October 7, 2014

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
27th Floor/ P.O. Box 2319
2300 Yonge St.
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: Z-Factor Application for Recovery of December 2013 Ice Storm Related Restoration Costs – Reply Submission
Halton Hills Hydro Inc.,
OEB Proceeding: EB-2014-0211

Halton Hills Hydro Inc. ("HHHI") hereby submits its Reply Submission in relation to HHHI's Z-Factor Application to the Ontario Energy Board ("the Board") for recovery of restoration costs related to the December 2013 Ice Storm.

The reply submission has been filed through RESS and two (2) copies have been couriered to the Board office. A copy of the reply submission has also been electronically mailed to the Board Secretary, Board Counsel, the Case Manager and all intervenors on file in proceeding EB-2014-0211.

In the event of any additional information, questions or concerns, please contact David Smelsky, Chief Financial Officer, at dsmelsky@haltonhillshydro.com or (519) 853-3700 extension 208, or Tracy Rehberg-Rawlingson, Regulatory Affairs Officer, at tracyr@haltonhillshydro.com or (519) 853-3700 extension 257.

Sincerely,

(Original Signed)

Arthur A. Skidmore, CPA, CMA
President & CEO

Cc: David J. Smelsky, CPA, CMA, CFO, HHHI
Interested Parties in proceeding EB-2014-0211
Richard King, Counsel, HHHI

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ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, being Schedule B to the *Energy Competition Act, 1998*, S.O. 1998, c.15 (as amended);

AND IN THE MATTER OF an Application by Halton Hills Hydro Inc. to the Ontario Energy Board for an Order or Orders approving the recovery of amounts related to the restoration of electricity service in the Town of Halton Hills due to the December 2013 Southern and Eastern Ontario Ice Storm (the "2013 Ice Storm", to be effective November 1, 2014 for 24 months.

Reply Submission of Halton Hills Hydro Inc. ("HHHI")

HHHI submits that all of its unforeseen costs incurred in responding to the 2013 Ice Storm meet the Board's eligibility criteria for Z-Factor treatment:

- Causation: All costs being claimed in this proceeding are directly related to the 2013 Ice Storm, and are clearly outside the base upon which rates were derived.

- Materiality: The amount claimed by HHHI is more than 30 times the Board's materiality threshold for HHHI ($50,000).

- Prudence: Despite very difficult conditions, HHHI management made appropriate and sound decisions to incur each of the costs being claimed.

The submissions of intervenors and Board Staff do not challenge any of HHHI's cost claims as lacking for causation, materiality or prudence in any significant manner. Rather, the bulk of the submissions request clarification of certain items, or address matters of cost allocation and recovery.

HHHI has organized its reply submission to respond to the issues raised in each of the submissions by VECC, Energy Probe and Board Staff (in that order).

Reply to VECC

(a) Reconciliation of Restoration Costs

VECC asked HHHI to reconcile the restoration costs shown in:

- Table 3 (page 10 of HHHI's application) = $1,542,229
- Tables IRR1, IRR3 and IRR4 (response to Board Staff) = $1,264,179
- "Cost of the Storm" slide (Appendix C of HHHI's application) = $1,500,000

The amounts shown in the first two bullets are reconciled in the following table:

TABLE 3 (page 10 of Application)		*Response to Interrogatories*						
HHHI-Internal Labour					Table IRR 3 contained a Spreadsheet Addition Error	Reallocate Hydro One costs for presentation purposes	Other Charges - Adam's Rent-all	**Correct Presentation**
Overtime	**$ 245,341**	Table IRR 1	Internal Labour Costs (Overtime)	$ 245,341				**$ 245,341**
Tree Trimming and Contractors	**$ 868,937**	Table IRR 3	External Contractor Detailed Costs	$ 497,102	$ 225,578	$ 143,467	$ 2,790	**$ 868,937**
Utilities	**$ 378,269**	Table IRR 4	Assisting LDCs (11) Detailed Cost	$ 521,736		(143,467)		**$ 378,269**
	$ 1,492,547			$ 1,264,179	$ 225,578	$ -	$ 2,790	**$ 1,492,547**
Other External Costs								
Accommodations	**$ 19,371**							**$ 19,371**
Communication Costs	**$ 15,253**							**$ 15,253**
Fuel	**$ 9,298**							**$ 9,298**
Meals	**$ 5,760**							**$ 5,760**
	$ 49,682							**$ 49,682**
	$ 1,542,229							**$ 1,542,229**

With respect to the amount shown on the "Cost of the Storm" slide (Appendix C of HHHI's application), this was a relatively early estimate of HHHI's restoration costs. It is important to note the date of this PowerPoint presentation was January 27, 2014. At that time, not all of the restoration costs were finalized. The rounded amount of $1,500,000 was prepared by HHHI Management based on actual costs invoiced as at January 27, 2014, plus an estimation of costs and accruals yet to be finalized.

This slide provides little value in terms of calculating HHHI's true costs. However, HHHI believes that this fairly accurate early estimate demonstrates that HHHI's management was acutely aware of, and truly on top of managing, the cost implications of the restoration work.

(b) Inclusion of Management Overtime

VECC argues that HHHI management overtime should be disallowed on the basis that without a written policy on the payment of overtime to non-union employees, ratepayers should not be expected to pay for management overtime, particularly when HHHI does not pay management overtime during normal course of business. Energy Probe makes the same argument.

HHHI does not believe that how HHHI compensates management during "normal course of business" has any relevance to the decision taken to pay management during the extraordinary circumstances in the 2013 Ice Storm. This event was not "normal course of business". This was an extraordinary weather related emergency that required extraordinary efforts from all HHHI's staff,

including the Management Team. Management played key roles in co-ordinating the restoration efforts, communicating with the media, as well as informing customers via social media and direct customer contact. Given that management staff cancelled holidays, worked extended hours and worked on statutory holidays over the Christmas and New Year period, all the while being away from their families, it is strongly believed that paying management personnel overtime was morally and ethically the right thing to do. HHHI thinks the customers would agree, and believe they are better served in the long run by having a Management Team that is recognized for its hard work and loyalty. Finally, it is important to note the President & CEO was not paid any overtime.

Reply to Energy Probe

HHHI notes that Energy Probe also argued that management overtime in the amount of $70,973 should be disallowed. HHHI's reply is as set out above (to VECC) will not repeat it here.

(a) Allocation of Recovery Costs

Energy Probe has suggested that restoration costs among the rate classes in the same proportion as the costs included in Uniform System of Accounts ("USofA") 5120 (Maintenance of Poles, Towers and Fixtures) and 5135 (Overhead Distribution Lines and Feeders – Right of Way), and not on the basis of distribution revenue by rate class.

HHHI believes that the Board's practice of allocating such costs on the basis of distribution revenue (*Combined Proceeding on Storm Damage Cost Claims*: EB-2007-0514/0595/0571/0551; and *Niagara-on-the-Lake Z-Factor Claim*: EB-2011-0186) remains appropriate.

