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January 30, 2013

**Our File Number: 72738**

Ms. Kirsten Walli  
Secretary  
Ontario Energy Board  
Suite 2700, 2300 Yonge Street  
P.O. Box 2319  
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: EB-2012-0136

Further to the Board's Procedural Order No. 5 issued January 10, 2013, enclosed please find Hydro One's submission regarding the threshold question raised by the Board, together with referenced appendices. Some of the appendices are the salient excerpts from larger documents. Should the Board require complete copies of the referenced documents, please let me know and we will arrange to have them filed.

Yours very truly,



Anita M. Varjacic

/nb  
Encl.

**Hydro One Networks Inc.'s Submission  
Regarding the Threshold Question Raised in Procedural Order No. 5**

**INTRODUCTION**

In Procedural Order No. 5 made in Hydro One's 2013 IRM Distribution Rate Application (EB-2012-0136), the Ontario Energy Board (the "Board") expressed its intent to determine whether the findings and instruction established in the Combined PILs Proceeding (EB-2008-0381) and findings in other cases related to payments in lieu of taxes ("PILs") should apply to Hydro One Networks Inc. ("Hydro One") even though it is not subject to section 93 of the *Electricity Act, 1998* ("the Act"), as amended. The Board indicated that it would consider submissions on the following threshold question:

*"Should the principles established in the Combined PILs Proceeding and in subsequent decisions on PILs issues regarding the decline in tax rates and changes in other tax laws be applied to Hydro One during the period covered by Hydro One's first OEB Rate Order (RP-1999-0001) through April 30, 2006 and if not, what approach should be taken to account for these changes in this time period?"*

Hydro One's position regarding the threshold question is that the principles established in the Combined PILs Proceeding regarding the decline in tax rates and changes in other tax laws do not apply to Hydro One for the period 1999 to April 2006. Hydro One submits that Account 1562 only applied to those distributors subject to section 93 of the Act and that the rationale for the variance account does not apply to Hydro One. Moreover, the Board and other stakeholders were aware that Hydro One was not using Account 1562. To now require Hydro One to do so is retroactive ratemaking, contrary to general ratemaking principles.

## BACKGROUND

Since the enactment of the *Electricity Act* in 1998, Hydro One has been making PILs to the Ontario Electricity Financial Corporation (“OEFC”) in accordance with sections 89 and 90 of the Act. The payments began on April 1, 1999. The Board did not establish a variance account for use by Hydro One to track any PILs variances.

This was not the case for the tax-exempt Municipal Electricity Utilities (“MEUs”) which form the majority of electricity distributors. MEUs were not subject to PILs until October 1, 2001 with the proclamation of section 93 of the Act. As a result of this legislative change, the Board issued a letter on August 24, 2001 informing these utilities that a new variance account would be established to implement the Board’s approach to recovery of PILs. The account was later identified as Account 1562 – Deferred Payment in Lieu of Taxes in the 2001 version of the Accounting Procedure Handbook (“APH”).

The establishment of this variance account allowed the MEUs to track and record variances that result from the difference between the Board approved PILs forecast amount and the amount of actual billings that relate to the recovery of PILs. The Board further clarified that Account 1562 and the methodology used to determine the PILs variance tracked in this account was designed to address PILs required under section 93 of the Act: see Appendix B of the December 21, 2001 Filing Guidelines for March 1, 2002 Distribution Rate Adjustments

The rationale behind the need for the variance account was due to the inherent uncertainty in any PILs forecast that an MEU would make. MEUs had been tax-exempt previously. Thus, there was no historical information that could be used to reliably forecast its PILs payment or tax liability.

In 2002, the government introduced the *Electricity Pricing, Conservation and Supply Act, 2002* which capped the price of electricity effective May 1, 2002. This froze all transmission and distribution electricity rates at existing levels until at least May 1, 2006.

In a communiqué issued in December 2005, the Board confirmed that it had established Account 1592 – PILs and Tax Variances for 2006 and Subsequent Years to capture the tax impact of specified potential changes to tax rules, rates and opening PILs account balances. This account was to apply to all electricity distributors, including Hydro One.

On April 12, 2006, the Board issued its Decision on Hydro One Distribution’s 2006 rate application (RP-2005-0020/EB-2005-0378) for distribution rates effective May 1, 2006. While Hydro One was to start tracking PILs at that time, the Board did not direct Hydro One to establish any mechanism to retroactively account for PILs variances for the period prior to May 1, 2006. Since the inception of Account 1592, Hydro One has filed two Cost of Service (“COS”) applications (EB-2007-0681 and EB-2009-0096) and two IRM applications (EB-2007-0542 and EB-2008-0187) prior to this current proceeding. Board Staff, the intervenors, and the Board have not raised this as an issue of concern in any of those prior proceedings.

## **HYDRO ONE’S SUBMISSION**

### **Scope of the Combined PILs Proceeding**

On March 3, 2008, the Board issued a letter to All Licensed Electricity Distributors with respect to Account 1562, Deferred PILs. In this letter, the Board clearly stated the purpose “is to *notify electricity distributors subject to **section 93** of the Act and interested parties that the Board intends to initiate a combined proceeding to determine the methodology that should be used for the calculation and disposition of these balances.*”

Subsequently, on August 20, 2008, Board Staff issued a Discussion Paper entitled “*Account 1562 – Deferred Payments in Lieu of Taxes: Methodology and Disposition of Balances for Electricity Distribution Companies affected by **section 93** of the Electricity Act, 1998.*” That discussion paper summarized the principles established by the Board to date with respect to the determination of the account 1562 balances.

Hydro One's position is that both of these documents demonstrate that the intent of the Combined PILs Proceeding was to focus on the disposition of account 1562 balances for electricity distributors who were subject to section 93 of the Electricity Act. The Board's documents showed no intent that this Combined PILs proceeding would apply to non-section 93 entities. Thus, the decisions resulting from this proceeding do not apply to non-section 93 entities, including Hydro One

### **Board's Decision in Canadian Niagara Power Inc.'s ("CNPI") 2013 Rate Application**

In its November 22, 2012 Decision and Order on CNPI 2013 rate application (EB-2012-0112), the Board ruled that Account 1562 does not apply to CNPI, subject to one exception.

CNPI noted that rates were initially set based on historical expenses; however MEUs had been tax-exempt prior to the proclamation of section 93. Absent any historical expenses, the Board had to come up with a mechanism to calculate a PILs proxy to be embedded into rates and established a pass-through mechanism in the form of Account 1562 to capture both the deferred amount for 2001 and the difference between the PILs proxy and the actual amount paid for those utilities to which PILs would now apply.

That rationale did not apply to CNPI. CNPI, as a privately owned utility, pays taxes according to the *Income Tax Act* and does not remit PILs under section 93 of the *Electricity Act*. It had been doing so historically. That history informed its forecast when setting rates. CNPI did not need a variance account.

Hydro One submits that its circumstance is the same as CNPI's. As a utility owned by the Government of Ontario, Hydro One had been making payments at the prescribed corporate tax rates to the OEFC in accordance with section 89 and 90 of the Act since 1999. Hydro One had not carried any deferred tax balance in its rate base similar to CNPI.

