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Ontario

BY EMAIL

January 9, 2012

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

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Welland Hydro-Electric System Corp. ("Welland Hydro")
2012 IRM3 Distribution Rate Application
Board Staff Submission
Board File No. EB-2011-0202

In accordance with the Notice of Application and Hearing, please find attached the Board Staff Submission in the above proceeding. Please forward the following to Welland Hydro-Electric System Corp. and to all other registered parties to this proceeding.

In addition please remind Welland Hydro-Electric System Corp. that its Reply Submission is due by January 23, 2012.

Yours truly,

Original Signed By

Christiane Wong
Information Administrator, Applications & Regulatory Audit

Encl.

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2012 ELECTRICITY DISTRIBUTION RATES

Welland Hydro-Electric System Corp.

EB-2011-0202

January 9, 2012

Board Staff Submission
Welland Hydro-Electric System Corp.
2012 IRM3 Rate Application
EB-2011-0202

<u>Introduction</u>

Welland Hydro-Electric System Corp. ("Welland") filed an application (the "Application") with the Ontario Energy Board (the "Board"), received on October 13, 2011, under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the distribution rates that Welland charges for electricity distribution, to be effective May 1, 2012. The Application is based on the 2011 3rd Generation Incentive Regulation Mechanism.

The purpose of this document is to provide the Board with the submissions of Board staff based on its review of the evidence submitted by Welland.

In the interrogatory phase, Board staff identified certain discrepancies in the data entered in the application models by Welland. In response to Board staff interrogatories which requested either a confirmation that these discrepancies were errors or an explanation supporting the validity of the original data filed with the application, Welland confirmed certain errors as described below and provided the necessary corrections to the models.

Board staff makes submissions on the following matters:

- Disposition of Group 1 Deferral and Variance Account Balances;
- Account 1521 – Special Purpose Charge ("SPC"); and
- Account 1562 – PILs Disposition.

DISPOSITION OF GROUP 1 DEFERRAL AND VARIANCE ACCOUNT BALANCES

Background

The *Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative (the "*EDDVAR Report") provides that during the IRM plan term, the distributor's Group 1 audited account balances will be reviewed and disposed if the preset disposition threshold of $0.001 per kWh (debit or credit) is exceeded.

Welland completed the 2012 IRM Rate Generator. The 2010 actual year end amount for Group 1 accounts with interest projected to April 30, 2012 is a credit of $1,436,775. Credit balances are amounts payable to customers. This amount results in a total claim of ($0.00339) per kWh that exceeds the preset disposition threshold of $0.001 per kWh.

Welland proposed a two-year disposition period for its Group 1 account balances, rather than the default disposition period of one-year. Welland stated that there would be a significant reduction to bills if a disposition period of one year were used. Welland indicated that phasing the disposition over a two year period would smooth the impact to customers and avoid significant increases or decreases in any one year.

Submission

Board staff has reviewed Welland's Group 1 Deferral and Variance account balances and notes that the principal amounts to be disposed of as of December 31, 2010 reconcile with the amounts reported as part of the RRR. Board staff therefore submits that the amounts should be disposed of on a final basis.

Board staff notes that Welland's application is not consistent with the guidelines outlined in the EDDVAR Report with respect to the default disposition period for Group 1 accounts (i.e. one year). Staff notes that the total bill impact for one year disposition is a decrease of 2.96% while the total bill impact for two years (as proposed) is a decrease of 1.77%.

While recognizing the value of the EDDVAR Report in guiding decisions with respect to the disposition of deferral and variance account balances, Board staff notes that in the past, the Board has made decisions which deviate from the EDDVAR Report if it deems it in the public interest to do so. For example, in Guelph Hydro's 2010 IRM application (EB-2009-0226), Guelph Hydro requested to dispose of Group 1 Account balances over a four-year period citing that disposition over a one-year period would negatively impact its cash flows. In that proceeding, Board staff submitted that while some volatility in customer bills may occur, it was in the best interest of customers to dispose of account balances over a shorter time frame so as to reduce intergenerational inequity. The

Board found that Guelph's rationale for proposing to extend the disposition was reasonable but believed that a four-year disposition period was too long. The Board found that a disposition period of two years was appropriate.

In this application, Board staff believes that using a disposition period of 2 year would strike an appropriate balance between reducing intergenerational inequity and mitigating rate volatility. Therefore, Board staff supports Welland's proposed disposition period of two years.

ACCOUNT 1521 – SPECIAL PURPOSE CHARGE ("SPC")

Background

On April 9, 2010, the Board issued a letter and invoice to all licensed electricity distributors outlining the amount of each distributor's SPC assessment and the associated SPC.

On April 23, 2010, the Board issued a letter to all licensed electricity distributors authorizing Account 1521, Special Purpose Charge Assessment Variance Account. Any difference between the amount remitted to the Ministry of Finance for the SPC assessment and the amount recovered from customers was to be recorded in "Sub-account 2010 SPC Assessment Variance" of Account 1521.

