EB-2008-0381

IN THE MATTER of the *Ontario Energy Board Act 1998*, S.O. 1998, c.15, Sch. B;

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

SUBMISSIONS OF THE

SCHOOL ENERGY COALITION

ON THE UNSETTLED ISSUES

1. Pursuant to a letter to distributors dated March 3, 2008, the Board on November 28, 2008 commenced a proceeding on its own motion with respect to the clearance of Account 1562 by electricity distributors. The structure of the proceeding has been that three distributors (EnWin, Barrie, and Halton Hills, collectively the "Applicants") have submitted evidence relating to their calculations of Account 1562, and from that and stakeholder discussions a set of generic issues has been established and discussed.

2. As a preliminary issue, the Board received submissions and made a determination as to the precise nature of its role in this proceeding, and in particular whether the scope of its role included assessing the reasonableness of rules applied by LDCs in the period 2001-2006, or whether it should be limited to determining whether the methodology in place during that period was applied appropriately. In a Decision made December 18, 2009 in this proceeding (the "Scope Decision"), the Board determined that the latter approach was the correct scope for its consideration of the issues in this case. The Scope Decision plays a key role in analysis of some of the unsettled issues set forth below.

3. After evidence and interrogatories, the parties, including many other interested utilities, entered into a negotiation that culminated in a Settlement Agreement, filed with the Board on September 30, 2010. SEC is a party to that agreement, along with CCC and the Applicants. Five issues currently remain unsettled.

4. Pursuant to Procedural Order #9, these are the submissions of SEC with respect to the unsettled issues.

5. In preparing these submissions, SEC has benefited from its review of the submissions of Board Staff, filed on December 24, 2010 (the "Staff Submissions"). We have also had the

opportunity to review a draft of the submissions of CCC, which has also been of considerable assistance.

Issue 3: Has the distributor correctly applied the true-up variance concepts established by the Board's guidance?

6. The Board has already determined that its role in this proceeding is not to revisit the past, but rather to "determine, where necessary, what the methodology was and what the appropriate application of the methodology should have been" [Scope Decision, p. 6]. However, as with many issues that arise before the Board, determining the principle does not mean that its application in specific circumstances is mechanistic. Issue #3 raises that problem.

7. The Staff Submissions suggest that the Board start from the concepts underlying the methodology, in effect to get a broad view of what the Board intended. Then, they suggest, that broad view can be used to inform the question of whether any given implementation of the methodology is the appropriate one.

8. As attractive and intuitive as that sounds, it is understandable that the utilities will likely fear a "re-litigation" of the Scope Decision, with intervenors and perhaps Staff seeking to expand the scope of the Board's consideration of the issues indirectly.

9. We agree with Staff that the Board must be clear on what the methodology was intended to achieve, or it is simply impossible to determine the "appropriate" implementation of the methodology. This seems self-evident. However, we propose that the Board achieve this result using a different approach.

10. By analogy, if it is plain on the face of a contract what the parties intended by their words, courts do not explore the concepts behind the words to see if they are consistent. Sometimes a duck is simply a duck. It is only if there is ambiguity, or the words are difficult to interpret, that a court will look behind the words, either to other evidence or to conceptual analysis, to determine how to apply them to a particular set of facts. A similar concept is used in interpretation of government legislation.

11. In our view, the same holds true here in interpreting the Board's methodology. Many aspects of that methodology are clear and straightforward. Even if parties may sometimes try to twist their meanings, for much of the methodology the Board can, applying simple common sense, identify exactly what the Board meant simply by looking at what was said.

12. There will be occasions – and we will look at some below – where it is not clear what was intended, or where the words appear to be at odds with the obvious intent. In those cases, the Board will have options in determining the "appropriate" implementation of the methodology, and should choose the option that is most consistent with the Board's policies and goals at the time, consistent with the instructions actually given.

13. In short, SEC is proposing that the Board adopt the "What you see is what you get" approach, but not to the extent of allowing form to triumph over substance. Where that would occur, the Board should seek an interpretation that is still consistent with the words used, but is also most consistent with getting the reasonable result intended at the time.

