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BY EMAIL

September 21, 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: Veridian Connections Inc.
Application for the Disposition of Account 1562 – Deferred Payments in
Lieu of Taxes
Board Staff Submission
Board File No. EB-2012-0061**

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

As a reminder, Veridian Connections Inc.'s Reply Submission is due by October 5, 2012.

Yours truly,

Original Signed By

Daniel Kim
Analyst, Applications & Regulatory Audit

Encl.



ONTARIO ENERGY BOARD

STAFF SUBMISSION

Veridian Connections Inc.

EB-2012-0061

September 21, 2012

**Veridian Connections Inc.
Board Staff Submission
Account 1562 – PILs Disposition**

Background

Veridian Connections Inc. (“Veridian” or “VCI”) filed a stand-alone application for the disposition of Account 1562 – Deferred PILs (“Account 1562”) dated May 1, 2012. The PILs evidence filed by Veridian 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. In pre-filed evidence, Veridian sought recovery of \$320,243, consisting of a principal debit balance of \$58,930 and debit carrying charges of \$261,313, effective September 1, 2012 over a one-year period.

	Principal at August 31, 2012	Interest at August 31, 2012	Total
VCI	- \$30,851	\$207,355	\$176,504
Scugog Hydro	2,247	1,671	3,918
Gravenhurst Hydro	87,534	52,287	139,821
	\$58,930	\$261,313	\$320,243

In response to Board staff interrogatories, Veridian filed revised PILs continuity schedules and a revised balance in Account 1562. Veridian is requesting to dispose a revised credit balance of \$233,004, consisting of a principal credit balance of \$357,352 and debit carrying charges of \$124,348.

	Principal at August 31, 2012	Interest at August 31, 2012	Total
VCI	- \$277,808	\$140,378	-\$137,430
Scugog Hydro	867	1,104	1,971
Gravenhurst Hydro	-80,411	-17,134	-97,545
	-\$357,352	\$124,348	-\$233,004

Submission

Billing Determinants used in the PILs Recovery Worksheets

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

In the application evidence filed in 2002, 2004 and 2005, utilities provided statistics of demand data. The 2006 EDR application also provided statistics for 2002 to 2004. The trend for the majority of distributors is that the PILs recoveries exceed the proxies for the full years of 2003, 2004 and 2005. As demand and population grew, the PILs dollar amounts recovered were higher than the proxy set using 2001 billing determinants. However, in Veridian's original application, the PILs recoveries were lower than one would expect compared to the PILs proxies in rates.

For the Scugog service area, the volumetric billing determinants for 10 months of 2002 appeared lower than expected. In addition, the billing determinants for the Sentinel Lighting and Street Lighting rate classes were not entered in the PILs Recoveries model.

For the Gravenhurst service area, the volumetric billing determinants for the 2002 recovery period also appeared lower than expected.

For the Veridian service area, errors were discovered in the volumetric billing determinants in the 2002 and 2005 recovery period for the Belleville service area and in the 2003 recovery period for the Port Hope service area.

In its responses to Board staff interrogatories #1 and #3 to #8, Veridian determined that the billing determinants entered for the PILs recoveries were in error. Veridian updated the revised billing determinants and PILs revenue collected and also revised the PILs continuity schedule. Board staff submits that the revised statistics utilized in the PILs recovery calculations are reasonable and consistent with the 2002-2006 historic billing determinant statistics.

Gravenhurst Hydro Proxy Entitlements from October 1, 2001 to May 31, 2002

In its PILs 1562 continuity schedule, Veridian recorded its entitlement to the 2001 PILs proxy starting on October 1, 2001 and the 2002 PILs proxy on January 1, 2002 for the Gravenhurst service area. However, since Gravenhurst Hydro delayed filing its 2002 application until April 17, 2002, the effective date of the 2002 rates including the 2001 and 2002 proxies was delayed to June 1, 2002. Therefore, there is a question as to whether the Board-approved accounting guidance for distributors following the standard application timing should not apply.