The letter also indicated, in accordance with section 8 of the SPC regulation, electricity distributors are required to apply to the Board no later than April 15, 2012 for an order authorizing them to clear any debit or credit balance in the "Sub-account 2010 SPC Variance". The Board expected that requests for disposition in "Sub-account 2010 SPC Variance" and "Sub-account 2010 SPC Assessment Carrying Charges" would be addressed as part of the proceedings for the 2012 rate year, except in cases where this approach would result in non-compliance with the timeline set out in section 8 of the SPC Regulation. In addition, the letter indicated in accordance with section 9 of the SPC Regulation, recovery of the SPC assessment is to be spread over a one-year period.

In response to Board staff interrogatory #5, Welland completed the following table which indicates a residual balance of $15,664 for disposition, comprising principal as of December 31, 2011 and interest to April 30, 2012.

SPC Assessment (Principal balance)	Amount recovered from customers in 2010	Carrying Charges for 2010	December 31, 2010 Year End Principal Balance	December 31, 2010 Year End Carrying Charges Balance	Amount recovered from customers in 2011	Carrying Charges for 2011	Forecasted December 31, 2011 Year End Principal Balance	Forecasted December 31, 2011 Year End Carrying Charges Balance	Forecasted Carrying Charges for 2012 (Jan 1 to Apr. 30)	Total for Disposition (Principal & Interest)
$181,409	-$92,257	$510	$89,152	$510	-$74,638	$569	$14,514	$1,079	$71	$15,664

Submission

Board staff notes that the usual practice by the Board is to dispose of audited deferral and variance account balances. The balances in the table above provided by Welland are not audited. Board staff notes that the residual balance in Account 1521 captures the difference between the assessed amount and the amounts recovered from ratepayers which arise as a result of the volume used in deriving the assessment unit rate (i.e. $0.0003725) and the actual volume consumed over the recovery period.

Board staff submits that despite the usual practice, the Board should authorize the disposition of Account 1521 as of December 31, 2010, plus the amount recovered from customers in 2011, including carrying charges as of April 30, 2012, because the account balance does not require a prudence review, and electricity distributors are required by regulation to apply for disposition of this account by April 30, 2012 in any event. It is Board staff's view that that there is no need to await the outcome of final audited results when these results may be available after April 30, 2012.

Consistent with the treatment of Group 1 account balances, Board staff submits that a disposition period of two years should be used.

Account 1562 – PILs Disposition

Background

Combined Proceeding (EB-2008-0381)

In 2001, the Board approved a regulatory PILs tax proxy approach for rate applications coupled with a true-up mechanism filed under the Reporting and Record-keeping

Requirements (“RRR”) to account for changes in tax legislation and rules, and to true-up between certain proxy amounts used to set rates and the actual amounts. The variances resulting from the true-up were tracked in account 1562 for the period 2001 through April 30, 2006.

On December 18, 2009 the Board issued a decision in the Combined PILs Proceeding (EB-2008-0381) and provided its views on how it will review the evidence related to account 1562 deferred PILs.

In that Decision, the Board states that:
“The parties may well differ in their interpretations of the methodology but the Board will decide those questions on the basis of the facts and the underlying documents. The Board will not enter into an enquiry as to what the methodology should have been but rather, will determine, where necessary, what the methodology was and what the appropriate application of the methodology should have been”.[1]

The PILs evidence filed by Welland in this proceeding includes tax returns, financial statements, Excel models from prior applications, calculations of amounts recovered from customers, SIMPIL[2] Excel worksheets and continuity schedules that show the principal and interest amounts in the PILs 1562 account balance.

Submission

Welland had losses and loss carry-forwards for tax purposes and therefore did not report any taxable income from 2001 to 2005 in its tax returns. In its applications for 2002 and 2005 rates, Welland used an income tax rate that was less than the maximum tax rate for the year based on the facts in those applications. The maximum income tax rates declined during the subject period from 40.62% in 2001 fourth quarter to 36.12% in 2005. Applicants must account for the decline in the income tax rates in order to determine the true-up variances to be recorded in PILs account 1562. In the absence of actual taxable income, and the income tax rates that otherwise would have applied, Welland was challenged to determine acceptable income tax rates that could be used in the true-up calculations in the SIMPIL models.

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[1] EB-2008-0381Combined Proceeding, Account 1562 Deferred Payments in Lieu of Taxes (PILs), Decision with Reasons, December 18, 2009, pg. 7.
[2] Spreadsheet implementation model for payments-in-lieu of taxes

For the 2002, 2003 and 2004 tax years, Welland calculated the income tax rates to be used in the true-up calculations in the SIMPIL models by selecting the regulatory taxable income from its 2002 rate application and determining how much tax would have applied to that amount of taxable income in 2002, 2003 and 2004. For the 2005 tax year, Welland used the regulatory taxable income from its 2005 rate application to calculate the taxes payable on that amount, and thereby derived the income tax rate used in the 2005 SIMPIL worksheets.

Staff submits that given the tax facts in Welland's case, and the tax losses during the period, Welland's methodology for determining the income tax rates used in the SIMPIL model true-up calculations is a reasonable alternative because the approach was symmetrical with how income taxes would have been determined for each of the rate applications.

Board staff submits that Welland has followed the regulatory guidance and the Board's decisions in determining the amounts recorded in Account 1562.

All of which is respectfully submitted