The guidance documents relating to Account 1562 in 2001 were the APH, the December 21, 2001 Filing Guidelines, and the Rate Adjustment Model (RAM). None of these guidelines

applied to Hydro One. Non-section 93 utilities were invited to contact staff regarding account 1562 and how it should be applied.

Hydro One wrote to the Board Secretary on July 31, 2003, July 30, 2004 and August 11, 2006. On each occasion Hydro One noted that it was not subject to section 93, had been paying PILS since 1999 and thus was not using the Board's RAM model or forms related to PILS. No direction to the contrary came from the Board.

In light of the foregoing, Hydro One submits that Account 1562 should not and was never intended to apply to Hydro One. Its circumstances were similar to that of CNPI. The Board should, in Hydro One's submission, afford it similar treatment and conclude that Account 1562 does not apply to Hydro One.

### **Hydro One's MEU Acquisitions**

Most of Hydro One's MEU acquisitions were completed prior to October 31, 2001 and the assets were consolidated with those of Hydro One Networks. The only two exceptions are: (i) the acquisition of Terrace Bay Superior Wires Inc. ("Terrace Bay") in 2007, and (ii) the acquisition of Brampton Hydro in 2001.

### **The Acquisition of Terrace Bay**

Terrace Bay was purchased by Hydro One in 2007 (EB-2007-0688) and had carried a balance in Account 1562 prior to the acquisition. The ending balance, as of April 30, 2007, recorded in Terrace Bay RRR report filed to the Board was \$2,765.

Hydro One recognizes that in the CNPI Decision, the Board ordered that Account 1562 applied to its Port Colborne service area because it had set up and carried a balance in Account 1562 before CNPI began operating Port Colborne's assets on April 15, 2002. Therefore, the methodology from the Combined PILs proceeding and subsequent Board decisions should apply for the Port Colborne Service Area.

Hydro One submits that the small Account 1562 balance of \$2,765 for Terrace Bay, is an immaterial amount relative to its rate base of approximately \$1M at the time of the acquisition. Hydro One therefore submits that the Board should not follow its decision relating to CNPI's Port Colborne Service area and should not require Hydro One to apply the methodology from the Combined PILs proceeding and subsequent Board Decisions for Terrace Bay.

### **The Acquisition of Brampton Hydro**

Since acquiring Brampton Hydro on July 31, 2001, it has been operated as Hydro One Brampton as a separate corporate legal entity wholly owned by Hydro One Inc. Unlike Terrace Bay, Hydro One Brampton's assets were never consolidated with those of Hydro One Networks. Prior to the acquisition, Brampton Hydro was owned by the City of Brampton. As an MEU, it was exempt from making PILs payment. With the proclamation of section 93 of the Act in 2001, the Board established the mechanism for the deferral and recovery of PILs for rate-making purposes. Unlike Hydro One Networks, which had been making tax payment to OEFC since 1999, Hydro One Brampton had not.

In order to incorporate the new requirement for PILs, Hydro One Brampton, although not subject to section 93 of the Act, sought the Board's approval to set up Account 1562 since it needed a mechanism to calculate a PILs proxy to be embedded into rates.

Hydro One submits that Hydro One Brampton was in a unique situation, given its history. This should not be construed as indicative of "acceptance in the industry" that distributors not subject to section 93 must use Account 1562, as was argued in the CNPI proceeding.

### **Retroactive Ratemaking**

The Board approved Ontario Hydro Services Company's ("OHSC's") application for 1999 and 2000 distribution revenue requirement (RP-1998-0001), including provisions for income taxes to set distribution rates for 1999 and 2000. Since 2002, Hydro One has been filing its

variance balances quarterly as part of the Board's Reporting and Record-keeping Requirements. The Board has reviewed all of Hydro One's deferral and variance account balances on an annual basis. Hydro One has never carried a balance in Account 1562. In addition, Hydro One has come before the Board in many rate proceedings and RRR filings over the years. The Board has been aware that Hydro One was not using Account 1562 nor any other mechanism to account for changes in rules and policy during that period and to track PILs variances.

As the Board is aware, Hydro One implemented a rate mitigation plan as part of the distribution rate application (RP-2000-0023/EB-2001-0016). The rate mitigation plan was undertaken to address the Ontario Government's concern that the rate increases that would have been permitted by the Electricity Distribution Rate Handbook and its associated phase-in principles, when combined with increases in the cost of power, would cause unduly negative customer impacts. Accordingly, Hydro One proposed to mitigate the impact on the average retail customer's bill by limiting rate increases in 2001, 2002 and 2003 as outlined in Exhibit D1, Tab 1, Schedule 1 of RP-2000-0023/EB-2001-0016.

Hydro One wrote to the Board on February 25, 2002, attached in Appendix E.1, and notified the Board of the impact the PILs guidelines would have on Hydro One's proposed distribution revenue requirement. Hydro One highlighted that the distribution rate application was based on the rate mitigation plan. As such, the reduction in distribution revenue requirement was already well above the adjustment that would be made by applying PILs guidelines to reflect timing differences and lower statutory rates.

Hydro One submitted that a further reduction to Hydro One's proposed distribution revenue requirement for tax considerations would not be appropriate and that the proposed distribution revenue requirement remained the same. The table below, also attached to Hydro One's February 25, 2002 letter, summarizes the amount of reduction in revenue requirement as a result of Hydro One's rate mitigation initiative and the potential impact of tax rate and timing changes for 2001, 2002 and 2003.



| (M\$)                                                                            | October<br>2001 | March 2002 | March 2003 | Total<br>Reduction |
|----------------------------------------------------------------------------------|-----------------|------------|------------|--------------------|
| Revenue Requirement Derived for<br>Rate Handbook (Without<br>Mitigation)         | 762.2           | 762.2      | 762.2      |                    |
| Mitigation Plan - Proposed<br>Distribution Revenues                              | 593.7           | 641.7      | 690        |                    |
| Mitigation Amount (annualized)                                                   | -168.5          | -120.5     | -72.2      |                    |
| Mitigation Amount Restated on<br>Annual Basis                                    | -42.1           | -128.5     | -80.3      | -250.9             |
| Impact of Tax Rate and Timing<br>Changes on Rate Handbook<br>Revenue Requirement | 7               | -20        | -17        | -30                |

The Settlement Proposal, dated March 11, 2002, affirms that Hydro One's application was based on the rate mitigation plan, and the proposed distribution revenue requirement was well below the PILs guidelines adjusted Handbook Revenue Requirement. The issue was settled and no party opposed the amount of the revenue requirement proposed. In the Board's Decision with Reasons dated June 12, 2002, the Board accepted the rate consequences flowing from the Settlement Proposal. Thus, no further adjustment to rates for tax considerations was required for Hydro One's customers.

Moreover, as noted above, Hydro One wrote to the Board in 2003, 2004 and 2006 advising that it did not have a PILs account. No concerns were expressed and there was no order or direction from the Board to take a contrary approach. Hydro One submits that to now require it to review and account for tax changes over a decade ago is retroactive rate making in the extreme.

The risk of retroactive ratemaking is that it creates intergenerational inequality by attempting to reverse over-recovery or under-recovery made in the past from current customers. One of the principles recognized and adopted by the Board in its ratemaking process is to minimize intergenerational unfairness. Hydro One submits that its position is consistent with the Board's ratemaking principles.