(b) Recovery

Energy Probe argues that a fixed rate rider based on current customer numbers will result in an over-collection of funds (particularly from residential customers), as it is expected that HHHI will have a greater number of customers at the conclusion of the 24 month recovery period.

HHHI agrees with Board Staff that the magnitude of the potential benefit of over-collection ($19,000, which is below the materiality threshold) may be outweighed by the administrative burden involved in tracking the collection of restoration costs on a rate class-by-rate class basis.

Reply to Board Staff

(a) Emergency Maintenance Costs

Board Staff asked HHHI to clarify its "approved Emergency Maintenance budget amount", with reference to HHHI's 2012 Cost of Service proceeding. As Board Staff knows, the OEB approves an OM&A amount for the purposes of rate-setting using an "envelope approach". A specific, annual Emergency Maintenance cost was not approved by the Board. Working within that envelope, HHHI budgeted for the following amounts for Emergency Maintenance (shown together with actual costs incurred):

Year	Budget	Actual
2010	$112,000	$116,165
2011	$120,000	$125,070
2012	$120,000	$123,766
2013	$122,000	$168,911 (excluding 2013 Ice Storm)

Board Staff is correct in that the $123,766 is an actual amount (for 2012) rather than a budgeted amount. In 2013, HHHI has explained that the $168,911 was incurred by HHHI before the 2013 Ice Storm. Thus, the entire restoration costs claimed by HHHI for the 2013 Ice Storm is beyond the budgeted amount, and certainly beyond the amount embedded in distribution rates.

(b) Reconciliation of Restoration Costs

Board Staff asked for clarification of the discrepancy between:

- Table 3 (page 10 of HHHI's Application)
- Tables IRR3 (Detailed External Contractor Costs) and IRR4 (Detailed Costs-Assisting LDCs).

This is similar to the clarification requested by VECC. Please refer to the reconciliation table on page 2 of this Reply Submission (Reply to VECC – (a) Reconciliation of Restoration Costs).

Board Staff has also requested completion of reconciliation between the total amount requested in the application of $1,561,372 and the audited balance of USofA 1572 of $1,712,395 (as at December 31, 2013). The audited amount of $1,712,395 was based on actual costs received to date, plus accruals and accounting estimates. In the opinion of HHHI's auditors, USofA 1572 (as at December 31, 2013) was a fair presentation of those costs and estimates (based on Management's measurement methods and assumptions). The actual costs (of $1,561,372) would be finalized later.

(c) Cost Recovery Options

On pages 6 and 7 of its submission, Board Staff seeks clarification about the factors leading to the one-time tax recovery in 2013, and the future implications of the recovery in future years. Board Staff states that it is exploring this issue to consider whether there are "alternatives to recovering the cost of the storm damage from ratepayers." This section explains the circumstances and consequences of the tax recovery. The issue of whether the 2013 tax recovery has any relevance or applicability to this proceeding is addressed by HHHI in the next section of this Reply Submission.

The one-time tax recovery to HHHI is tied to the implementation of Modified International Financial Reporting Standards ("MIFRS"), allowing HHHI to expense certain amounts that had been capitalized in previous years.

The following is a breakdown of the factors leading to the 2013 income tax recovery recorded in HHHI's financial statements for the year ended December 31, 2013 including the related future tax impact. The main factors leading to the recovery in 2013 are as follows:

1. Certain expenses totaling $2,164,901 that were capitalized for accounting but deducted for income tax purposes.

2. Refunds received in 2013 for amending prior year tax returns to deduct certain expenses for income tax purposes that had been previously capitalized.

The aforementioned adjustments resulted in accelerated current deductions and therefore a reduction of current income tax for the current and the prior amended years. The following is a brief summary of the adjustments.

2013 Timing Difference

In 2013, certain expenses were capitalized by HHHI for accounting purposes. In general, the costs related to overhead and pole replacement costs that were capitalized for accounting purposes. However, such costs were eligible to be deducted for income tax purposes in the year incurred. By deducting these outlays for tax purposes in the year incurred, HHHI is immediately recognizing the income tax reduction associated with these costs. Had such amounts been capitalized for income taxes, the income tax deduction would have been realized over the course of several years based on the applicable capital cost allowance rate ("CCA Rate").

The following chart highlights the impact expensing $2,164,901 of costs for income taxes as opposed to capitalizing such amounts, and claiming CCA at an assumed CCA Rate of 8%. As noted below, expensing an item for income tax results in an immediate reduction in income tax equal to the expense multiplied by the tax rate, whereas capitalizing the expense for tax purposes recognizes the reduction in income taxes of that expense over several years depending on the corresponding CCA Rate.

	Year 1	Year 2	Year 3	Year 4	Year 5	Beyond	Total
Expensed For Income Taxes							
Amount Deducted	2,164,901						2,164,901
Current Income Tax Reduction	335,560						335,560

	Year 1	Year 2	Year 3	Year 4	Year 5	Beyond	Total
Capitalized for Income Taxes							
Amount Deducted	86,596	166,264	152,963	140,726	129,468	1,488,884	2,164,901
Current Income Tax Reduction	13,422	25,771	23,709	21,813	20,068	230,777	335,560

It is important to note that deduction of the above costs for income tax purposes in the 2013 year represents a timing difference only, and that the total income tax reduction in both scenarios is equal ($335,560). In general, based on HHHI's treatment of the above items, income for tax purposes for 2014 and subsequent years will be increased because accounting amortization will be added back to

income with no tax deduction claimed for such amounts, as the costs were not capitalized for income tax purposes. If HHHI had capitalized these costs for tax purposes in 2013, the income tax reduction would be recognized in 2013 and in subsequent taxation years as CCA.

In general, the current and future tax expense (recovery) reported in the income statement will offset each other whether or not the costs were capitalized or expensed for income tax purposes. However, when applying Part 5 of Section 3465 of the Canadian Institute of Chartered Accountants ("CICA") Handbook, future income tax expense is not reflected in the income statement but rather as part of the regulatory accounts on the balance sheet on the basis that such tax would be reflected in the approved rates charged to customers in the future. As a result, a rate-regulated entity would report the current tax reduction while excluding the future tax impact (i.e., future tax expense) from the income statement.

Prior Year Amended Returns

In 2013, HHHI amended prior year returns to deduct certain pole replacement costs that had been previously capitalized for income tax purposes. However, these costs should be deducted in the year incurred for income tax purposes notwithstanding that they are capitalized for accounting purposes. As previously noted, by deducting these expenses for income tax purposes in the year in which they were incurred, HHHI immediately recognized the income tax reduction associated with these costs. In this regard, as a result of the amended income tax returns, HHHI reduced the appropriate tax depreciation class accordingly for each particular year.

An income tax recovery of $530,441 relating to refiling prior year income tax returns was included in current income tax reported in the 2013 income statement.