14. Against that background, there is one component of this issue that we will address specifically.

15. The Staff Submissions raise the example of the tax rate error in the 2003 SIMPIL model. This is not the only error in the model, but it is the only one that has raised a serious dispute between the parties. The others have simply been corrected.

16. Staff argue that this is an “inadvertent miscalculation”, not an intentional expression of Board policy. As the Staff Submissions note, some parties will disagree, arguing that this error was “frozen” into the model as a result of Bill 210.

17. In our submission, this latter, formalistic approach to interpretation of the model is unsustainable. The Board did not intend that the 2002 tax rate be applicable in subsequent years. That was never intended when the original model was developed, and it was not intended in 2003. It was simply a mistake.

18. An error that is patent on its face should, generally speaking, be interpreted as if corrected to produce the intended result. This is the Board’s practice generally, and is also a common practice in statutory interpretation, contractual interpretation, and many other activities involving interpretation.

19. In this case, the intended result of the methodology is known and does not appear to be in dispute. Unless parties can point to words in Bill 210 or in the Board’s instructions that clearly override that intended result, the appropriate implementation of the Board’s methodology was and is to use the correct tax rate each year.

Issue 8: How should the materiality threshold be applied to determine which amounts should be trued up?

20. This is another question arising because the methodology, applied in a formalistic way, can produce results that were clearly not intended. In this case, the methodology allowed distributors to establish a materiality level for certain parts of the calculations. The problem, well described in the Staff Submissions, is that materiality levels could sometimes produce unintended mismatches between credits and debits that relate to the same thing.

21. We do not agree with the solution proposed in the Staff Submissions, i.e. retroactively changing the materiality level to zero for all distributors. That was not the methodology at the time, and that was not the intent of the methodology. As convenient as it may be to fix the problem this way, we believe it is a slippery slope that opens up many other aspects of the calculations for review, contrary to the Scope Decision.

22. In any case, in our submission the problem can be solved in a different way. The Scope Decision asks the “appropriate” implementation of the methodology. In our submission, in implementing the methodology, distributors were obligated to select a materiality level that:

(a) Did not produce mismatches between debits and credits whose amounts should have been related in a particular way, and

(b) Did not exhibit a bias that would either increase or decrease the payment to, or recovery from, the ratepayers in the future.

23. In our submission, it is not changing the methodology to say that it was supposed to be implemented in an unbiased way. That should be obvious. The alternative is to propose that the Board intended the utilities to be able to optimize the model parameters for their own benefit. That would be a very surprising conclusion.

24. We add one other thing. The simplicity of the proposal by Staff commends it, and it may in fact be preferred by some utilities. We propose that the Board allow utilities, as an option, to choose a zero materiality level if they wish, but if they prefer a positive number, it must comply with the two conditions above. Each application for disposition of Account 1562 should contain both calculations, so that the Board can see if the materiality level has generated any bias in the result.

Issue 9: What are the correct tax rates to use in the true-up variance calculations?

25. SEC has some difficulty with this issue. Staff has proposed an "effective tax rate" approach. It does not appear to us that this was part of the methodology at the time, so adding this now would be inconsistent with the Scope Decision. We have been unable to determine a patent error in the model that needs to be corrected here, as well. Nothing in the contemporaneous material appears to refer to the effective tax rate, or indirectly express the intent that the effective tax rate be used.

26. In addition, it is not obvious to us that the "effective tax rate" would be the correct rate, even if it were consistent with the methodology. It may be that the marginal tax rate (usually the legislated rate) is more appropriate. Further, the effective tax rate suffers from its integration of a number of deductions and credits, including loss carryforwards, that may not be appropriate changes to the tax rate that should be used.

27. Our reading of the April 2003 FAQ is that it is referring, in several places, to the "legislated" tax rates, not effective tax rates. This seems to us to be quite clear, and so in keeping with our earlier comments on interpreting the methodology, prima facie that is what the distributors should have used.