## **CONCLUSION**

Hydro One respectively submits that the principles established in the Combined PILs Proceeding and in subsequent Board Decision on PILs issues are not applicable to Hydro One for the reasons outlined above. Hydro One requests that the Board so find and further find that Hydro One need not account for any tax changes from the time of its first Board rate order to April 30, 2006.

**Hydro One Networks Inc.'s Submission**  
**Regarding the Threshold Question Raised in Procedural Order No. 5**

**Appendices**

|                                                                                |            |
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**Hydro One Networks Inc.'s Submission**  
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**Appendix A**  
**The Electricity Act**  
**(Sections 89, 90, 93)**

### **Payments in lieu of federal corporate tax**

**89. (1)** If Hydro One Inc., a subsidiary of Hydro One Inc., Ontario Power Generation Inc. or a subsidiary of Ontario Power Generation Inc. is exempt under subsection 149 (1) of the *Income Tax Act* (Canada) from the payment of tax under that Act, it shall pay to the Financial Corporation in respect of each taxation year an amount equal to the amount of the tax that it would be liable to pay under that Act if it were a corporation to which that subsection did not apply. 1998, c. 15, Sched. A, s. 89 (1); 2002, c. 1, Sched. A, s. 15 (1); 2007, c. 7, Sched. 12, s. 2.

### **Corridor land**

**(1.1)** The amount payable under subsection (1) by a person or entity from whom corridor land is transferred by section 114.2 shall be determined, for the taxation year in which the transfer occurs and for subsequent taxation years, as if the transfer did not occur. 2002, c. 1, Sched. A, s. 15 (2).

### **Payments to Minister of Finance**

**(2)** After Part V is repealed under section 84.1, all payments required by this section shall be paid to the Minister of Finance, instead of to the Financial Corporation. 1998, c. 15, Sched. A, s. 89 (2); 2000, c. 42, s. 31.

### **Commencement of new taxation year**

**(3)** A corporation that is required to make payments under this section shall be deemed, for the purposes of this section, to commence a new taxation year on the day this section comes into force. 1998, c. 15, Sched. A, s. 89 (3).

### **Payments in lieu of provincial corporate tax**

**90. (1)** If Hydro One Inc., a subsidiary of Hydro One Inc., Ontario Power Generation Inc. or a subsidiary of Ontario Power Generation Inc. is exempt under subsection 57 (1) of the *Corporations Tax Act* from the payment of tax under that Act for a taxation year that ends before January 1, 2009, it shall pay to the Financial Corporation in respect of each taxation year ending before that day an amount equal to the total amount of tax that it would be liable to pay under Parts II, II.1 and III of that Act for that year if it were a corporation to which that subsection did not apply. 2007, c. 7, Sched. 12, s. 3 (3).

### **Same**

**(1.0.1)** If Hydro One Inc., a subsidiary of Hydro One Inc., Ontario Power Generation Inc. or a subsidiary of Ontario Power Generation Inc. is exempt under subsection 27 (2) of the *Taxation Act, 2007* from the payment of tax under that Act for a taxation year that ends after December 31, 2008, it shall pay to the Financial Corporation in respect of each taxation year ending after that day an amount equal to the total amount of tax that it would be liable to pay under Divisions B, C and E of Part III of that Act for the taxation year if it were a corporation to which that subsection did not apply. 2007, c. 7, Sched. 12, s. 3 (3).

### **Corridor land**

**(1.1)** The amount payable under subsection (1) by a person or entity from whom corridor land is transferred by section 114.2 shall be determined, for the taxation year in which the transfer occurs and for subsequent taxation years, as if the transfer did not occur. 2002, c. 1, Sched. A, s. 16 (2).

### **Payments to Minister of Finance**

**(2)** After Part V is repealed under section 84.1, all payments required by this section shall be paid to the Minister of Finance, instead of to the Financial Corporation. 1998, c. 15, Sched. A, s. 90 (2); 2000, c. 42, s. 32.

### **Commencement of new taxation year**

(3) A corporation that is required to make payments under this section shall be deemed, for the purposes of this section, to commence a new taxation year on the day this section comes into force. 1998, c. 15, Sched. A, s. 90 (3).

### **Municipal electricity utilities**

#### **Payments in lieu of federal corporate tax**

**93. (1)** If a municipal electricity utility is exempt under subsection 149 (1) of the *Income Tax Act* (Canada) from the payment of tax under that Act, it shall pay to the Financial Corporation in respect of each taxation year an amount equal to the amount of the tax that it would be liable to pay under that Act if it were not exempt. 1998, c. 15, Sched. A, s. 93 (1).

#### **Same: payments in lieu of provincial corporate tax**

(2) If a municipal electricity utility is exempt under subsection 57 (1) of the *Corporations Tax Act* from the payment of tax under that Act in respect of a taxation year ending before January 1, 2009, it shall pay to the Financial Corporation in respect of each taxation year ending before that day an amount equal to the total amount of tax that it would be liable to pay under Parts II, II.1 and III of that Act for the year if it were a corporation to which that subsection did not apply. 2007, c. 7, Sched. 12, s. 3 (4).

#### **Same**

(2.1) If a municipal electricity utility is exempt under subsection 27 (2) of the *Taxation Act*, 2007 from the payment of tax under that Act for a taxation year ending after December 31, 2008, it shall pay to the Financial Corporation in respect of each taxation year ending after that day an amount equal to the total amount of tax that it would be liable to pay for the taxation year under Divisions B, C and E of Part III of that Act if it were a corporation to which that subsection did not apply. 2007, c. 7, Sched. 12, s. 3 (4).

#### **Payments to Minister of Finance**

(3) After Part V is repealed under section 84.1, all payments required by this section shall be paid to the Minister of Finance, instead of to the Financial Corporation. 1998, c. 15, Sched. A, s. 93 (3); 2000, c. 42, s. 35.

### **Commencement of new taxation year**

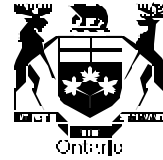
(4) A corporation that is required to make payments under this section shall be deemed, for the purposes of this section, to commence a new taxation year on the day this section comes into force. 1998, c. 15, Sched. A, s. 93 (4).

**Appendix B.1**  
**Letter to All Electricity Distribution Companies**  
**August 24, 2001**



**Ontario Energy  
Board**  
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Numéro sans frais: 1-888-632-6273



August 24, 2001

**To: All Electricity Distribution Companies**

**Re: Impact of Proposed Proxy Taxes on Rates**

Section 93 of the *Electricity Act, 1998* ("the Act"), which has yet to be proclaimed, provides that previously tax-exempt local electricity distributors ("LDCs") will become subject to payments in lieu of taxes ("PILs") commencing October 1, 2001. When proclaimed, the first PILs installments will be due October 31, 2001, which necessitates that LDCs ascertain the financial and rate making implications of this rapidly approaching requirement. It would therefore be expedient to establish a method for dealing with PILs for rate-making purposes in advance of the proclamation of section 93, to enable LDCs time to consider their particular circumstances, and to take account of various options available to them.