The current income tax recoveries recognized in 2013 as a result of accelerating expenses deducted for income tax purposes and from refiling its prior year income tax returns are in respect of timing differences and are not a permanent tax saving. The future tax expense related to the current recovery is not reported in the income statement. In general, income for tax purposes for 2014 and subsequent years will be increased since amortization for the amounts capitalized for accounting will be added back to income with no corresponding tax deduction as the costs were not capitalized for income tax purposes.

(d) Policy Considerations

On pages 7 to 9 of its submission, Board Staff submits that the presence of earnings in excess of what the Board has established as a fair return should be considered by the Board when evaluating whether HHHI ought to recover its full restoration costs. Specifically, Board Staff states that given the level of HHHI's "overearnings" due to the one-time tax recovery in 2013, it may be appropriate for the Board to amend HHHI's rate setting plan with respect to this Z-Factor claim. Board Staff further suggests that an appropriate modification might be to deny HHHI recovery of any restoration costs that would push HHHI's earnings over 300 basis points above the Board-approved ROE (which Board Staff estimates to be approximately $557,000).

Neither VECC nor Energy Probe makes this argument.

HHHI submits that Board Staff's suggestion would amount to retroactive rate-making, and is clearly beyond the Board's jurisdiction. HHHI's submission on this point is supported by two recent utility cases (attached as Appendices A and B) that have dealt with precisely the same situation, discussed immediately below:

Alberta Utilities Commission ("AUC") (Decision 2009-215): In 2007, ATCO Electric Ltd. ("ATCO") received tax refunds as a result of deductions for various costs for 2006, 2007 and 2008 (in the amount of $6 million). These costs were previously treated as capital additions for income tax purposes. In late 2007, ATCO became aware of the ability to deduct these items. Consumer groups intervened and argued that the $6 million be flowed through to customers (or that ATCO's rate base be reduced going forward, or ATCO's undepreciated capital cost balance be set at the pre-refund level so that taxable income would be lower going forward via an annual CCA deduction).

The AUC found that the rate-making principles of prospectivity, the prohibition against retroactivity, and the need for regulatory certainty all supported ATCO's retention of the tax refund. The AUC found that these fundamental principles would be undermined if the refunds were paid to customers.

The AUC also noted that issues arising from the difference in treatment of capital versus expense as between tax and regulatory accounts are not new. The AUC further commented on the difference between the tax regime (where there may be reassessments and retroactive changes) and the regulatory regime (where certainty is the guiding principle):

> "The [AUC] notes the conflicting incentives and imbalance that arise between shareholders and customers when customer rates are finalized but income tax reassessments and refunds may be requested and recieved by a utility outside of the test years. While the income tax legislation and its regulations allow for retroactive changes to be made in the calculation of income tax expense resulting in an income tax refund to the benefit of shareholders, the [AUC] must adhere to the principle against retroactive ratemaking, the prospectivity principle and the principle of regulatory certainty."

The AUC decision was not appealed or judicially reviewed. It was relied upon in a more recent judicial decision on the same point.

Northland Utilities et al. V. NWT Public Utilities Board (2010 NWTSC 92): This case dealt with an appeal of a decision by the NWT Public Utilities Board ("NWT PUB") to "flow through" tax refunds (for a prior rate year (2007)) to the utility's customers. The NWT PUB's had decided that the flowing through the tax refund from a prior year to the utility's customers did not amount to retroactive rate-making, for the following reason:

> "The Board considers the amount of Capital Cost Allowance (CCA) that is claimed as a deduction in one time period versus another, for tax purposes, is a timing issue. If more CCA is claimed in a past year, then less Un-depreciated Capital Costs pools would be available for use in future years resulting in a reduction in the CCA deductions in future years. Since CCA claims in a past year impact future year tax calculations, the Board considers any potential adjustments to future

> customer rates to reflect the carry over effects of past deductions to be not a retroactive adjustment of historical rates but rather a prospective adjustment to restore the integrity of prospective rate-making."

The NWT PUB also based its decision on the fact that the tax benefit was one-sided in favour of the utility, and not an "efficiency" gain. The NWT PUB felt that this resulted in harm to customers. The NWT Supreme Court disagreed.

The NWT Supreme Court overturned the NWT PUB decision, finding that the NWT PUB "in taking the refunds away from the utilities and passing them on to the customers, the [NWT PUB] is in effect restating the utilities' rate base and revenue requirement for that past year." The NWT Supreme Court cited with approval the AUC decision in ATCO (noted immediately above), and concluded that "[a]ny attempt to deal with the refunds received for 2007 within the context of the 2008-2010 rate application is, in my opinion tantamount to retroactive ratemaking."

HHHI submits that these two cases are directly applicable to the issues raised by Board Staff. In both cases above, the underlying jurisdiction of the AUC and NWT PUB is the same as that of this Board, to set or fix "just and reasonable rates". In the absence of specific legislative authority, a regulatory tribunal does not have the authority to retroactively change rates (*ATCO Gas & Pipelines v. Alberta (Energy & Utilities Board)*, [2006] 1 S.C.R. 140 at para.71).

The prohibition against retroactive rate-making (which was followed in the two cases above) has been incorporated into the Ontario Energy Board's own policy governing incentive rate-making for Ontario distributors (see section 3.2.10 of the Filing Requirements for Electricity Distribution Rate Applications, July 2014). This Board's own IR regime (which governs HHHI's rates) operates such that any earnings over or under the 300 basis point deadband can trigger a regulatory review, which in turn could result in a <u>prospective</u> modification to the utility's rate-setting plan. The Board's IR regime does not permit a clawback of any overearnings above the 300 point deadband. The reason is clear – because it cannot, based on the prohibition on retroactive ratemaking.

The tax recovery to HHHI is the result of following CRA *Interpretation Bulletin IT-128R: Capital Cost Allowance – Depreciable Property* to expense amounts capitalized under MIFRS requirements. These tax refunds relate to prior years 2010, 2011 and 2012. They cannot be used as the source of funds to pay ratepayers in 2014, 2015 and 2016 for an emergency event that occurred in 2013.

Further, Board Staff's suggestion sets a dangerous precedent: Do we want utilities, operating in emergency situations, to be wondering whether their costs might be disallowed because they had higher revenues than expected in previous years? Board Staff's argument would have to work both ways: Do we want utilities that have under-earned in past years to be able to bring forward proposals for increased earnings in future years? The principle of rate certainty is meant to preclude these types of issues being raised.

Finally, this Z-Factor claim has nothing to do with the tax recovery. Within the context of the Board's IRM regime, Z-Factor claims are deliberately "outside" a utility's IR plan. That is their very nature – they allow for the recovery of unanticipated costs for anomalous situations that were not

included in a utility's IR plan. They should be evaluated on their own, as an independent item, and not tied to unrelated issues. The tax recovery for HHHI's prior years is irrelevant to HHHI's Z-Factor claim, and it would be inappropriate for the Board to base its decision in this matter on any revenues from a previous tax recovery.