28. We are, however, conscious that the use of the legislated tax rates may in fact mean an over-recovery of PILs by the distributors, sometimes in very large amounts, since they were not actually paying at those rates. We would invite Staff, in their January 31st submissions upcoming, to explore the practical and methodological implications of this, perhaps with numerical examples to make those implications clearer. We would also invite Staff in those submissions to provide further analysis of how, if at all, the solution they have proposed

(a) Deals with the issues of loss carryforwards and other adjustments that impact effective tax rates;

(b) Is conceptually more correct than the use of marginal tax rates; and

(c) Is consistent with the specific instructions given to the utilities by the Board on how to implement the methodology.

29. Subject to the further input from Staff, it is SEC's view that the legislated tax rates for each year are the ones required by the methodology, and should be used in the calculations.

Issue 10: How should the continued collection of the 2001 PILs amount in rates be considered in the operation of the PILs deferral account?

30. This is a perfect example of the "frozen by Bill 210" issue. Simply put, the rates frozen by Bill 210 included not only the 2002 PILs proxy, which related to the 2002 revenue requirement and MARR, but also the 2001 PILs proxy, which was a catchup amount dealing with the PILs for the 2001 stub period.

31. It would, of course, be much simpler if the 2001 PILs proxy had been a rate rider, which would have terminated in the ordinary course when it was collected in full. It was not. It was part of rates, and the utilities quite rightly point out that their rates were frozen by government mandate. They had both costs and benefits arising out of that freeze. This is simply, they say, one of the (few) benefits, and it is not fair for the Board, today, to take away that benefit when the costs were fully borne by the LDCs and their shareholders. It is hard not to have sympathy for that point of view.

32. On the other hand, the Board has, in the Scope Decision, made clear that its role today is not to determine, in hindsight, what is fair. Its role today is to determine the appropriate application of the methodology that was in place at the time. Consistent with that, it is our view that if the methodology says that the utilities keep this overcollection, they should do so. If it doesn't, they shouldn't.

33. Based on that foundation, it is our view that this analysis is not about what the rates should have been in 2001 through 2006. That is already known, and cannot be changed. Was the PILs proxy in 2003 and 2004 rates too high? Clearly yes, but many other components of rates in those years were probably too low. The Board is not being asked to go back and change any of that.

34. This is, rather, about how the reconciliation and true-up of whatever PILs was collected in rates should be done, consistent with the Board's methodology. In the Account 1562 reconciliation, it appears to us to be clear that the 2001 PILs proxy was in fact collected from ratepayers until 2004, and therefore in reconciling amounts collected from amounts paid (and subject to the many other caveats in that calculation), the amounts collected should reflect the amounts actually included in rates in each year.

35. We are aware that the PILs true-up was not simply a matter of comparing PILs included in rates to PILs actually paid. Only some things were trued up, and the calculation was less direct than a simple true-up would have been. On the other hand, nothing in the methodology in place at the time suggests to us that the Board intended at any time that, for reconciliation purposes, distributors should pretend that the 30 months of PILs actually collected in rates from 2003 and 2004 was really only 24 months of PILs.

36. We therefore believe that the methodology required the 2001 PILs proxy to be included in the calculations, thus reducing the amounts now recoverable from the ratepayers by, generally, the amount of that extra recovery in 2003 and 2004.

Issue #11: Should the SIMPIL true-up to specified items from tax filings be recorded in the period after the 2002 rate year until the 2001 deferral account allowance was removed from rates?

37. We have reviewed the Staff Submissions on this issue, and we agree with their characterization of the methodology and the Board's instructions. Our conclusion from that characterization is that, absent any instructions to stop truing up variances relating to 2001 amounts, those true-ups should have continued.

38. However, we invite Staff in their January 31st submissions to comment on whether and, if so, why they believe this is a reasonable conclusion based on the lack of specific instructions provided to distributors at the time.

39. In light of Staff's comment that these amounts may not be material, we also invite Staff in those submissions to provide specific examples, including numerical examples, of the possible impact of the Board's determination to require continued 2001 true-up, or not.

Conclusion

40. We hope our submissions are of assistance to the Board, and we look forward to supplementing them with sur-reply, as necessary, on February 7th.

Respectfully submitted on behalf of the School Energy Coalition this 21st day of January, 2011.

____

Jay Shepherd
Counsel for the School Energy Coalition