A number of divergent views relating to techniques for determining the appropriate tax gross-up and incorporating this into distribution rates have been received by the Board. The Board also has had several requests for consultations regarding this issue. Undoubtedly, in the Board's view, consultations on these matters are desirable, but given the anticipated October commencement of PILs prescribed by section 93, it is clear that it is prudent at this time to make some provision for the recovery of PILs, pending the Board's consultation process.

In general terms, the Board considers PILs on the wires-only portion of the LDC revenue as an additional expense that should be recovered through an increase in distribution rates. Moreover, in the *Electricity Distribution Rates Handbook*, the Board has already indicated that "the incorporation of PILs will be treated as a pass through".

After considering all the circumstances, the Board proposes that the recovery of PILs for the LDCs' current regulatory year be implemented by means of suitable adjustments to the LDCs upcoming March 1, 2002 rate applications. Therefore, recovery of the section 93 tax expense for the period from October 2001 to February 2002 would be deferred and collected through rates in the 2002-3 regulatory year, along with the utilities' annualized tax expense for 2002.

There are several advantages of this approach, including: reduction in the number of rate changes; reduction in administration and extra processes, especially in light of the short time period for any initial tax adjustment (until March 1, 2002); the opportunity for the Board to conduct consultations on the details relating to implementation of PILs; the utilities would not be impeded in their efforts for market readiness; and the special installment provisions contained in Regulation 162/01 significantly reducing utilities' 2001 PILs-related cash flow requirements.

To implement the above approach, the Board proposes to establish a deferral account with interest thereon, determined at the utilities' long-term debt rate as indicated in the Rate Handbook. The mechanics of this deferral account will be discussed during the Board's consultation process.

The Board is mindful that LDCs will face an increased cash flow burden for a few months under this deferral approach, and that some utilities may experience financial duress as a result. The Board will therefore provide an opportunity for utilities which can demonstrate financial distress to apply for an adjustment to their current rates, to include provisions for PILs based on its annualized 2001 PILs estimates. Further details, including suggested methodologies for estimating PILs, will be provided as soon as possible.

The Board will also announce particulars of the consultation process, in the near term, to be undertaken with stakeholders regarding the mechanics of the main tax adjustment to take effect on March 1, 2002. Among the issues to be considered are use of a true-up mechanism, non-utility adjustments, and use of deemed interest expense versus actual interest expense.

Utilities requiring further information or guidance on these matters should contact John Vrantidis at 416-440-7637 (toll free, 1-800-632-2727) or E-mail at [vrantisjo@oeb.gov.on.ca](mailto:vrantisjo@oeb.gov.on.ca)

Yours truly,

Paul Pudge

**Appendix B.2**  
**2001 Accounting Procedures Handbook**  
**(Article 220, pages 17-18)**

## Uniform System of Accounts

### Balance Sheet Accounts

#### Other Assets And Deferred Charges

funds must revert back to the fund and are not available for normal operating purposes. See related account 2330, Development Charge Fund.

#### 1548 RCVA<sub>STR</sub>

This account shall be used to record the net of:

- i) revenues derived from the Service Transaction Request services described in the Rates Handbook and charged by the distributor, as prescribed, in the form of a:
  - a) Request fee;
  - b) Processing fee;
  - c) Information Request fee;
  - d) Default fee; and
  - e) Other Associated Costs fee;

AND
- ii the incremental cost of labour, internal information system maintenance costs, and delivery costs related to the provision of the services associated with the above items.

Sub-accounts may be used to separately record variances related to items listed above.

#### 1560 Deferred Development Expenditures

- A. This account shall be charged with the cost of all material expenditures meeting the criteria for deferral to future periods to the extent that their recovery can reasonably be regarded as assured.
- B. Amortization of amounts in this account shall be recorded in account 5735, Amortization of Deferred Development Costs.
- C. The entries in this account must be so maintained as to show separately each project along with complete detail of the nature and purpose of the development project together with the related costs.

#### 1562 Deferred Payments In Lieu of Taxes

- A. This account shall record the amount resulting from the Board approved PILs methodology for determining the 2001 Deferral Account Allowance and the PILs proxy amount determined for 2002 and subsequent years. The amount determined using the Board approved PILs methodology will be recorded equally over the applicable PILs period (e.g. the 2001 PILs Deferral Account Allowance would be recorded in three equal installments in October, November and December for utilities with a December 31, 2001 taxation year end).
- B. Any entries resulting from the PILS Deferral Account Allowance will be effective at the end of a utilities taxation year (often December 31) and any entries resulting from the pass through of variances between

## Uniform System of Accounts

### Balance Sheet Accounts

#### Other Assets And Deferred Charges

the Deferral Account Allowance and the actual results reflected in a utility's tax filing (e.g. to the Ministry of Finance for payments in lieu of tax) will be effective as of the filing deadline (e.g. usually six months after year end).

- C. Any amounts included rates (i.e. through a Z - factor) shall be credited back to this account at the time of billing.
- D. Simple interest will be determined on the monthly opening balance. The interest rate shall be based on the deemed capital structure and the Debt Cost Rate found in Table 3-1 of the Electricity Distribution Rate Handbook.

#### 1570 Qualifying Transition Costs

When authorized or directed by the Board, this account shall be used to record transition costs that meet the four qualifying criteria established in the Electricity Distribution Rate Handbook and associated interest.

This account shall be further sub-divided by the appropriate general categories of activities as prescribed by the Board. Consequently, qualifying transition costs transactions shall be recorded in the appropriate cost and recovery sub-accounts as provided in Article 480.

More specifically, records shall be maintained as to permit the separate identification of any capital and non-capital cost components of this account. The capital sub-account will include capital assets that generally are included in the utility's rate base for rate-making purposes while the non-capital sub-account records the related annual amortization expense and operating and maintenance costs.

#### 1571 Pre-Market Opening Energy Variance

- A. As authorized by the Board, this account shall be used for the sole purpose of recording the difference between the utility's purchased cost of power based on time-of-use (TOU) and the amounts billed to non-TOU customers (charged at an average rate) for the same period.
- B. Amounts recorded in this account shall be restricted to the period starting January 1, 2001 and ending on the date prior to the opening of the electricity market in Ontario. (Upon market opening, the LDC shall use Account 1588,  $RSVA_{\text{Power}}$  to record the difference between the amount charged by the IMO, host distributor or embedded generator based on the settlement invoice for the energy cost and the amount billed to customers for the energy costs).
- C. This account shall be further sub-divided by customer classes if the average rate billed by classes are different. Where applicable, sub-accounts shall be maintained by class as follows:
  - Residential Non - TOU
  - General Service < 50 KW Non - TOU
  - General Service > 50 KW Non - TOU

**Appendix B.3**  
**2001 Distribution Filing Guidelines**  
**(Appendix B)**

## **Appendix B**

### **Filing Guidelines for PILs Proxy**

In reviewing the comments by stakeholders on the draft PILs spreadsheet previously posted on the Board's website, the Board makes the following comments.

In terms of the overall design of the PILs provision under first generation PBR, the Board wishes to reaffirm that:

- PILs will continue to be treated as a pass-through, as indicated in the Rates Handbook and by the Board in its correspondence of August 24, 2001.
- PILs will continue to be calculated on a flow-through basis, consistent with the Board's decision setting Hydro One's initial rate revenue requirement RP-1998-0001.
- Provision for PILs will be assessed on a stand-alone basis, consistent with the Board's practice in the natural gas industry.