Draft Accounting Order

HHHI requests approval from the Board allowing the tracking of costs and recovery related to this Z-factor application in the USoA 1572 Extraordinary Event Costs – Ice Storm Z-Factor for true-up and future disposition of the residual balance in this account after the two-year recovery period expires.

Conclusion

For all of the reasons set out above, HHHI submits that it should be permitted to recover all of its costs incurred in responding to the 2013 Ice Storm. This is a textbook Z-Factor case:

- The entire amount being claimed ($1,561,372) is directly related to an incident beyond the control of HHHI, and something that HHHI could not have prepared for.
- The amounts spent restoring power following the 2013 Ice Storm were beyond the forecasted costs included in HHHI's rates.
- The costs of HHHI's efforts are material – exceeding the Board's threshold for materiality by 3000%.

The prudence of the expenditures cannot be questioned. The expenditures were made to restore power to customers over the holiday season. As the evidence demonstrates, every single customer of HHHI was without power at one point. All the expenditures incurred and decisions made by HHHI were for the benefit of the customers to restore power in a timely manner during very difficult circumstances.

Respectfully submitted,

(Original signed)

Arthur A. Skidmore, CPA, CMA
President & CEO
Halton Hills Hydro Inc.

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APPENDIX A

Alberta Utilities Commission ("AUC") (Decision 2009-215)

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Decision **2009-215**

AUC
Alberta Utilities Commission

ATCO Electric Ltd.

2009-2010 General Tariff Application – Regulatory Treatment of Income Tax Refund

November 12, 2009

ALBERTA UTILITIES COMMISSION
Decision 2009-215: ATCO Electric Ltd.
2009-2010 General Tariff Application – Regulatory Treatment of Income Tax Refund
Application No. 1578371
Proceeding ID. 86

November 12, 2009

Published by
Alberta Utilities Commission
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ALBERTA UTILITIES COMMISSION
Calgary, Alberta

ATCO ELECTRIC LTD.
2009-2010 GENERAL TARIFF APPLICATION –
REGULATORY TREATMENT OF INCOME TAX REFUND

Decision 2009-215
Application No. 1578371
Proceeding ID. 86

1 INTRODUCTION

1. The Alberta Utilities Commission (AUC or Commission) received Application No. 1578371, entered as Proceeding ID. 86, (Application) dated July 4, 2008 from ATCO Electric Ltd. (AE). The Application requested Commission approval of AE's 2009-2010 Transmission and Distribution General Tariff Application (GTA), and an order or orders to establish a Transmission Facility Owner Tariff and a Distribution Tariff. AE also requested approval to dispose of its 2007 Transmission and Distribution Deferral Accounts and Annual Filing for Adjustment Balances.

2. On July 2, 2009, the Commission issued Decision 2009-087[1] which dealt with the Application except for specific income tax deductions claimed by AE. In the Application, AE identified the following matters related to income tax: inclusion for the test years of three additional income tax deductions for easement costs, stock handling costs, and removal and abandonment costs; and the retention of the income tax refund related to these deductions for 2006, 2007 and 2008 in the amount of $6 million (Additional Deductions). On this issue, the Commission found that more information was required.

3. The Commission posed five questions related to the Additional Deductions and established the following process:[2]

Process Steps	Deadline Date & Time
Simultaneous Responses	July 31, 2009 - 4:00 pm
Simultaneous Reply Responses	August 14, 2009 - 4:00 pm

4. Parties who participated in this additional process are listed in Appendix 1 to this Decision. Simultaneous responses and reply responses were received from interested parties on July 31, 2009 and August 14, 2009, respectively. The Commission considers the record for this additional process closed on August 14, 2009.

5. In reaching the determinations contained within this Decision, the Commission has considered all relevant materials comprising the full record of this proceeding. Accordingly, references in this Decision to specific parts of the record are intended to assist the reader in understanding the Commission's reasoning relating to a particular matter and should not be taken

[1] Decision 2009-087 - ATCO Electric Ltd. 2009-2010 General Tariff Application - Phase I (Application No. 1578371) (Released: July 2, 2009).
[2] Decision 2009-087, page 60.

as an indication that the Commission did not consider all relevant portions of the record with respect to that matter.

2 BACKGROUND

6. The following is a brief summary of the information from the record prior to the establishment of the additional process by the Commission.

7. AE began using the flow-through method for calculating both federal and provincial income taxes in 2007. In its determination of taxable income for the test years AE included deductions for easement costs, stock handling costs, and removal and abandonment costs.[3] These costs were previously treated as capital additions for income tax purposes.

8. AE had earlier applied to and received from the Canada Revenue Agency (CRA) an income tax refund for a combined total of $6 million for the Transmission and Distribution business units in relation to the Additional Deductions claimed for 2006, 2007 and 2008. This refund was recorded as a benefit to AE shareholders outside the test years.

9. With regard to the timing of this action, AE, in its evidence submitted the following:

> ATCO Electric was not aware of these additional tax deductions prior to filing its 2005-2006 and 2007-2008 GTA Applications. Once these additional tax deductions were identified, ATCO Electric acted appropriately by including these deductions in its next GTA Application (2009-2010 GTA).
>
> ATCO Electric only became aware of the possibility of deducting stock handling costs when ATCO Gas received a ruling on its special audit request in late 2007.
>
> ATCO Electric only became aware of the additional tax deduction for right-of-way costs in late 2007, based on advice provided by ATCO's Tax Department.
>
> ATCO Electric only became aware of the possibility of deducting Removal and Abandonment costs from FortisAlberta's 2008-2009 Phase I GTA filed June 1, 2007. This application was filed subsequent to ATCO Electric filing its 2007-2008 GTA application.
>
> For potential tax deductions (Removal and Abandonment/Capital Repair Costs), where formal approval from CRA had not been received prior to the filing of its GTA Application, ATCO Electric included these deductions (with a deferral mechanism), thereby giving customers the benefit of all deductions that ATCO Electric was pursuing that are relevant to ATCO Electric's situation.[4]

[3] Information Response CG-AE-18(c), page 3. Easement costs include such items as clearing of vegetation for right of way enlargement, overgrowth removal to adhere to right of way standards, maintenance to reduce wild fire damage, and realignment of overhead lines or their replacement with underground lines. Stock handling costs include those related to the procurement, handling and warehousing of inventory. Removal and abandonment costs, also referred to as dismantling or disposal costs, represent the costs to demolish or dismantle an asset that has reached the end of its useful life.

[4] AE Rebuttal Evidence, pages 60 and 61.

10. The Utilities Consumer Advocate (UCA) objected to AE's change in treatment for the Additional Deductions outside of a test period. Previously these indirect costs were capitalized and formed part of the undepreciated capital cost (UCC) which was then available to lower taxable income over a period of years through a yearly capital cost allowance (CCA) deduction. In order to receive the $6 million refund, the UCC balances were reduced by the amount of the Additional Deductions for 2006, 2007, and 2008, which reduced CCA on a going forward basis. The UCA stated that while these Additional Deductions claimed by AE generated a $6 million income tax refund for the benefit of shareholders, customers had lost the future benefit of CCA deductions totaling $19.2 million.[5]

11. The UCA stated that claiming the Additional Deductions was not a productivity gain or a cost saving initiative to which the regulatory principle of prospectivity should apply. Instead, the UCA requested that the UCC income tax deduction balances be reinstated on a regulatory basis back to their level prior to the Additional Deductions being claimed by AE, for use with future rates.

