

**Ontario Energy
Board**
P.O. Box 2319
27th. Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416-481-1967
Facsimile: 416-440-7656
Toll free: 1-888-632-6273

**Commission de l'énergie
de l'Ontario**
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone: 416-481-1967
Télécopieur: 416-440-7656
Numéro sans frais: 1-888-632-6273



BY EMAIL

July 23, 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: Niagara-on-the-Lake Hydro Inc.
Application for the Disposition of Account 1562 – Deferred Payments in
Lieu of Taxes
Board Staff Submission
Board File No. EB-2012-0026**

In accordance with the Notice of Application and Hearing and Procedural Order No. 1, please find attached the Board Staff Submission in the above proceeding.

In addition, Board staff reminds Niagara-on-the-Lake Inc. that its Reply Submission is due by August 13, 2012.

Yours truly,

Original Signed By

Daniel Kim
Analyst, Applications & Regulatory Audit

Encl.



ONTARIO ENERGY BOARD

STAFF SUBMISSION

Niagara-on-the-Lake Hydro Inc.

EB-2012-0026

July 23, 2012

Niagara-on-the-Lake Hydro Inc. (“NOTL”)
Board staff Submission
Account 1562 – PILs Disposition

Background

NOTL filed a stand-alone application for the disposition of Account 1562 – Deferred PILs, dated February 28, 2012. The PILs evidence filed by NOTL in this proceeding includes tax returns, financial statements, Excel models from prior applications, calculations of amounts recovered from customers, SIMPIL¹ Excel worksheets and continuity schedules that show the principal and interest amounts in the Account 1562 Deferred PILs balance. In pre-filed evidence NOTL applied to collect from customers a debit balance of \$280,294 consisting of a principal debit amount of \$238,725 plus related carrying charges of \$41,569.

After reviewing and answering Board staff interrogatories, NOTL filed three sets of revised SIMPIL models, a PILs continuity schedule and a revised balance for disposition. NOTL is requesting to dispose a total 1562 deferred PILs balance using “Scenario X” of \$27,852 consisting of a principal debit amount of \$242 plus related carrying charges of \$27,610.² NOTL is requesting a two-year recovery period from May 1, 2012 to April 30, 2014 to coincide with the eve of NOTL’s requested next rebasing period starting May 1, 2014.

Submission

Fixed Asset Transactions

Like most distributors, NOTL included its fixed assets in the calculation of rate base for the 2000-2001 rate unbundling application. Distributors in general continued to receive the return on these assets from ratepayers even though they may have disposed of assets during the period of 2002 through 2005. Under the PILs methodology, fixed asset transactions should not true-up to ratepayers and the applicant should enter any write-downs, gains and losses on sheet TAXREC3 of the SIMPIL model.³

¹ Spreadsheet implementation model for payments-in-lieu of taxes

² Responses to Board Staff Interrogatories, July 9, 2012, Page 2.

³ North Bay, EB-2011-0187, Page 16.

In its original application, NOTL tried up gains and losses on disposal of fixed assets by recording the transactions on TAXREC2 sheet. In response to interrogatory #2, NOTL moved fixed asset transactions to sheet TAXREC3 and updated the PILs continuity schedule. Board staff submits that the treatment of fixed asset transactions on the SIMPIL models is consistent with decisions already made by the Board.

Billing Determinants used to Calculate Recoveries from Ratepayers

In the original application, the PILs recoveries were lower than one would expect compared to the PILs proxies in rates. The trend for the majority of distributors is that the PILs recoveries exceed the proxies for the full years of 2003, 2004 and 2005. Board staff asked NOTL in interrogatory #5a to explain why PILs recoveries were low, especially within the 2004 recovery period.

NOTL responded:

We have reviewed in detail the available documents from 2004 and there do not appear to be any errors in the calculation and recording of PILS recovery [except for the minor correction referred to in IRR 5b].

We submit that the trend for the majority of distributors did not apply to NOTL's actual situation in 2004.

The reason for a reduction in usage in 2004 could be due to weather, conservation behaviour, tourism levels in Niagara-on-the-Lake that year, economic activity, etc. We are unable to determine the specific effects of such factors on the billing determinants in 2004. Nonetheless, we believe the PILs recovery calculations to be correct.⁴

Board staff accepts NOTL's explanation.

