**EB-2012-0026**

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

**AND IN THE MATTER OF** an application by Niagara-on-the-Lake Hydro Inc. for an order or orders to dispose Account 1562 – Deferred Payments in Lieu of Taxes ("Deferred PILS").

**BEFORE:** Karen Taylor
Presiding Member

Cynthia Chaplin
Vice Chair and Member

**DECISION AND ORDER**
**September 20, 2012**

## Background

On December 23, 2010, the Board issued its Decision on the Combined PILs proceeding EB-2008-0381 ("Combined PILs Decision"). The Board indicated that the remaining distributors will be expected to apply for final disposition of Deferred PILs with their next general rates application, either IRM or cost of service.

The Board also indicated in the Combined PILs Decision that if the distributor files evidence in accordance with the various decisions made in the course of the Combined PILs proceeding, including the use of the updated SIMPIL model, the determination of the final account balance will be handled expeditiously and in a largely administrative manner. However, if a distributor files on a basis which differs from what is contemplated by the Combined PILs Decision, the application can take some time to process, and therefore should not be included in an IRM application. Deviations from the Combined PILs Decision could include taking a different position on issues considered by the Board in the Combined PILs proceeding, addressing issues not arising in the Combined PILs proceeding or filing older SIMPIL models rather than the updated models containing the Excel worksheet 'TAXREC 3' as used by Halton Hills Hydro Inc.

Niagara-on-the-Lake Hydro Inc. ("NOTL") filed its Deferred PILs claim as part of its 2012 Incentive Rate Mechanism ("IRM") Application (EB-2011-0186), dated September 15, 2011. The Board determined that NOTL's application was not consistent with the various decisions made in the course of the Combined PILs proceeding. Therefore, the Board did not hear the request for disposition of Deferred PILs as part of NOTL's 2012 IRM application and noted that it would consider it on a stand-alone basis in a separate application which NOTL was expected to file by no later than April 1, 2012.

## The Application

NOTL filed its stand-alone Deferred PILs application on February 29, 2012. NOTL proposed a two-year disposition period effective May 1, 2012. The Board assigned the application file number EB-2012-0026.

The Board issued a Notice of Application and Hearing and Procedural Order No. 1, dated May 31, 2012, granting intervenor status and cost eligibility to the intervenors of record in NOTL's 2012 IRM proceeding. The Board noted that the Vulnerable Energy Consumers Coalition ("VECC") was granted intervenor and cost eligibility status in the IRM proceeding.

The Deferred PILs evidence filed by NOTL in this proceeding includes tax returns, financial statements, Excel models from prior applications, calculations of amounts recovered from customers, SIMPIL[1] Excel worksheets and continuity schedules that show the principal and interest amounts in the Deferred PILs balance. In pre-filed evidence NOTL applied to collect from its customers a debit balance of $317,852 consisting of a principal debit amount of $238,725 plus related carrying charges of $79,127.

### *Fixed Asset Transactions*

In its application, NOTL trued-up gains and losses on disposal of fixed assets by recording the transactions on TAXREC2 sheet. In response to Board staff interrogatory

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

#2, NOTL changed fixed asset transactions to sheet TAXREC3 and updated the PILs continuity schedule.

Board staff submitted that the treatment of fixed asset transactions on the SIMPIL models is consistent with the decisions already made by the Board.

*Billing Determinants used to Calculate Recoveries from Ratepayers*

The trend for the majority of distributors is that the PILs recoveries exceed the proxies for the full years of 2003, 2004 and 2005. However, in NOTL's application the PILs recoveries were lower than the proxies.

In response to Board staff interrogatory #5a, NOTL confirmed that there does not appear to be any errors in the calculation and recording of PILs recovery, except for a minor correction referred to in interrogatory response #5b. NOTL submitted that the trend for the majority of distributors did not apply to NOTL's actual situation in 2004.

Board staff submitted that it accepted NOTL's explanation. Board staff also submitted that the statistics filed in the PILs recovery worksheets are consistent with the demand statistics filed in previous rate applications.

*Excess Interest True-up*

In response to Board staff interrogatory #4, NOTL provided a table that discloses all of the components of its interest expense for the period 2001 to 2005. NOTL also noted that the interest expense, as reported in its audited financial statements, was comprised of interest on customer deposits and IESO prudentials.

In its submission, Board staff submitted 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 also submitted that fees charged on IESO or other prudential letters of credit should be included in the true-up calculations. Board staff further submitted 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.

In its reply submission, NOTL provided the revised calculation of interest in accordance with Board staff's submission. NOTL also noted that it had made the adjustments as submitted by Board staff.

*Income Tax Rates*

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. These income tax rates are entered on sheet TAXCALC by the applicant.

In response 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 shown 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% |

NOTL also stated that it 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. NOTL requested that "Scenario X: Maximum tax rates" be used to calculate the PILs true-up. 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. However, the 2002 maximum tax rate was not used.