12. Consumer Group's (CG) position on the Additional Deductions was similar to that of the UCA however it recommended that either the income tax refund flow to customers or that the Commission deem the UCC balance as at January 1, 2009, for regulatory purposes, be restored to the level prior to AE's refiling for the $6 million income tax refund. Had the change in income tax treatment been implemented beginning with 2009, customers would have received the full benefit in the test years and beyond related to the Additional Deductions.

13. AE submitted that the benefits from the Additional Deductions belonged to shareholders in the short term and to the customers in the long term. AE estimated that the long term benefits available to customers as a result of the methodology change for the years 2009 through 2029 were $5.5 million for transmission and $16.4 million for distribution.[6] AE reiterated that its forecasts were prepared using the best available information at the time, and when it became aware of the Additional Deductions it took the necessary steps to obtain them. AE commented that it has been the ATCO Utilities' practice to record both positive and negative income tax adjustments received in a finalized test period to the account of shareholders.

14. AE argued that due to the regulatory principle against retroactive ratemaking, the Commission was prohibited from adjusting a utility's prior years revenue requirements once final rates had been determined, unless deferral account treatment had been approved to capture these amounts. AE submitted that this applied to both the direct refund proposal by CG and the indirect refund through restatement of the opening UCC balances as proposed by the UCA and CG.

15. The Commission, in Decision 2009-087 stated:

> 295. The Commission has reviewed the record of this proceeding and has concluded it requires more information to determine the proper regulatory treatment, for the test years, of the following income tax deductions claimed by AE: easement costs, stock handling costs, and removal and abandonment costs.

[5] UCA Evidence, page 56.
[6] AE Rebuttal Evidence, pages 62-63.

296. The Commission acknowledges that in their submissions with respect to the tax refund of $6 million being recorded as a benefit to AE shareholders and restoration of the UCC pools, parties addressed the principle against retroactive ratemaking, the principle of prospectivity, the principle of regulatory certainty and the "no-harm" principle. However, none of the parties provided evidence as to whether, if AE was allowed to keep the refund, these Additional Deductions should have any effect on the amounts included in the determination of AE's rate base for the test years. In particular, the Commission seeks the parties' views on the following matters:

1. Should opening rate base balances for the test years be reduced to reflect the expensing of the Additional Deductions which were previously capitalized for income tax purposes? And if so, by what amount?

2. If opening rate base balances are adjusted should AE be permitted to adjust its operating expense in the test years? And in prior years?

3. If opening balances remain unadjusted for the test years, will customers pay higher rates than would have otherwise been required?

4. Since $19.2 million of UCC is no longer available for use to reduce income tax expense for customers, should AE continue to earn a return on these items which remain in rate base as capital? Please support your answer with references to legal and regulatory principles.

5. Are there any changes other than the reduction of rate base opening balances that should be considered? [7]

16. Further, the Commission directed AE to separately identify and treat all amounts related to the Additional Deductions, which were included in the 2009 Plant and Other Assets Opening Balances, as placeholders and to reflect this in its compliance filing.

3 SUMMARY OF VIEWS ARISING FROM INCOME TAX QUESTIONS

17. The views of parties in response to the Commission's five questions are summarized below.

Question 1. Should opening rate base balances for the test years be reduced to reflect the expensing of the Additional Deductions which were previously capitalized for income tax purposes? And if so, by what amount?

18. AltaLink Management Ltd. (AML) submitted that the Additional Deductions related to the income tax cost base and the UCC balance, and not to the rate base. AML stated rate base was related to the recovery of costs.

[7] Decision 2009-087, pages 60 and 61.

19. CG stated that any adjustment to the regulatory treatment should be approached with caution as depreciation, return and income tax impacts would also need to be considered. Further, CG commented that there was no evidence which showed that costs related to the Additional Deductions were imprudently incurred.

20. The UCA preferred the reinstatement of the UCC balances, but alternatively supported a regulatory adjustment to the opening rate base based on the after tax difference to the UCC balance caused by the Additional Deductions, with possible consideration being given to the time value of money impact. The UCA argued these adjustments were not retroactive ratemaking as only current and future rates would be affected, and that the Commission had wide discretion for determining just and reasonable rates.

21. AE argued that no adjustment was needed as there was no indication that asset values required for providing utility service should be reduced, and that any adjustment to opening rate base would confiscate utility asset value by transferring the income tax refunds to customers by lowering future rates. AE submitted that section 122 (1) of the *Electric Utilities Act* allowed the electric utility to recover costs and expenses associated with capital and reducing rate base for the income tax refunds had nothing to do with whether the assets were used or required to be used. AE stated that certain costs, such as ES&G and capital repairs, were subject to different capital versus expense treatment for income tax and regulatory accounting purposes, and that this was consistent with utility regulation practice. Also, financial statements already stated that costs had been appropriately charged to accumulated depreciation (removal and abandonment costs) and to capital (for stock handling and easement costs). AE stated that the principles of retroactive ratemaking, prospectivity, regulatory certainty, and doing indirectly that which cannot be done directly, did not allow adjustment to the opening rate base balances for the test years.

Question 2. If opening rate base balances are adjusted should AE be permitted to adjust its operating expense in the test years? And in prior years?

22. CG submitted that the Additional Deductions should not be recovered as part of operating expenses either in the test year or prior period revenue requirement as this would involve changing AE's capitalization policy. CG stated that this type of recovery would also need to adjust the return, depreciation and income taxes associated with those amounts. Further, no operating expense adjustment was necessary as the assets associated with the Additional Deductions still existed and were used to provide utility service even though AE confiscated the UCC for income tax purposes.

23. The UCA submitted that the utility should be allowed to recover the amount of the write-off, but only in future test periods. The UCA stated that since income tax deductions for these adjustments have already been taken, any operating expense adjustment would need to take this into consideration.

24. AE proposed to collect any adjustment amount in its next annual filing for adjustments and deferral account application. AE proposed to record the adjustment as depreciation and amortization and not as operating expense, with no restatement to prior year financial results being made.

Question 3. If opening balances remain unadjusted for the test years, will customers pay higher rates than would have otherwise been required?

25. AML argued that the opening balance of rate base should not be affected by the Additional Deductions as it related solely to UCC and not to the capital costs included in rate base.

26. Both CG and the UCA argued that customers will pay more as the CCA deductions, which previously offset the depreciation add-back for calculating income tax expense, have been lost to customers. CG commented that the assets remained in rate base and were part of depreciation even though they were written off when calculating income taxes.