The Board has decided that certain modifications should be made to the draft PILs spreadsheet issued for comment on December 5, 2001 (which is now superseded), including:

- The instructions regarding treatment of the interest deduction have been changed to ensure utilities that move to the capital structure authorized in the Rates Handbook at an early stage are not penalized.
- The instructions regarding the calculation of capital taxes have been clarified, so that parties understand that the full capital tax exemptions must be claimed by the regulated corporate entity (although allocation can occur between wires and non-wires activities undertaken by the regulated corporate entity).
- The instructions regarding the calculation of EBIT in 2002 onwards will not contain any reference to an IPI-X adjustment, since the 1<sup>st</sup> generation PBR is a price cap rather than revenue cap and earnings are not directly impacted by a price adjustment.

On December 21, 2001 the Board will post on its website ([www.oeb.gov.on.ca](http://www.oeb.gov.on.ca)) under "What's New?" the approved revised worksheet, entitled Spreadsheet Implementation Model For PILs ("SIMPIL").

The spreadsheet provides a consistent methodology for calculating both a 2001 and 2002 PILs amount for inclusion in the upcoming March 1, 2002 rates adjustment. In general, the methodology employs the wires-only earnings before interest and income ("EBIT") used in the establishment of the utility's unbundled rates, adjusted for incremental income associated with the implementation of MARR and for certain mandatory additions and deductions to determine income-related PILs. Capital-related PILs uses wires-only rate base, adjusted for exempt amounts.

The total PILs calculation consists of income taxes, Ontario Capital Tax and federal Large Corporations Tax ("LCT"). The LCT and income taxes are not deductible in computing income tax, therefore these tax amounts will be grossed up to permit the pass-through referred to in the Electricity Distribution Rate Handbook. By contrast, Ontario Capital Tax is a deductible expense for both Federal and Ontario income tax purposes; therefore, the actual amount (without gross-up) is the pass-through.

The attached comments and notes to the spreadsheet provide detailed, step-by-step instructions and should be reviewed carefully. The footnotes/explanations have been supplemented with document files containing a sample of a utility's filing sequence for 2001 and 2002 (in six parts), to assist utilities in their own preparation of the filing material. Utilities should consult their own tax advisors to determine how to complete a PILs calculation for Ministry of Finance purposes (for which a different set of rules are applicable).

The worksheet represents a full cycle filing requirement for PILs (over an 18 month period), from the inclusion of PILs in rates, to the deferral account allowance entry calculation, to the tax authority filing details (which will be used to support the "true-up" deferral account entry).

The blank spreadsheets provided are generic. Utilities should copy the spreadsheet once to prepare a 2001 PILs deferral account allowance, and make a second copy to create a 2002 PILs proxy for inclusion in the rate adjustment model.

In the workbook, there are three blank worksheets entitled "REGINFO", "TAXCALC" and "TAXREC". It is recommended that one workbook be created for 2001 and one for 2002. Different columns will be completed at different times during the period from now through June, 2003.

Utilities should then file, as part of their March 1, 2002 rates application, 6 hard copies of the 2001 and 2002 PILs spreadsheets, as well as an electronic copy of each on disk. The PILs worksheets will form part of the evidentiary material to be considered by the Board in order to approve just and reasonable rates for the rate year starting March 1, 2002. The resulting 2001 and 2002 PILs amounts should be entered in the appropriate sheet in the RAM Model as outlined in Appendix "A" and submitted to the Board no later than January 25, 2002.



Should you have questions regarding the PILs worksheets, please contact Duncan Skinner (416-440-8127 or [skinnedu@oeb.gov.on.ca](mailto:skinnedu@oeb.gov.on.ca)) or John Vrantsidis (416-440-7613 or [vrantsjo@oeb.gov.on.ca](mailto:vrantsjo@oeb.gov.on.ca)).

Please note that the model is designed to address PILs imposed under section 93 of the *Electricity Act*. Contact the above staff regarding how it should be applied in the case of utilities paying proxy taxes under different rules, or paying regular corporate taxes.

**Appendix C.1**  
**Combined PILs Proceeding: Letter to All Electricity Distribution Companies**  
**March 3, 2008**

**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 E-MAIL**

March 3, 2008

**To: All Licensed Electricity Distributors  
All Intervenors in 2008 Electricity Distribution Rate Proceedings**

**Re: Review Initiative  
Account 1562, Deferred Payments in Lieu of Taxes ("PILs")  
Board file number EB-2007-0820**

The majority of electricity distributors that are rate regulated by the Board became subject to PILs effective October 1, 2001 with the proclamation of section 93 of the *Electricity Act, 1998* (the "Act"). As of the date of this letter, seven distributors subject to section 93 of the Act that filed cost of service applications for 2008 rates have requested the disposition of account 1562, Deferred PILs. To date, the Board has not reviewed the methodology or account balances for account 1562 for any distributor subject to section 93 of the Act.

It is apparent from a review of applications before the Board that distributors have used a variety of methods to record balances in account 1562 for the time period applicable to this account, October 1, 2001 to April 30, 2006. This letter is to notify electricity distributors subject to section 93 of the Act and interested parties that the Board intends to initiate a combined proceeding to determine the methodology that should be used for the calculation and disposition of these balances.

Going forward, it is the Board's expectation that the decision stemming from the combined proceeding will be used to determine the final account balances with respect to account 1562, Deferred PILs for the remaining distributors. The Board intends to proceed with the review and disposition of the account 1562, Deferred PILs balances for the remaining distributors subsequent to the completion of the combined proceeding.

Further information regarding this initiative, including how to participate in it, will be made available in the near future. If you have any questions regarding this

initiative, please contact Harold Thiessen, Senior Advisor, at 416-440-7637 or by e-mail at [harold.thiessen@oeb.gov.on.ca](mailto:harold.thiessen@oeb.gov.on.ca).

Yours truly,

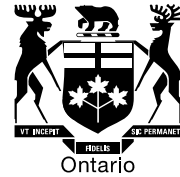
*Original signed by*

Kirsten Walli  
Board Secretary

**Appendix C.2**  
**Combined PILs Proceeding: Letter to All Electricity Distribution Companies**  
**August 20, 2008**

**Ontario Energy Board**  
P.O. Box 2319  
27<sup>th</sup> 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  
27<sup>e</sup> étage  
2300, rue Yonge  
Toronto ON M4P 1E4  
Téléphone: 416-481-1967  
Télécopieur: 416-440-7656  
Numéro sans frais: 1-888-632-6273



**BY E-MAIL**

August 20, 2008

**To: All Licensed Electricity Distributors  
All Intervenors in the 2008 Electricity Distribution Rate Proceedings**

**Re: Review Initiative: Account 1562, Deferred Payments in Lieu of Taxes  
("PILs") Board file number EB-2007-0820**

**Board staff discussion paper: Account 1562 – Deferred Payments in  
Lieu of Taxes, Methodology and Disposition of Balances for  
Electricity Distribution Companies affected by section 93 of the  
Electricity Act, 1998.**

Attached is the Ontario Energy Board staff discussion paper entitled, Account 1562 – Deferred Payments in Lieu of Taxes, Methodology and Disposition of Balances for Electricity Distribution Companies affected by section 93 of the Electricity Act, 1998.

