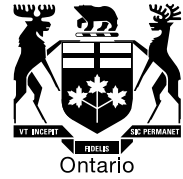


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**BY E-MAIL**

June 8, 2010

Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge Street, 27<sup>th</sup> Floor  
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: Centre Wellington Hydro Ltd.  
Disposition of Account 1562 – Deferred PILs  
Board Staff Submission  
Board File No. EB-2012-0052**

In accordance with the Notice of Application and Hearing, please find attached the Board Staff submission in the above proceeding.

Yours truly,

*Original Signed By*

Stephen Vetsis  
Analyst – Applications & Regulatory Audit

Encl.

**2012 ELECTRICITY DISTRIBUTION RATES**  
**Centre Wellington Hydro Ltd.**  
**Application for Disposition of Account 1562 –**  
**Deferred Payments in Lieu of Taxes**

**EB-2012-0052**

**STAFF SUBMISSION**

**June 8, 2012**

**Centre Wellington Hydro Ltd. (“CWHL”)**  
**Board staff submission**  
**Account 1562 – PILs Disposition**

**Background**

In CWHL’s 2012 IRM application, the Board determined that CWHL’s PILs component was not consistent with the various decisions made in the course of the Combined PILS proceeding. The inconsistencies identified related to the use of tax rates in the true-up calculations that were not supported by the tax return evidence filed, the possible inclusion of regulatory assets in the true-up calculations, and that SIMPIL models were not balanced to tax returns in all years. Additionally, CWHL did not file Excel versions of the necessary models for review.

Therefore, the Board did not hear the request for disposition of Account 1562 as part of CWHL’s 2012 IRM application and noted that it would consider it on a stand-alone basis in a separate application which CWHL was expected to file by no later than April 1, 2012.

***Submission***

CWHL filed a stand-alone application for the disposition of Account 1562 – Deferred PILs on April 2, 2012. The PILs evidence filed by CWHL in this proceeding includes tax returns, financial statements, Excel models from prior applications, calculations of amounts recovered from customers, SIMPIL<sup>1</sup> Excel worksheets and continuity schedules that show the principal and interest amounts in the account 1562 deferred PILs balance. In pre-filed evidence CWHL applied to refund to customers a credit balance of \$190,314 consisting of a principal credit amount of \$163,069 plus related carrying charges of \$27,245.<sup>2</sup>

**Excess Interest True-up Calculations**

When the actual interest expense, as reflected in the financial statements and tax returns, exceeds the maximum deemed interest amount approved by the Board,

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<sup>1</sup> Spreadsheet implementation model for payments-in-lieu of taxes

<sup>2</sup> CWH 2001-2012 PILs CONTINUITY SCHEDULE.XLS

the excess amount is subject to a claw-back penalty and is shown in the TAXCALC worksheet as an extra deduction in the true-up calculations.

CWHL replied to Board staff's interrogatories and provided a table that discloses the components of its interest expense for the period 2001 to 2005. The Board-approved maximum deemed interest expense was \$310,073.

Centre Wellington Hydro Ltd.							
Composition of Interest Expense for 2001 to 2005							
USofA	Account Description	2001	2002	2003	2004	2005	2006
6005	Interest on Long Term Debt	101,636.00	223,599.20	345,562.40	365,889.60	365,889.60	365,889.60
6035	Cust Deposits	511.10	561.47	561.47	1,206.12	3,976.20	7,926.28
6035	Other Int:Retailers Dep			7,332.53	-	-	-
6035	Other Int:Misc	140.07				716.83	6,129.97
6035	Other Int:IESO Letter of Credit				7,312.50	7,312.50	7,312.50
6035	Other Int:Variance Accounts						2,235.66
	Total Interest	102,287.17	224,160.67	353,456.40	374,408.22	377,895.13	389,494.01

CWHL stated in its response to Board staff interrogatories that "interest expense as reported in the audited financial statements, is comprised of interest on the note payable to the Township of Centre Wellington, interest on customer deposits, fee for IESO letter of credit and carrying charges on regulatory liabilities."<sup>3</sup>

The Board decided in EB-2011-0174 that Hydro One Brampton's interest expense used to calculate the interest claw-back variance should not include interest on customer deposits.<sup>4</sup>

CWHL included fees charged on the IESO Letter of Credit account in the interest expense subject to claw-back which is consistent with the Board's decisions.<sup>5</sup>

Board staff submits that interest on customer deposits should not be included in the excess interest claw-back calculations. Board staff also submits that CWHL

<sup>3</sup> Responses to Board Staff Interrogatories dated May 25, 2012/PDF page 3.

<sup>4</sup> Hydro One Brampton, EB-2011-0174, December 22, 2011. Kingston Hydro, EB-2011-0178, April 19, 2012. Innisfil Hydro, EB-2011-0176, April 19, 2012. Milton Hydro, EB-2012-0025, April 26, 2012.