Board staff submits that the PILs proxy should be pro-rated for the period from June 1, 2002 (the effective date for 2002 rates) to March 31, 2004, or 22 months. The sum of the 2001 PILs proxy of \$63,992 and the 2002 PILs proxy of \$328,177 is \$392,169. The rates were determined based on a twelve month rate year which implies a monthly PILs proxy amount of \$32,681 (\$392,169/12) for the 22 months. Using this monthly entitlement, the total for the period shown is \$718,976 (\$32,681 x 22). Veridian Gravenhurst has recorded \$870,381 for the same time period in its continuity schedules.²

Rate Period	PILs Proxy
2002 - billings for 7 months only	\$228,765
2003	392,169
2004 – Jan.1 – Mar. 31	98,042
Total	\$718,976

Board staff submits that this alternative proffered by staff of calculating the PILs proxy with effect from June 1, 2002 is equitable to the ratepayers and to the shareholder. This alternative is consistent with decisions already made by the Board.³

Board staff requests that Veridian file a revised PILs continuity schedule for Gravenhurst Hydro with pro-rated PILs proxy entitlements from June 1, 2002 and final balance in Excel format as one alternative scenario for the Board to consider.

Gravenhurst Hydro 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.

Board staff asked in interrogatory #2a to provide the calculations of the income tax rates from 2001 to 2005 and why the minimum income tax rates would not be appropriate for Gravenhurst Hydro.

² Veridian_rev_Gravenhurst_ED Disposition 1562 Balance_20120831.xls/ Tabs F1.1, F1.2, F1.3, F1.4

³ Board Decisions: Thunder Bay, EB-2012-0212; St. Thomas, EB-2012-0248.

Veridian reviewed the income tax rates used in the SIMPIL models and provided information on the rates used for Gravenhurst in the table below:⁴

	Income Tax Rate used in SIMPIL	Explanation
2001	34.12%	Rate used within the 2002 Board-approved RAM decision model.
2002	34.12%	Rate used within the 2002 Board-approved RAM decision model.
2003	31.87%	Gravenhurst's actual taxable income in 2003 was \$947,825 as filed on Row 139 of the TAXREC tab in the 2003 SIMPL model. The table on the Tax Rates tab indicates 31.87% as the appropriate tax rate for income ranges between \$400,000 and \$1,128,000.
2004	31.87%	Gravenhurst's actual taxable income in 2004 was \$505,701 as filed on Row 139 of the TAXREC tab in the 2003 SIMPL model. The table on the Tax Rates tab indicates 31.87% as the appropriate tax rate for income ranges between \$400,000 and \$1,128,000.
2005	36.12%	\$635,941 as filed on Row 139 of the TAXREC tab in the 2003 SIMPL model. Based on the table on the Tax Rates tab, 31.87% would be the appropriate tax rate for income ranges between \$400,000 and \$1,128,000. Veridian notes that an update of the tax rate to 31.87% from 36.12% would result in no change in the calculated True Up Variance Adjustment as there were no amounts within this section to true up.

Veridian also commented that:

Veridian has reviewed the Board Decision in Midland EB-2012-0219/EB-2011- 0182 as referenced by Board Staff. Veridian submits that 2002 rate base is not the appropriate driver for the income tax rate to be used for the purposes of the True Up Variance Adjustment as calculated on line 133 of the TAXCALC sheet of the SIMPIL models, but rather the level of taxable income

⁴ Responses to Board staff interrogatories, August 31, 2012, #2a.

as set out in the tables on the Tax Rates sheet of the SIMPIL models.⁵

Gravenhurst Hydro's rate base was \$8,718,402 for the applications in 2001 through 2005. 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 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.

Board staff submits that the minimum income tax rates as shown in the Board's decision in the combined proceeding on page 17 are reasonable alternatives since Gravenhurst's rate base is below \$10 million.