This discussion paper is the next step in the EB-2007-0820 proceeding as announced on March 3, 2008. The paper is designed to assist parties in the EB-2007-0820 proceeding to resolve outstanding issues with respect to the disposition of balances in account 1562. The EB-2007-0820 proceeding is planned to begin in the fall of 2008.

A procedural document will be issued in the near future outlining the next steps in the EB-2007-0820 proceeding.

If you have any questions regarding this initiative, please contact Harold Thiessen, Senior Advisor, at 416-440-7637 or by e-mail at [harold.thiessen@oeb.gov.on.ca](mailto:harold.thiessen@oeb.gov.on.ca).

Yours truly,

*Original signed by*

Kirsten Walli  
Board Secretary

**Appendix D.1**  
**Hydro One Letter to OEB on Reconciliation of PILs for 2002**

July 31, 2003

Mr. Paul Pudge  
Board Secretary  
Ontario Energy Board  
Suite 2601, 2300 Yonge Street  
P. O. Box 2319  
Toronto, Ontario  
M4P 1E4

**Hydro One Networks Distribution Business - Reconciliation of PILs for 2002**

Dear Mr. Pudge:

Hydro One Networks Inc. (HONI) and Hydro One Network Services Inc. (HONSI) filed tax returns with the Ministry of Finance on June 27, 2003. Networks also filed its audited financial statements for the Distribution business on April 30, 2003, with the Board. In order to assist the Board in reviewing Networks payments of PILs in 2002, a reconciliation of the Distribution business PILs contained in the tax returns filed with the Ministry of Finance to the audited financial statements filed with the Board is attached as Schedule 1. In addition, we have completed the MoF column of the SIMPIL model, attached as Schedule 2, for the Distribution business. Schedule 3 provides a summary of the actual values per the tax returns filed for the total HONI and HONSI entities and the amounts associated with the Distribution business.

Hydro One Networks is not subject to section 93 PILs and has been paying PILs since 1999. Consequently, Networks has not used the Board's RAM model to include PILs in customer rates and has not used the TAXCALC, TAXREC or SIMPIL forms. However, to assist the Board, Networks has prepared the SIMPIL model to show the Ministry of Finance values attributed to the Distribution business. In 2002, HONI and HONSI were separate legal entities. The values shown as Networks business totals in the MoF column reflect the combined Distribution business of these two entities. HONI and HONSI have been combined into one entity in 2003.

The Distribution business effective tax rate of 32.00% on a tax return basis is lower than the effective tax rate per the audited 2002 Financial Statements of 45.63% and the effective tax rate of 44.49% included in Networks' 2001 rate application. The lower effective tax rate is primarily due to temporary differences, such as the RSVA variances, deducted for tax return purposes that will reverse in the future.



On February 25, 2002, Networks wrote to the Board to outline how its rate mitigation plan impacts the application of PILs for Networks. The mitigation plan reduces revenue levels in 2001, 2002 and 2003 to levels considerably lower than would result from adjustments for PILs to the Handbook revenue requirement level in those years so that no further adjustment to rates is required for Networks customers.

Yours truly,

Brian Gabel

Attach.

**Appendix D.2**  
**Hydro One Letter to OEB on Reconciliation of PILs for 2003**

**Hydro One Networks Inc.**

483 Bay Street  
South Tower, 10<sup>th</sup> Floor  
Toronto, ON, M5G 2P5  
ian.gabel@HydroOne.com  
[www.HydroOne.com](http://www.HydroOne.com)

Tel: (416) 345-5419  
Fax: (416) 345-5870  
Cell: (647) 294-0335



**Brian Gabel**

Vice-President and Chief Regulatory Officer

July 30, 2004

Mr. Peter O'Dell  
Acting Board Secretary  
Ontario Energy Board  
Suite 2601, 2300 Yonge Street  
P. O. Box 2319  
Toronto, Ontario M4P 1E4

**Hydro One Networks Distribution Business - Reconciliation of PILs for 2003**

Dear Mr. O'Dell:

Hydro One Networks Inc. (HONI) filed its tax returns with the Ministry of Finance on June 29, 2004. Networks also filed its audited financial statements for the Distribution business on April 30, 2004 with the Board. In order to assist the Board in reviewing Networks payments of PILs in 2003, a reconciliation of the Distribution business PILs contained in the tax returns filed with the Ministry of Finance to the audited financial statements filed with the Board is attached as Schedule 1. In addition, we have completed the MoF column of the SIMPIL model, attached as Schedule 2, for the Distribution business. Schedule 3 provides a summary of the actual values per the tax returns filed for HONI and the amounts associated with the Distribution business.

Hydro One Networks is not subject to section 93 PILs and has been paying PILs since 1999. Consequently, Networks has not used the Board's RAM model to include PILs in customer rates and has not used the TAXCALC, TAXREC or SIMPIL forms. However, to assist the Board, Networks has prepared the SIMPIL model to show the Ministry of Finance values attributed to the Distribution business.

The Distribution business effective tax rate of 50.3% on a tax return basis is higher than the effective tax rate per the audited 2003 Financial Statements of 46.5%. The higher effective tax rate is primarily due to temporary differences, such as the 2002 RSVA benefit being reflected in the 2003 F/S but not in the 2003 tax return. The elimination of the 2002 RSVA benefit was partially offset by the capitalized overhead deduction reflected in the tax returns filed.

On February 25, 2002, Networks wrote to the Board to outline how its rate mitigation plan impacts the application of PILs for Networks. The mitigation plan reduces revenue levels in 2001, 2002 and 2003 to levels considerably lower than would result from adjustments for PILs to the Handbook revenue requirement level in those years so that no further adjustment to rates is required for Networks customers.

Yours truly,

A handwritten signature in cursive script that reads "Brian P. Gabel".

Brian Gabel

Attach.

**Appendix D.3**  
**Hydro One Letter to OEB on Reconciliation of PILs for 2005**

**Hydro One Networks Inc.**

8<sup>th</sup> Floor, South Tower  
483 Bay Street  
Toronto, Ontario M5G 2P5  
www.HydroOne.com

Tel: (416) 345-5700  
Fax: (416) 345-5870  
Cell: (416) 258-9383  
Susan.E.Frank@HydroOne.com

**Susan Frank**

Vice President and Chief Regulatory Officer  
Regulatory Affairs



BY COURIER

August 11, 2006

Ms. Kirsten Walli  
Secretary  
Ontario Energy Board  
Suite 2700, 2300 Yonge Street  
P.O. Box 2319  
Toronto, ON.  
M4P 1E4

Dear Ms. Walli:

**Hydro One Networks Distribution Business – Reconciliation of PILs for 2005**

Hydro One Networks Inc. filed its tax returns with the Ministry of Finance (MoF) on April 28, 2006. Networks also filed its audited financial statements for the Distribution business on April 28, 2006 with the Board. We have completed the MoF column of the SIMPIL model for the Distribution business.

Hydro One Networks is not subject to Section 93 PILs and has been paying PILs since 1999. Consequently, Networks has not used the Board's RAM model to include PILs in customer rates and has not used the TAXCALC, TAXREC or SIMPIL forms. Hydro One has traditionally prepared the SIMPIL forms as a means of sharing with the Board the Ministry of Finance values attributed to the Distribution business. In light of the recent changes to the Distribution Rate Handbook, Hydro One anticipates that the current reporting requirements embodied in the SIMPIL forms will now cease and we do not expect to continue to file this information.