27. AE argued that customers benefited in the long term due to the Additional Deductions.

Question 4. Since $19.2 million for AE of UCC is no longer available for use to reduce income tax expense for customers, should AE continue to earn a return on these items which remain in rate base as capital? Please support your answer with references to legal and regulatory principles.

28. AML submitted that section 122 of the *Electric Utilities Act* allowed a return on investment costs included in rate base, and that AE has not recovered its investment in this case.

29. CG stated that if the assets are used and required for providing services to customers and were prudently incurred, then the utility is entitled to earn a reasonable return on its investment.

30. The UCA commented that this would depend on whether these costs were for used and useful utility assets or whether they were operating costs. For AE to get the income tax ruling, it had to demonstrate these costs were not capital under the income tax rules, but this was in conflict with AE's capitalization policy which required a use of more than one year. The UCA expressed concern that AE recovered the income tax balance benefit twice; once in the income tax re-filings and a second time in rates.

31. AE argued it should continue to earn a return on the capital invested to provide utility services as the assets were prudently incurred. The rate base included other items, no different than the Additional Deductions, such as capital repair costs and ES&G which have been deducted for income tax purposes but continued to be part of AE's regulatory rate base.

Question 5. Are there any changes other than the reduction of rate base opening balances that should be considered?

32. CG recommended as an alternative approach that the Commission direct a reduction to the depreciation add-back in the calculation of income tax expense by the amount of foregone CCA. CG also submitted that a simpler alternative would be to increase the amount of the no-cost capital by the amount of the income tax refund received by AE. Customers would receive a credit equal to the weighted average cost of capital. CG argued that an opening rate base adjustment for Additional Deductions should not be treated as a current year depreciation and amortization adjustment as proposed by AE, with it being collected from customers in the next

adjustment deferral account application. Instead of recovering the adjustment over the lives of the assets for this one year adjustment, CG recommended that the Commission deem the amount to be a prior year adjustment.

33. The UCA stated that AE should be required to submit all substantive changes like the Additional Deductions for approval within the context of a GTA. The UCA also recommended the review of AE's capitalization policy in a future GTA.

34. AE disagreed with the UCA regarding the need for approval of all substantive changes stating it would result in inefficient management of income tax issues.

4 COMMISSION FINDINGS

Legal Principles

35. AE provided an undertaking responding to questions that were raised as follow up to (Decision 2008-113)[8] (ATCO Gas' 2008-2009 GRA).[9]

36. One of the questions posed by the Commission in Decision 2008-113 (Question 8 at page 102 of Decision 2008-113) was as follows:

> Is the Commission limited in the range of options available to it by application of legal principles dealing with retrospectively or retroactive ratemaking, or any other legal principles? If so, please describe the limitations with reference to applicable case law and how the case law supports the position being taken.

37. In response to this question, AE identified the following legal principles as applicable to the issue: (a) the principle against retroactive ratemaking; (b) the principle of prospectivity; and (c) the principle of regulatory certainty.

38. The Commission has reviewed the legal principles identified by AE and has considered the application of these principles in the context of its determination of what treatment should be applied to the $6 million income tax refund, including whether it should be returned to customers, whether the Commission should adjust the UCC balance or whether there should be an adjustment to the opening rate base balance for the test years if AE is permitted to keep the refund.

Principle Against Retroactive Ratemaking

39. The principle against retroactive ratemaking has been canvassed by the courts in a number of decisions.

[8] Decision 2008-113 - ATCO Gas - 2008-2009 General Rate Application Phase I (Application No. 1553052) (Proceeding ID. 11) (Released: November 13, 2008).
[9] Exhibit 224.

40. In the Supreme Court of Canada decision of *Northwestern Utilities Limited and P.U.B. v. City of Edmonton*, [1979] 1 S.C.R. 684 ("Northwestern"), the issue centered on whether future rates could recover past revenue losses. On the basis of the rule against retroactivity, the Court stated that future rates could not be used to recover accumulated losses in the past:

> ... It is conceded of course that the Act does not prevent the Board from taking into account past experience in order to forecast more accurately future revenues and expenses of a utility. It is quite a different thing to design a future rate to recover for the utility a "loss" incurred or a revenue deficiency suffered in a period preceding the date of a current application. A crystallized or capitalized loss is, in any case, to be excluded from inclusion in the rate base and therefore may not be reflected in rates to be established for future periods."[10]

41. Similarly, the Supreme Court of Canada in *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, 2006 SCC 4 ("Stores Block") commented on the issue of retroactive ratemaking as follows:

> [71]There is no power granted in the various statutes for the Board to execute such a refund in respect of an erroneous perception of past-overcompensation. It is well established throughout the various provinces that utilities boards do not have the authority to retroactively change rates.[11]

42. More recently, the Board in Decision 2008-023[12] stated:

> [If] [Westridge] did not have a labour capitalization policy in 2004/2005, it was collecting 100% of its Board-approved labour costs from customers in its operating revenue requirement. To allow [Westridge] to capitalize some of those costs in 2005/2006 would require a corresponding adjustment to the labour costs approved by the Board in Decision 2005-028[13] for the 2004/2005 period. To do so would require the Board to engage in retroactive ratemaking and, for that reason, the Board does not approve these capitalized amounts attributed to 2004/2005 in [Westridge's] 2005/2006 rate base.[14]

43. The Commission considers itself to be bound by the principle against retroactive ratemaking as outlined above.

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[10] Decision 2004-066, page 699.
[11] *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, 2006 SCC 4 ("Stores Block") paragraph 71.
[12] Decision 2008-023 - (Erratum): Westridge Utilities Inc. - General Rate Application (Application No. 1462020) (Released - May 8, 2008).
[13] Decision 2005-028: Westridge Utilities Inc. General Rate Application (Application No. 1352216) (Released: April 19, 2005).
[14] Decision 2008-023, page 17.

Principle of Prospectivity

44. The principle of prospectivity has been addressed by the Commission in Section 2.2 of Decision 2009-087 in relation to the use of updated information in a prospective rate-setting environment. In addition to these findings, the Commission has also considered the following principle as explained by Canada Energy Law Services (Alta. Commentary):

> The Board's approach to utility regulation follows the principle of prospective ratemaking. Rates are established on the basis of information relating to or available at the test period and apply until such time as another rate decision is issued by the Board. The Board will not approve rates designed to recover revenue shortfalls in past years. Equally, utilities are entitled to profits which are in excess of earnings projected at the time of rate setting.[15]

45. Consistent with the principle of prospectivity and the principle against retroactive ratemaking, the Commission considers that it is incumbent on utility management to prepare forecasts using the best information available at the time. These forecasts are subject to updates during the evidentiary portion of the proceeding where material changes have occurred that impact the initial assumptions. However, once the evidentiary portion of the proceeding has closed, the Commission issues its decision based on the information before it.