Board staff introduces an additional scenario as an alternative for Veridian to consider. A regulatory approach would use rate base as the proxy for taxable capital, regulatory taxable income from applications for the 2001 fourth quarter, 2002 and 2005 and the tax return forms for 2001 through 2005 to calculate the blended income tax rates. For 2003 and 2004, the 2002 regulatory taxable income would be used. 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 staff submits that a consistent approach would be more appropriate for the income tax rate calculations.⁶

Board staff requests that Veridian file for Gravenhurst the active income tax rate calculations, SIMPIL models for 2001 to 2005 and a PILs continuity schedule under the regulatory approach described in the paragraph above to assist the Board in considering the evidence in this case.

Scugog Income Tax Rates Used in SIMPIL Models Sheet TAXCALC

Veridian used the minimum income tax rates as shown on page 17 of the Board's combined proceeding decision for the purpose of true-up calculations for Scugog Hydro. Scugog Hydro's rate base was \$2,000,887 for the applications in 2001 through 2005.

⁵ Responses to Board Staff Interrogatories, August 31, 2012, #2b, Pages 5-6.

⁶ Board Decisions: Centre Wellington, EB-2012-0052; Brant County Power Inc. EB-2011-0425.

Board staff submits that the minimum income tax rates are appropriate for Scugog Hydro.

Veridian Main Income Tax Rates Used in SIMPIL Models Sheet TAXCALC

Veridian used the maximum income tax rates as shown on page 17 of the Board's combined proceeding decision for the purpose of true-up calculations for Veridian main. Veridian main's rate base was \$144,971,437 for the applications in 2001 through 2005.

Board staff submits that the maximum income tax rates are appropriate for Veridian main.

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.

In determining the excess interest true-up variances in the SIMPIL models, the Board-approved maximum deemed interest of \$5,255,215 was deducted from actual interest expense. To be consistent with past Board decisions, Veridian excluded interest on customer deposits and any effects on interest expense due to regulatory assets and liabilities. Veridian also confirmed that fees relating to the requirement to provide a prudential letter of credit to IESO have been included in interest expense.

Board staff submits that there are no issues concerning the interest expense true-up calculations submitted by Veridian.

Veridian 2004 LCT True-up Variance

The large corporation tax (LCT) threshold increased to \$50 million in 2004 from \$10 million prior to 2004. In its original application, the 2004 SIMPIL model contained an error in cell E173 which calculated the LCT true-up variance on sheet TAXCALC.

In its response to Board staff interrogatory #9, Veridian reviewed the formula in cell E173 and confirmed that a credit variance of \$118,287 should appear in cell E173 and that the grossed up amount in cell E178 should be a credit of \$181,980. Veridian

corrected the formula and updated the variance account adjustment in the PILs continuity schedule.

Board staff submits that the revision made to the 2004 SIMPIL model correctly calculates the LCT true-up variance on sheet TAXCALC.

Veridian 2005 LCT True-up Variance

The federal LCT was repealed retroactively in 2006 with effect from January 1, 2006. However, both the 2005 and 2006 rates contained LCT since the repeal was issued after the Board's decisions were issued. Distributors have to account for the refund to ratepayers and were instructed to use both PILs Account 1562 and Account 1592 for this purpose.

Board staff submits that Veridian should confirm if the repeal of the LCT was included in the continuity schedule of Account 1562 for the period January 1, 2006 to April 30, 2006 in accordance with FAQ July 2007. Board staff requests that Veridian confirm that 4/12ths of the 2005 LCT amount of \$125,764⁷ is recorded as an adjustment. If this credit variance has not been included in the continuity schedule in 2006, Board staff submits that Veridian should enter the amount in the Excel schedule or add the amount to the total refund to be made to customers.

Rate Rider Refund Period

Board staff requests Veridian to recommend the number of months over which it would prefer to refund the balance to be approved by the Board.

All of which is respectfully submitted

⁷ Exhibit 2, PDF page 262.