<sup>5</sup> Burlington Hydro, EB-2011-015, March 20, 2012. Kitchener-Wilmot Hydro, EB-2011-0179, April 4, 2012.

should update the excess interest claw-back calculations in the SIMPIL models, the SIMPIL model adjustments recorded in the 2001 to 2012 PILs continuity schedule, and the final balance to be refunded to customers in Excel format.

#### Income Tax Rates Used in SIMPIL Models Sheet TAXCALC

The SIMPIL models require income tax rates to be input in order to calculate the variances that support some of the entries in account 1562 deferred PILs. These income tax rates are entered on sheet TAXCALC by the applicant.

CWHL's rate base was \$8,553,726 for the applications in 2001 through 2005. In determining the 2002 and 2005 distribution rates, rate base was used by CWHL as a proxy for taxable paid-up capital on which the Ontario capital tax was calculated. Since rate base was below \$10 million, no Large Corporation Tax (LCT) was included in rates.

Following a regulatory approach to determining income tax rates used in the SIMPIL true-up calculations would have allowed CWHL to recognize the full federal small business deduction. The federal small business deduction is phased out when paid-up capital is above \$10 million and is no longer available when paid-up capital reaches \$15 million. In calculating the income tax rates<sup>6</sup> CWHL has reduced the business limit which results in an increase in the effective income tax rate. CWHL did not use rate base to determine the eligibility for the small business deduction, and instead used actual taxable capital from the tax returns as seen in the table below.

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Taxable Capital (\$)	11,054,068	11,567,833	12,062,217	12,502,508	12,923,063

CWHL has used a hybrid method to calculate the income tax rates to be used in the SIMPIL models for 2001-2005. Board staff submits that a proper regulatory approach would use rate base as the proxy for taxable capital, regulatory taxable income and the tax return forms for 2001 through 2005 to calculate the blended income tax rates. Following this method, there would be no business limit

<sup>6</sup> Excel worksheet "CWH tax rate calcn.xls" filed on March 31, 2012.

reduction since rate base as the proxy for taxable capital is less than \$10 million. Board staff submits that using actual taxable capital which results in the business limit reduction should also require the use of actual taxable income to be internally consistent. CWHL did not have taxable income for 2001 and 2002 due to tax losses, but CWHL did have taxable income for 2003-2005.

Board staff asked in interrogatory #4c why CWHL did not use the actual taxable income to calculate the income tax rate in each year. CWHL responded:

Actual taxable income was not used since CWHL had tax losses in 2001 and 2002 and applied a loss carry forward to reduce taxable income in 2003. Actual taxable income could not be used in these years since it was negative (2001, 2002) or distorted (2003). For consistency the same approach was applied to each year.<sup>7</sup>

Board staff asked in interrogatory #4d.i that CWHL use rate base as the proxy for taxable capital and regulatory taxable income for the tax years 2001 through 2005 and to recalculate the income tax rates. In its response, CWHL's calculations did not use rate base and instead used actual taxable capital, which resulted in the same income tax rates as filed in its pre-filed evidence.<sup>8</sup>

Board staff submits that a consistent approach would be more appropriate for the income tax rate calculations. Since CWHL considers the actual tax return approach to be inappropriate in 2001 and 2002 and distorted in 2003, Board staff submits that the regulatory approach of using rate base as the proxy for taxable capital and regulatory taxable income for the tax years 2001 through 2005 should be used to calculate the income tax rates as one alternative scenario for the Board to consider.

CWHL's rate base is below \$10 million, and CWHL considers it inappropriate to rely on the tax returns to determine the income tax rates. Board staff submits that an alternative approach would be to use the minimum income tax rates as

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<sup>7</sup> Responses to Board Staff Interrogatories, dated May 25, 2012, PDF page 9.

<sup>8</sup> Responses to Board Staff Interrogatories, dated May 25, 2012, PDF pg11; and Application Appendix 5, PDF page 179.

identified in the Board's Decision in the combined proceeding<sup>9</sup> in the determination of the recalculated balance in account 1562 deferred PILs.

Board staff submits that CWHL should file the active SIMPIL models for 2001-2005 and a continuity schedule for each of the following two scenarios to assist the Board in considering the evidence in this case. One scenario is to use rate base as the proxy for taxable capital and that the full federal small business deduction be claimed in calculating the income tax rates. The second scenario is to use the minimum income tax rates from the Decision in the combined proceeding in the recalculation of the balance in account 1562 deferred PILs.

Board staff also submits that CWHL should re-file the revised SIMPIL models including the removal of interest on customer deposits in interest expense as previously mentioned, the 2001 to 2012 PILs continuity schedule, and the final balance to be refunded to customers in Excel format.

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<sup>9</sup> EB-2008-0381, Decision and Order, June 24, 2011, page 17.