46. CG has submitted that the principle of prospectivity and the principle against retroactive ratemaking, which enable a utility to realize productivity gains over the test years, cannot be applied in this situation because an income tax deduction is not a productivity gain. In support of this, CG cited Decision 2008-113, wherein the Commission held:

> The Commission acknowledges that AGPL pursued the tax deductions that resulted in the reassessment but cannot agree that a company availing itself of a permitted tax deduction that it qualified for in the past but had not pursued, are attributable to a productivity gain.[16]

47. The Commission in Decision 2008-113 arrived at its finding that there was no productivity gain in that circumstance because it found that AGPL had simply availed itself of an available income tax deduction.

48. It was AE's evidence that it was not aware that the Additional Deductions could be classified as period expenses for income tax purposes, thereby reducing taxable income and resulting income tax expense in its 2005-2006 and 2007-2008 GTA Applications. In those GTA Applications, AE stated its income tax forecast was based on the best information it had available to it at the time. The Commission has considered that AE is a large, sophisticated utility with access to centralized ATCO Tax group services, for which it is allocated costs, and that it would have a high level of awareness of developments and their related income tax applicability. In the absence of any evidence on the record of this proceeding to the contrary, the Commission accepts AE's evidence that it was not aware of these potential deductions. Further, the Commission notes that none of the interveners challenged AE's evidence on this point.

[15] Paragraphs 757 and 758, AE Argument, page 31.
[16] Decision 2008-113, page 101.

Principle of Regulatory Certainty

49. The principle of regulatory certainty recognizes that there is significant benefit and strong preference for certainty and stability in the regulatory process. For public policy reasons, companies should have the ability to operate in an environment that is predictable.

50. The Board in Decision 2004-035[17] acknowledged this principle when it stated that its decision was rendered to be in "keeping with its past practices and to promote regulatory consistency".[18]

51. The Commission agrees with its predecessor that it is important for the public, including utilities, to be able to rely on the finality of its decisions, subject to any appeal remedies that may be available.

Adjustment of Rate Base for Test Years

52. The income tax refund for the Additional Deductions related to prior years has resulted in a reduction of the UCC balances available to offset future taxable income and thus lower income tax expense. Consequently customers will pay a slightly higher amount of income tax expense through rates in future years, although as AE stated, customers will benefit in future years from the expensing of any future easement costs, stock handling costs, and removal and abandonment costs. In general terms, because of the separation of income tax and regulatory accounts, the deduction of these costs (which were previously capitalized for income tax purposes) did not result in a corresponding adjustment by AE to lower the rate base.

53. When considering a tariff application, the Commission must, pursuant to section 122 (1) of the *Electric Utilities Act*

> ...have regard for the principle that a tariff approved by it must provide the owner of an electric utility with a reasonable opportunity to recover
>
> (a) the costs and expenses associated with capital related to the owner's investment in the electric utility, ...
>
> if the costs and expenses are prudent and if, in the Commission's opinion, they provide an appropriate composition of debt and equity for the investment,

54. The Commission notes AE's position that no adjustment to the asset values required to provide utility service was needed and that any opening rate base adjustment would confiscate utility asset value by transferring the income tax refunds to customers by lowering future rates.

55. Given the absence of any supporting evidence on the record to demonstrate that these assets in rate base were either imprudently incurred or that their value has been impaired, the Commission finds no basis in evidence to support an adjustment to opening rate base if AE is permitted to keep the income tax refund.

[17] Decision 2004-035 - ANCL/ANCA and Fortis Alberta Share Transfer and Financing Applications (Application Nos. 1318425 and 1317233) (Released: April 29, 2004).
[18] Decision 2004-035, page 12.

Summary of Commission Findings

56. Regarding the positions of the UCA and CG that the income tax refund should be returned to customers, the Commission notes that customers' rates have been finalized for the years to which the refund relates based on the forecast amounts for income tax expense previously approved.

57. The Commission considers that it cannot direct that the $6 million refund be allocated to customers as it would offend the principle against retroactive ratemaking, would not support the principle of prospectivity and would undermine the principle of regulatory certainty.

58. Alternatively the UCA and CG recommended restoration of the UCC balances used for regulatory purposes. Other methods proposed included: reduction of the depreciation add-back in the calculation of income tax expense, or increasing the amount of no-cost capital by the amount of the income tax refund.

59. The Commission considers the alternative approaches put forward by the UCA and CG to be indirect means to facilitate the refund to customers and therefore they must be rejected by the Commission. The Commission cannot circumvent the principle against retroactive ratemaking, the prospectivity principle and the principle of regulatory certainty through an alternative technique/mechanism employed to reallocate the refund. The Commission considers that adjusting the UCC balances for regulatory purposes would be adjusting future rates (through higher CCA) for the sole purpose of recovering the relevant income tax deduction amounts for the customers benefit. Regarding the proposed reduction of the depreciation add-back in the calculation of income tax expense, the Commission considers this to be another means of adjusting future rates (through lower income tax expense) to indirectly recover the reduced CCA that was previously available as an income tax deduction. Finally, the Commission considers the proposed method of increasing the amount of no-cost capital by the amount of the income tax refund would retroactively change the cost components of the previously approved forecast revenue requirement and therefore offend the principle against retroactive ratemaking.

60. The UCA took the position that restating the UCC balances was necessary to address the harm that had resulted as a consequence of AE's action and that this was a matter of future, not retroactive, ratemaking. In support of its argument, the UCA identified the "no harm" test established by the Board. A description of this test can be found in Decision 2003-098.[19]

61. In response to this position, AE argued that there was no harm caused by this action and further, if there was, that the "no harm" test had limited application.

62. The Commission notes that AE follows the flow-through method for calculating income tax for the test years which leads to the lowest forecast amount of income tax based on existing laws or laws expected to be enacted. AE's calculation of long term benefits of $5.5 million in transmission and $16.4 million for distribution is premised on significant assumptions over the twenty year period, including the assumption that expenditures will remain at the forecast levels

[19] Decision 2003-098 - ATCO Electric Ltd., ATCO Gas North and ATCO Gas South, Both Operating Divisions of ATCO Gas and Pipelines Ltd. Transfer of Certain Retail Assets to Direct Energy Marketing Limited and Proposed Arrangements with Direct Energy Regulated Services to Perform Certain Regulated Retail Functions, (Application No. 1299855) (Released: December 4, 2003), page 4.

for the Additional Deductions. The Commission notes that both CG[20] and the UCA[21] argued that the long term benefit for customers calculated by AE would have been even higher had AE claimed the Additional Deductions beginning with the test years.

63. The Commission considers that ratepayers may have lost some benefit as a consequence of the action taken by AE to claim the Additional Deductions related to prior years for its shareholders. Notwithstanding, the Commission has also considered whether the "no harm" test applies in this case or could be used to circumvent the principle against retroactive ratemaking, the principle of prospectivity and the principle of regulatory certainty. The Commission considers that the application of the "no harm" test both by itself and its predecessor, the Board, has been limited to proceedings involving the disposition of a utility's asset outside of the normal course of business, share acquisitions and financings.[22] Based on the record of this proceeding, the Commission finds that if the "no harm" test was allowed a more broadly based application, the applicability of the "no harm" standard could effectively allow the regulator to rely on it as a mechanism to circumvent the principles of prospectivity and retroactive ratemaking. Further, as noted in paragraphs 9 and 48 above, there are no facts on the record that would support a conclusion that AE deliberately acted to take potential income tax deductions to cause a loss of income tax benefits to customers. In the result, the Commission has decided that it will not circumvent the principle against retroactive ratemaking, the prospectivity principle and the principle of regulatory certainty through the broad application of the "no harm" test.