Board staff noted a further discrepancy with the Street Light class. The billing determinant data used for PILs recovery was not consistent with the load forecast data contained in NOTL's 2006 EDR model for 2002. NOTL reviewed the statistics filed in the 2006 EDR and made the necessary adjustments to the billing determinants for the Street Light class in response to interrogatory #5b).

⁴ Responses to Board Staff Interrogatories, July 9, 2012, Page 12-13.

Board staff submits that the statistics filed in the PILs recovery worksheets are consistent with the demand statistics filed in previous rate applications.

Excess Interest True-up

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

NOTL replied to Board staff's interrogatory #4 and provided a table that discloses all of the components of its interest expense for the period 2001 to 2005.⁵ NOTL has included all components of interest expense from the table below in its SIMPIL models. Interest on consumer deposits and on deferral and variance accounts should be excluded from the true-up calculations based on recent Board decisions related to disposition of the balances in Account 1562 deferred PILs. Stand-by fees or charges on prudential letters of credit or lines of credit are considered by the Board to be interest and must be included in the interest true-up calculations. The Board-approved maximum deemed interest expense was \$502,410. Interest true-up variances arise in the years 2002 through 2005 when actual interest is compared to deemed interest.

⁵ Responses to Board Staff Interrogatories, July 9, 2012, Page 8.

Table 1

Line	OEB Account	Description of Interest Expense Item	2001	2002	2003	2004	2005
1	6005	Interest on loan from Town to NOTL Hydro-Electric Commission in year 2000	\$ 17,280	\$ -	\$ -	\$ -	\$ -
2	6005	Interest on Promissory Note with Town of NOTL	\$ 458,651	\$ 501,297	\$ 500,347	\$ 500,347	\$ 500,347
3	6005	Interest on loan from CIBC for construction of a new transformer station	\$ -	\$ -	\$ 74,851	\$ 172,675	\$ 159,973
4	6005	Interest on loan from CIBC for purchase of a transformer station from Hydro One	\$ -	\$ -	\$ -	\$ -	\$ 32,954
5	6005	Interest on loan from affiliate (ESNI)	\$ 5,015	\$ 3,263	\$ -	\$ -	\$ -
6	6005	Bank issuance commission for IMO prudential letters of credit	\$ -	\$ 5,797	\$ 4,718	\$ -	\$ -
	6005	Total of OEB Account	\$ 480,945	\$ 510,356	\$ 579,916	\$ 673,021	\$ 693,274
7	6035	Accrued Interest on customer deposits	\$ 3,457	\$ 1,440	\$ 894	\$ 136	\$ 2
8	6035	Late payment interest for various vendors (e.g. OPG, Visa, Revenue Canada, office suppliers, PILs)	\$ 2,908	\$ 1,860	\$ 1,423	\$ 4,110	\$ 3,238
9	6035	Bank overdraft credit facility interest	\$ 3,625	\$ 23,682	\$ 1,060	\$ 963	\$ 2,880
10	6035	Deferral and Variance account carrying expenses	\$ -	\$ 4,277	\$ -	\$ -	\$ -
11	6035	Interest on "work-in-progress" loan from CIBC for construction of a transformer station	\$ -	\$ -	\$ 9,848	\$ -	\$ -
12	6035	Business Protection Plan Rebate interest	\$ -	\$ -	\$ -	\$ 632	\$ -
	6035	Total of OEB Account	\$ 9,990	\$ 31,259	\$ 13,224	\$ 5,840	\$ 6,120
	INTEREST EXPENSE per audited Financial statements ("F/S")		\$ 490,936	\$ 541,615	\$ 593,140	\$ 678,861	\$ 699,394

Board staff submits that interest on customer deposits and deferral and variance accounts should be excluded from the true-up calculations to be consistent with decisions already made by the Board. Board staff submits that fees charged on IESO or other prudential letters of credit should be included in the true-up calculations to be consistent with decisions already made by the Board.

Board staff also submits that NOTL 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 for disposition 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. NOTL had tax losses and loss carry-forward and carry-back from 2001 to 2003. In the absence of actual taxable income, and the income tax rates that otherwise would have applied, NOTL was faced with the challenge in determining acceptable income tax rates that could be used in the true-up calculations in the SIMPIL models.

