrogatories filed October 24, 2007, page 5 of 11

The procedure that was followed minimized the impact on PUC Distribution customers. There was no financial benefit to PUC Distribution. One of the basic tenets of the Rate Handbook is that distributors employ prudent tax management which PUC Distribution has done.

10.5 We again refer to Schedule "A" for an accounting of the regulatory asset and Regulatory Assets Receivable treatment.

11.0 Loss Carry Forwards on a Retroactive Basis and Effective Date of Rates

11.1 VECC submits that on the basis of when notice was filed, the earliest date a rate increase should take effect is October 1, 2007 . Even then, VECC states that it has reservations with the October 1, 2007 date citing that there is no effective date on the Notice of Application. VECC further states that its position is that a rate increase should not be retroactive and to the extent any bill impact is material, VECC suggests the authorization of a deferral account.

11.2 As indicated in addressing the Board Staff's observation on this point, PUC Distribution is amenable to making rate changes on a go-forward basis.

12.0 Implications for 2008 Rates

12.1 VECC raises concerns related to the preparation of PUC Distribution's 2008 Rate Application using inflated base rates.

12.2 PUC Distribution filed its 2008 Rate Application on Friday, November 30, 2007. The 2008 Rate Application has been prepared on the basis of a forward test year cost of services based mechanism. Therefore, PUC Distribution confirms that the 2008 Rate Application is not based on inflated numbers.

13.0 Conclusion

13.1 Finally, PUC Distribution submits that it has met the test that as a result of the three factors delineated in the Application, depletion of loss carry forwards, tax liability resulting from realization of Regulatory Assets Receivable and a change in provincial tax policy, 2007 distribution rates currently in place will not provide a sufficient amount to meet PUC Distribution's PILs liability.

13.2 PUC Distribution employed a tax management strategy recommended to it on the basis that it would minimize impact and costs to ratepayers. In taking such steps, PUC Distribution itself received no benefit. PUC Distribution submits that it has followed proper tax strategy. It is required to pay taxes and has done so. Therefore, PUC Distribution should be entitled to recover the taxes it is required to pay in distribution rates.

Respectfully submitted on the 7th day of December, 2007.

ORIGINAL SIGNED BY CHRISTINE E. LONG

Christine E. Long

Counsel for PUC Distribution

SCHEDULE "A"

PILS History From Tax Returns and Approved Distribution Rates

	From Tax Return and Audited F/S	From Tax Return and Audited F/S	From Tax Return - [represents Capital Tax deducted from Accounting Income that is required to be included in Taxable Income (K)]	From Tax Return	From 2007 Budget - [included in Accounting Income (interest expense based on current debt/equity ratio)]	Interest eligible to deduct from Accounting Income based on March 22, 2007 provincial budget		Additions/Deduction to/from Accounting Income for regulatory assets - per tax consultants - deducted from Taxable Income in years incurred and added to Taxable Income in years collected in rates					From Final Notice of assessments	From Final Notice of assessments		From Rate Applications	
	A	B	C	D	E	F	G=A+B+C-D+E+F	H	I=H+G	J	K=I-J	L=K*.3612	M	N	O=L+M+N	P	Q=(L+N)/.6388 +M
Year	Accounting Income	Add Depreciation	Add Tax Deduction Expensed	Deduct CCA	Add Interest Expense included in Accounting Income	Deduct Eligible Interest	Subtotal	Adjustment due to Reg. Assets	Subtotal	Loss c/f	Taxable Income	Income Tax Payable	Capital Tax Prov.	Capital Tax Fed.	Total Tax Paid/Payable	Tax Component In Rates	Taxes Payable Grossed-Up
2000							$0		$0		$0	$0			$0	$0	$0
2001	-$176,494	$597,227		$466,597			-$45,864		-$45,864		$0	$0	$26,399	$20,469	$46,868	$0	$58,442
2002	$117,327	$2,455,890	$64,026	$1,948,027			$689,216	-$862,434	-$173,218		$0	$0	$123,245	$79,158	$202,403	$330,268	$247,162
2003	$1,263,632	$2,495,457	$95,813	$1,950,152		$0	$1,904,750	-$2,088,477	-$183,727		$0	$0	$165,244	$72,638	$237,882	$250,932	$278,954
2004	-$1,387,081	$2,574,456	$21,810	$1,962,855		$0	-$753,670	-$1,561,292	-$2,314,962		$0	$0	$138,221	$21,509	$159,730	$250,932	$171,892
2005	-$738,755	$2,668,236	$16,900	$1,999,695		$0	-$53,314	$809,576	$756,262	$756,262	$0	$0	$119,701	$16,342	$136,043	$123,292	$145,283
2006	-$329,739	$2,764,612	$0	$2,036,892		$0	$397,981	$1,307,586	$1,705,567	$1,705,567	$0	$0	$129,166	$0	$129,166	$164,831	$129,166
2007 Est.	-$516,755	$2,870,000	$0	$2,000,000	$2,829,662	-$1,679,119	$1,503,788	$1,450,000	$2,953,788	$255,942	$2,697,846	$974,462	$98,059	$0	$1,072,521	$155,590	$1,623,516
															$1,984,613	$1,275,844	$2,654,415

Negative amount is a deduction from Accounting Income for Regulatory Assets Receivable included in accounting revenue but deductible for calculating Taxable Income

Positive amount is the addition to Taxable Income of the Regulatory Assets Receivable previously included in accounting revenue and previously deducted from Taxable Income