Sincerely,

A handwritten signature in dark ink, appearing to read "Susan Frank". The signature is fluid and cursive, with the first name "Susan" and last name "Frank" clearly distinguishable.

Susan Frank

**Appendix E.1**  
**Hydro One Letter to OEB on Recovery of PILs**  
**February 25, 2002**

Hydro One Networks Inc.  
483 Bay Street  
South Tower, 13th floor  
Toronto, Ontario M5G 2P5  
www.HydroOne.com

Tel: (416) 345 5419  
Fax: (416) 345 5870  
Cell: (416) 805-9619

**Brian Gabel**  
Vice President, Regulatory Affairs



February 25, 2002

Mr. Paul Pudge  
Secretary  
Ontario Energy Board  
Suite 2601, 2300 Yonge Street,  
P.O. Box 2319  
Toronto, ON.  
M4P 1E4

Dear Mr. Pudge:

**Re: RP-2000-0023 / EB-2001-0016 Hydro One Networks Inc. - Distribution Rates -  
Recovery of PILs**

---

The Ontario Energy Board has instructed utilities subject to section 93 of the Electricity Act on the method they were to employ for recovery of PILs in their rate applications by information circulated on December 21, 2001 (PILs guidelines). Networks understands from discussions with Board Staff that the Board expects Networks, who collects PILs in accordance with sections 89 and 90 of the Electricity Act, to follow similar procedures for PILs recovery.

Networks supports the concept of allowing distribution utilities to recover PILs through the revenue requirement to take into account the statutory tax rate, significant timing differences and the Federal Large Corporation Tax (LCT).

The purpose of this letter is to notify the Board of the impact of the PILs guidelines on Networks RP-2000-0023 proposed revenue requirement.

For tax purposes, Networks returns are filed and PILs payments are made on a legal entity basis. The distribution rate application filed with the Board on January 19, 2001 incorporates a 2001 corporate tax rate of 44.5% comprised of 41% for income tax and 3.5% for LCT.

Applying the PILs guidelines utilizing timing differences and the lower statutory rates for 2002 and 2003 results in a lower revenue requirement when it is calculated in accordance with the Electricity Distribution Rate Handbook (Handbook Revenue Requirement). When Networks applies the annual corporate tax rate reductions to the Handbook Revenue Requirement, revenues are reduced by about \$1 million for 2001 (due to an updated lower provincial tax rate effective on October 1), \$11 million for 2002 and \$20



Mr. Paul Pudge

- 2 -

February 25, 2002

million for 2003. Application of timing differences, which are primarily the result of changes in Capital Cost Allowance and deferral accounts, results in the Handbook Revenue Requirement being increased by \$8 million for 2001, reduced by \$9 million for 2002 and increased \$3 million in 2003. The total combined impact of these changes would result in an increase in Handbook Revenue Requirement of \$7 million in 2001, a reduction of \$20 million in 2002 and a reduction by \$17 million in 2003. However, as the RP-2000-0023 Application is based on Networks' Rate Mitigation Plan, the distribution revenues being requested are well below the PILs guidelines adjusted Handbook Revenue Requirements (see attached Schedule A). For this reason the mitigated distribution revenue being requested remains the same. A reduction to our proposed distribution revenue for the above tax considerations would not be appropriate.

If you wish to discuss this matter further, please call Anne Powell 416 345-5925.

Yours truly,



Brian Gabel  
Vice-President  
Regulatory Affairs

Attachment

cc: All Intervenors

# Hydro One Networks Distribution Application (RP-2000-0023)

| (M\$)                                                                               | October 2001 | March 2002 | March 2003 |
|-------------------------------------------------------------------------------------|--------------|------------|------------|
| Revenue Requirement<br>Derived for Rate Handbook<br>(Without Mitigation)            | 762.2        | 762.2      | 762.2      |
| Mitigation Plan - Proposed<br>Distribution Revenues                                 | 593.7        | 641.7      | 690.0      |
| Mitigation Amount<br>(annualized)                                                   | -168.5       | -120.5     | -72.2      |
| Mitigation Amount Restated<br>on Annual Basis                                       | -42.1        | -128.5     | -80.3      |
| Impact of Tax Rate and<br>Timing Changes on Rate<br>Handbook Revenue<br>Requirement | +7           | -20        | -17        |

**Appendix E.2**  
**RP-2000-0023 Decision with Reasons**  
**(Section 7.1 and Appendix 1, Issue 1.0)**

**7. IMPLEMENTATION AND COST AWARDS**

**7.1 IMPLEMENTATION**

7.1.1 This Decision dealt with the contested issues not agreed to in the attached Settlement Proposal. In the Board's view, its findings on the contested issues do not negate the settlement on the non-contested issues. The Board therefore accepts the rate consequences flowing from the Settlement Proposal. The Board also approves as final all rates previously approved on an interim basis.

7.1.2 The Board directs the Applicant to file a draft order with the Board, with dispatch, which shall reflect the Board's findings in this Decision. The draft order shall:

- include the appropriate rate schedules and deferral accounts;
- incorporate an effective date of May 1, 2002, which is the date that subsection 26(1) of the *Electricity Act* came into effect;
- reflect an implementation date for the new rates as soon as practical;
- list interim rate approvals that will be final as a result of this Decision.

## APPENDIX 1

### The Settlement Proposal

RP-2000-0023  
EB-2001-0016

## **1.0 PROPOSED DISTRIBUTION REVENUE REQUIREMENT (Settled)**

- **REASONABLENESS OF 1999 REVENUE REQUIREMENT FOR SETTING UNBUNDLED RATES AND COMPARABILITY WITH OEB RATE ORDER (RP-1998-0001) (Settled)**

### **The Applicant's Proposal**

Hydro One Networks Inc (Networks) has requested approval of rates to apply in the initial PBR period as specified in the Electricity Distribution Rate Handbook.

Networks would have a \$814.5 million revenue requirement based on its 1999 costs including its market-based rate of return and payments in lieu of taxes. Networks has proposed to recover this revenue requirement through a combination of retail rates, miscellaneous charges and LV charges.

The Networks' proposal is that the revenue requirement applicable to retail rates is \$762.2 million. As a consequence of Regulation changes Networks' cost of power has increased from 4.97¢/kWh in 1999 to 6.82¢/kWh effective October 1, 2001. When the full increase in the cost of power to 6.82¢/kWh is taken into account the increase in the retail customer bill effective October 1, 2001 would be 22%, compared to the Handbook's distribution revenue requirement for 1999.

Networks proposes to mitigate the increase in the average retail customer's bill by limiting the proposed increase to 4% on October 1, 2001, and 2.8% on each of March 1, 2002 and 2003. In order to effect this mitigated level of increase, the revenue requirement for purposes of setting the retail rates has been reduced from \$762.2 million to \$593.7 million for October 1, 2001, \$641.7 million as of March 1, 2002 and \$690 million as of March 1, 2003. Exhibit D, Tab 1, Schedule 1, provides a more complete explanation of the bill impact mitigation plan.