NOTL's rate base was \$13,859,589 for the applications in 2001 through 2005. In determining the 2002 and 2005 distribution rates, rate base was used by NOTL as a proxy for taxable paid-up capital. Corporate taxpayers are eligible for the full federal small business deduction when taxable capital is below \$10 million. The small business deduction is phased out on a straight-line basis as taxable capital increases above \$10 million, and is completely eliminated when taxable capital reaches \$15 million. The taxpayer pays a lower rate of income tax than the maximum rate as long as taxable capital remains below \$15 million.

In its responses to Board staff interrogatory #1, NOTL provided three sets of SIMPIL models and PILs continuity schedules. The income tax rates used under each scenario are in the table below.

	2001	2002	2003	2004	2005
Scenario A: Minimum tax rates	19.12%	19.12%	18.62%	18.62%	18.62%
Scenario X: Maximum tax rates	40.62%	36.54%	36.62%	36.12%	36.12%
Scenario B: hybrid approach	33.86%	32.56%	31.57%	27.34%	24.63%

Referring to "Scenario A: Minimum tax rates", NOTL stated in its responses to interrogatories that:

NOTL did not consider using the minimum income tax rate because it is not entitled to a full small business deduction as can be seen in the taxation years 2002, 2004 and 2005 when the company did have taxable income.

This method arbitrarily uses the minimum tax rates as the appropriate tax rate

to use in the SIMPIL models. NOTL is not such a small distributor that it is entitled to use the minimum income tax rates on its tax returns. This can be clearly seen in 2004 and 2005. Using the minimum tax rates results in inaccurate true-ups and is arbitrary in nature with no basis in tax reality.⁶

In years where tax losses are created or utilized and taxable income is zero, the only possible tax rate assumption would be zero using the tax return approach. Board staff interprets the Board's PILs-related decisions to have defined the floor as the minimum income tax rates and the ceiling as the maximum income tax rates. There are innumerable income tax rate possibilities between these two limits. The challenge for the Board is to select the most appropriate set of income tax rates based on the specific tax evidence filed by the applicant. A plausible scenario using the tax returns would be to use the actual taxable capital for each year and the minimum tax rates for the years in which losses were incurred. In years where taxable income was earned, the applicable tax rates from those tax returns would be used.

NOTL requested that "Scenario X: Maximum tax rates" be used to calculate the PILs true-ups. NOTL believed that the maximum tax rates are more appropriate than the minimum tax rates since NOTL's actual tax rates are closer to the maximum than they are to the minimum rates. Board staff notes that under this scenario, the 2002 maximum tax rate was not used. The 2002 maximum tax rate was 38.62%. NOTL chose a tax rate of 36.54%. Board staff requests NOTL to explain why the maximum tax rate was not chosen in 2002 and to provide the calculations supporting the selected income tax rate.

NOTL also proposed "Scenario B: Hybrid approach" to determine the appropriate tax rate to be used in the years 2001 and 2003. The hybrid approach uses regulatory taxable income as an estimate for taxable income and actual taxable capital to estimate the impact of the claw back of the small business deduction.

Board staff introduces a fourth scenario as an alternative for NOTL to consider. A 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. Board staff submits that rate base should be used as the proxy for taxable capital along with regulatory taxable income to be internally consistent. Board

⁶ Responses to Board Staff Interrogatories, July 9, 2012, Page 2.

staff submits that a consistent approach would be more appropriate for the income tax rate calculations.

Board staff submits that NOTL should file the active income tax rate calculations, SIMPIL models for 2001 to 2005 and a continuity schedule under the regulatory approach described in the paragraph above to assist the Board in considering the evidence in this case. Board staff also submits that in this alternative scenario, NOTL should also reflect the adjustments made to the excess interest claw-back calculations in the SIMPIL models. Interest on customer deposits and variance accounts should be excluded from the true-up calculations to be consistent with decisions already made by the Board. Fees charged on IESO or other prudential letters of credit should be included in the true-up calculations. NOTL should file a revised balance reflecting these adjustments, including carrying charges to August 31, 2012.

All of which is respectfully submitted