NOTL also proposed a 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.

In its submission, Board staff requested NOTL to explain why the maximum tax rate, under “Scenario X: Maximum tax rates”, was not chosen in 2002 and to provide the calculations supporting the selected income tax rate.

Board staff submitted that 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 also submitted that rate base should be used as the proxy for taxable capital along with regulatory taxable income to be internally consistent. Board staff submitted that a consistent approach would be more appropriate for the income tax rate calculations.

Board staff further submitted that NOTL should file the active income tax rate calculations, SIMPIL models for 2001 to 2005 and a continuity schedule under the regulatory approach to assist the Board in considering the evidence in this case. Board staff also submitted that in the regulatory approach, NOTL should also reflect the adjustments made to the excess interest claw-back calculations in the SIMPIL models.

NOTL noted that in response to Board staff interrogatory #1b, it stated that NOTL had no taxable income in 2001 through 2003. However, NOTL stated that in its response that NOTL did have taxable income in 2002. NOTL noted under “Scenario X: Maximum tax rates” that an actual tax rate of 36.54% was used in 2002.

NOTL submitted income tax calculations under the regulatory approach introduced by Board staff. NOTL also submitted SIMPIL models for 2001 to 2005 and a continuity schedule under this scenario as requested by Board staff to assist the Board in its decision. The income tax rates used under the fourth scenario are shown in the table below.

| | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| Scenario 4: regulatory approach | 33.86% | 29.77% | 31.22% | 25.99% | 26.06% |

Under the regulatory approach introduced by Board staff, NOTL provided a revised credit balance of $230,864 consisting of a principal credit amount of $202,991 plus related carrying charges of $27,873 up to August 31, 2012.

## Board Findings

The Board approves a disposition balance for Account 1562 of a credit balance of $230,864, representing a credit principal balance of $202,991 to April 30, 2006 and carrying charges of $27,873 to August 31, 2012. The Board also approves a 19-month disposition period, commencing October 1, 2012 and ending April 30, 2014.

The Board finds that NOTL's treatment of fixed asset transactions in the SIMPIL models, NOTL's updated excess interest true-up calculation and related adjustments, and the billing determinants used in NOTL's PILs recovery worksheets are consistent with regulatory guidance and previous decisions of the Board.

With respect to the taxation rates used in the true-up calculation, the amount approved by the Board for disposition reflects the fourth scenario (regulatory approach), as proposed by Board staff. The regulatory approach uses regulatory rate base as the proxy for taxable capital, regulatory taxable income, and the tax return forms for 2001 to 2005 to determine the blended income tax rates used in the true-up calculation. The Board is of the view that the regulatory approach is more appropriate than the alternative scenarios presented by NOTL.

There is sufficient evidence on the record that the use of the minimum and/or maximum taxation rates as per page 17 of the Combined Decision is not consistent with NOTL's factual situation. Further, the Board finds that the hybrid scenario proposed by NOTL is inconsistent with the intent of Account 1562 and is asymmetric in favour of the utility.

The Board is also of the view that the hybrid approach is inconsistent with the purpose of utility rate making. From a ratemaking perspective, the Board is concerned with regulated balances, not balances that are constructed for taxation purposes. Tax accounting and regulatory accounting have different purposes and from a rate making perspective, the Board is concerned with the latter and not the former.

The Board notes that Account 1562 is not to be used to true-up PILs proxy amounts collected with the PILs amounts actually paid - rather, Account 1562 is to be used to track the difference between the amount of the 2001 PILs and 2002 PILs proxies included in rates and the actual amounts recovered from customers.

## Cost Awards

VECC was found to be eligible for an award of costs in the IRM proceeding. However, VECC did not participate in this proceeding, and therefore the Board will not award costs to VECC.

## THE BOARD ORDERS THAT:

1. NOTL shall file with the Board a draft Rate Order attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision and Order, within **7 days** of the date of this Decision and Order. The draft Rate Order shall also include customer rate impacts and detailed supporting information showing the calculation of the final rates.

2. Board staff shall file any comments on the draft Rate Order with the Board and forward to NOTL within **5 days** of the date of filing of the draft Rate Order.

3. NOTL shall file with the Board responses to any comments on its draft Rate Order within **3 days** of the date of receipt of the submission.

4. NOTL shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

All filings to the Board must quote file number **EB-2012-0026,** be made through the Board's web portal at, https://www.pes.ontarioenergyboard.ca/eservice/ and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.ontarioenergyboard.ca**.** If the web portal is not available parties may email their document to BoardSec@ontarioenergyboard.ca . Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 2 paper copies.

**DATED** at Toronto, September 20, 2012
**ONTARIO ENERGY BOARD**

*Original Signed By*

Kirsten Walli
Board Secretary