The total combined impact of incorporating the timing differences set out in the Board's Guidelines and application of the annual corporate tax rate would result in an increase in Handbook Revenue Requirement of \$7 million in 2001. There would be a reduction of \$20 million in 2002 and a reduction of \$17 million in 2003. However, as the Application is based on Networks' rate mitigation plan, the distribution revenues being requested are well below the PILs guidelines adjusted Handbook Revenue Requirements. Networks has already embarked on a cost reduction plan as set out in Exhibit A, Tab 2, Schedule 1 and Exhibit G, Tab 1, Schedule 5, to address the revenue shortfall during the transition period. Even with these measures in place, Networks will likely not recover the approved return on equity.

After considering the impact of Networks rate mitigation plan the aggregate charges to be collected by Networks from retail rates, miscellaneous charges and LV charges are \$646 million effective October 1, 2001, \$694.0 million effective March 1, 2002 and \$742.3 million effective March 1, 2003. In each of 2001, 2002 and 2003 LV rates are proposed

to recover revenues of \$38.6 million and miscellaneous charges are set to recover \$13.7 million.

In RP-1998-0001, the Board had approved distribution revenue requirements for OHSC (Networks' predecessor) retail rates of \$656.6 million for 1999 and \$602.8 million for 2000 respectively. These revenue requirements are both substantially lower than the revenue requirement for use in setting retail rates of \$762.2 million that Networks is requesting in this application. A full explanation of this difference is included in Exhibit G, Tab 1, Schedule 42. Among the more significant factors are the inclusion of Retail Customer Relations with the Distribution business, inclusion of contributed capital and the change to the allowed return on equity.

The evidence regarding the calculation of the \$814.5 million revenue requirement, and the retail rate revenue requirement of \$762.2 million can be found at Exhibit D, Tab 1, Schedule 3, page 1; Exhibit E, Tab 1, Schedule 1 and Exhibit G, Tab 1, Schedule 4, page 1. The evidence respecting the distribution revenues secured through 1999 rates of \$755 million can be found at Exhibit D, Tab 1, Supplementary Schedules 3 and 4 and Exhibit E, Tab 1, Schedule 1, pages 9 and 10.

### Agreement

All Parties agree or take no position respecting the aggregate revenue requirement of \$814.5 million proposed by the Applicant respecting 2001, 2002 and 2003.

All Parties agree or take no position regarding the aggregate of amounts proposed to be collected by Networks via miscellaneous charges, retail rates and LV rates in the amount of \$646 million, \$694.0 million and \$742.3 million in 2001, 2002 and 2003 respectively, subject to AMPCO's and the Power Budd Coalition's right to argue that the shareholder should bear some portion of the low voltage cost.

However, as indicated under "Line Loss Allocation" and under "Low Voltage Rates" some Parties have expressed concerns respecting the apportionment of aggregate revenues between LV rates as compared to other charges.

No Party expressed any concern regarding compatibility with the order in RP-1998-0001.

The Agreement of the Power Workers' Union to settlement of this issue is given in consideration of the Applicant filing with the Board prior to the hearing a statement setting out in more detail its plans concerning work which may be deferred as part of its rate mitigation plan. The statement will include information with respect to:

- (a) The nature and amount of work being deferred;
- (b) An estimate of when Networks anticipates that the deferred work will be completed;
- (c) An estimate of the units of work being deferred;
- (d) A description of Networks' plan with respect to how the catch up of deferred work will be funded, for example related to the incremental increase to the Revenue

Requirement; reallocation of resources within present level of Revenue Requirement, or other options.

The parties have agreed to defer further consideration of issues relating to affiliate transactions, non-utility eliminations and revenues from miscellaneous services [Exhibit E, Tab 4, Schedule 1] and external recoverable work [Exhibit C, Tab 2, Schedule 2, page 2 and Exhibit E, Tab 2, Schedule 1, page 6] in light of the following considerations:

1. Networks has proposed a rate mitigation adjustment whereby it is expected to under-recover relative to its derived revenue requirement in all years of the first generation distribution PBR plan. Such under-recovery produces a fiscal pressure to ensure that the charges for miscellaneous, non-utility and external recoverable work recover the full costs of the activities underlying these service offerings, thereby partially addressing cross-subsidy concerns.
2. Networks has also advised that costs have been allocated to the miscellaneous services [Exhibit E, Tab 4, Schedule 2] (save for those deterrent charges listed below under issue 4.0 and set to be comparable to fees charged by a number of other utilities) and to the external recoverable work on a "fully loaded" or "fully allocated" basis (including allocations of administrative and general overheads, taxes and return on equity).
3. Summary information regarding the costs underlying the miscellaneous services has been provided in Exhibit E, Tab 4, Schedule 2.
4. Given the imminence of market opening and the need to have unbundled distribution rates approved and in place, there is value to the public in having this proceeding disposed of as quickly as reasonably possible.
5. Networks anticipates a full cost of service review for both the distribution and transmission functions, to be filed in the spring of 2003 for review and approval of 2<sup>nd</sup> generation PBR rates to be in place for 2004.

In order to facilitate full review of issues relating to affiliate transactions, non-utility eliminations and revenues from miscellaneous services and external recoverable work, Networks has agreed at the request of ECAO that its filing for FYE 2004 rates will include evidence related to the following topics:

1. The corporate structure of the Hydro One group of companies.
2. The internal organization of Networks and its various lines of business, including transmission, distribution and any non-utility or contestable activities (including the miscellaneous services and external recoverable work referred to at the evidence cited above).



3. Any plans in respect of "separation" (from the utility company) or discontinuance (by the utility company) of any non-utility or contestable activities (including the miscellaneous services and external recoverable work referred to at the evidence cited above).
4. For any miscellaneous services and external and recoverable work activities proposed to be continued by the utility beyond FYE2003:
  - a. Responses to appropriate interrogatories requesting Networks' position in respect of retaining such activities in the utility in light of subsection 50(4) of the *Electricity Act, 1998* and Appendix D of the *Electricity Distribution Rate Handbook*.
  - b. Explanation of the methodology used for the allocation of costs to each of these activities, and provision of the cost allocations resulting.
  - c. Rate of return schedules for each such material activity.
5. A listing of transactions between Networks and its affiliates, which includes the following information:
  - a. A list of the affiliates to which the utility provides or from which the utility procures services, or with which the utility shares services.
  - b. A general description of the services provided, procured or shared.
  - c. A description of the methodology used to cost, set transfer prices for, or derive non-utility eliminations for any such services.

Networks further agrees to consider suggestions provided by interested parties in respect of the presentation and content of the evidence to address the matters listed above, in an effort to ensure a proper evidentiary basis for determination of these issues.

### Settlement

*Therefore, this issue is settled on the basis that no party will contest the amount of the revenue requirement set out above or seek to cross-examine upon it, except that AMPCO and the Power Budd Coalition have reserved the right to argue that the shareholder should bear some portion of the low voltage costs, and the agreement of the Power Workers' Union and ECAO is given in consideration of the undertakings of Networks set out above.*

*Networks, Power Budd Coalition, FOCA, Toronto Hydro Electric System, VECC, ECMI, AMPCO, BLG Coalition, PWU, and ECAO agree with the settlement of this issue, subject to the qualifications noted.*