64. For all of the above reasons, the Commission denies the UCA's and CG's requests that the income tax refund should be either directly or indirectly returned to customers. The Commission rescinds its direction from Decision 2009-087 which requires AE to treat the Additional Deductions as placeholder amounts with regards to the 2009 Plant and Other Assets Opening Balances.

Direction

65. The Commission notes the UCA position that all substantive changes like the Additional Deductions should be submitted for approval within the context of a GTA, and AE's response that the UCA proposal would result in inefficient management of income tax issues. The Commission also notes AE's Argument[23] on the use of a deferral account regarding the Additional Deductions:

> During questioning reference was made to another, unrelated deferral account from ATCO Electric's *2003/2004* GTA (Decision 2003-071).[24] In that decision, ATCO Electric was directed to propose a form of deferral account, with specific criteria, to capture certain additional tax savings relating to Rainbow capital repair costs. The AEUB considered it appropriate for ATCO Electric to set up the deferral account because there was a level of uncertainty associated with the utility's ability to take the deductions (4T550).

[20] CG Argument, page 34.
[21] UCA Reply Argument, page 16, paragraph 98.
[22] See for example Decision 2003-098, Decision 2005-112, Decision 2007-094, Decision 2008-079.
[23] AE Argument, page 24.
[24] Decision 2003-071 – ATCO Electric Ltd. - 2003-2004 General Tariff Application Rate Case Deferrals Application 2001 Deferral Application (Application Nos. 1275494, 1275539, 1275540) (Released: October 2, 2003).

66. As noted above, issues arising from the difference in treatment of capital versus expense between the income tax and regulatory accounts relating to certain costs, such as ES&G and capital repairs, are not new. As stated in Decision 2003-071:

> This issue arises because the recent *Rainbow Pipeline*[25] and *Canderel*[26] tax rulings of the Federal Court of Canada have arguably made it possible for companies to deduct, as current expenses, certain capital expenditures, including overhead costs that in the past would have been capitalized. [27]

67. AE's current Capital Repair Cost deferral account, referenced in AE's Argument, captures part of a broader category of costs which may be capitalized for accounting purposes but deducted as an expense for income tax purposes (referred to hereinafter as "Income Tax Deductible Capital Costs"). The *Rainbow Pipeline* and *Canderel* decisions addressed examples of costs that fall within this broader category. Since the flow-through income tax method is used by AE, this requires AE to evaluate these types of potential deductions.

68. The Commission notes the conflicting incentives and imbalance that arise between shareholders and customers when customer rates are finalized but income tax reassessments and refunds may be requested and received by a utility outside of the test years. While the income tax legislation and its regulations allow for retroactive changes to be made in the calculation of income tax expense resulting in an income tax refund to the benefit of shareholders, the Commission must adhere to the principle against retroactive ratemaking, the prospectivity principle and the principle of regulatory certainty.

69. The Commission considers that, without an expansion of the scope of AE's Capital Repair Cost deferral account, similar circumstances may arise in the test years and in the future wherein capitalized costs may be permitted to be expensed for income tax purposes, similar to the circumstances in which the Additional Deductions were taken, and with a similar result. To establish a balance of fairness in this area, the Commission directs AE to amend the scope of its Capital Repair Cost deferral account to include all Income Tax Deductible Capital Costs beginning with 2009 and going forward. The amended deferral account shall be referenced as the Income Tax Deductible Capital Cost deferral account. AE is directed to provide a breakdown of the types and amounts of deductions that are being included in this deferral account as part of all future regulatory applications.

70. The Commission finds that the use of the Income Tax Deductible Capital Cost deferral account will allow AE to continue to pursue income tax deductions for use with the flow-through income tax method and mitigate the risk that the CRA might disallow these deductions. As was recommended by the UCA, the Income Tax Deductible Capital Cost deferral account will address substantive changes for this broader group of income tax deductions while not delaying their implementation until the next GTA application.

Future Process

[25] *Rainbow Pipe Line Co. v. Canada*, [1999] T.C.J. No. 604; *Rainbow Pipe Line v. Canada*, [2002] F.C.J. No. 920 (Appeal Dismissed).

[26] *Canderel Ltd. v. Canada*, [1998] 1 S.C.R. 147.

[27] Decision 2003-071, page 59.

71. The Commission intends to initiate a proceeding which will address consistent income tax methodologies for all utilities. The Commission is also considering initiating a separate consultation process to review the regulatory framework for rate regulation in Alberta, including the use of deferral accounts, how incentives for utilities may be affected, and the resulting impacts on utilities and customers.

5 ORDER

72. IT IS HEREBY ORDERED THAT:

ATCO Electric Ltd. amend the scope and change the name of its existing Capital Repair Cost deferral account to include all Income Tax Deductible Capital Costs for purposes described in this Decision, effective January 1, 2009.

Dated in Calgary, Alberta on November 12, 2009.

ALBERTA UTILITIES COMMISSION

(original signed by)

Carolyn Dahl Rees
Vice-Chair

(original signed by)

Bill Lyttle
Commissioner

(original signed by)

Anne Michaud
Commissioner

APPENDIX 1 – PROCEEDING PARTICIPANTS

Name of Organization (Abbreviation) **Counsel or Representative (APPLICANTS)**
ATCO Electric Ltd. (AE) L. Keough
The Office of the Utilities Consumer Advocate (UCA) R. McCreary
Consumer Group (CG) – Representing Consumers' Coalition of Alberta Public Institutional Consumers of Alberta Alberta Sugar Beet Growers and Potato Growers of Alberta
Consumers Coalition of Alberta (CCA) J. Wachowich
Public Institutional Consumers of Alberta (PICA) N. McKenzie
Alberta Sugar Beet Growers and Potato Growers of Alberta (ASBG/PGA) H. Unryn
AltaLink Management Ltd. (AML) Z. Lazic

Alberta Utilities Commission
Commission Panel C. Dahl Rees, Vice-Chair B. Lyttle, Commissioner A. Michaud, Commissioner
Commission Staff C. Wall (Commission Counsel) S. Ramdin (Commission Counsel) D. Cherniwchan C. Burt B. Clarke K. Schultz

APPENDIX B

Northland Utilities et al. V. NWT Public Utilities Board (2010 NWTSC 92)

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Date: 2010 11 24
Docket: S-1-CV-2010000079

IN THE SUPREME COURT OF THE NORTHWEST TERRITORIES

BETWEEN:

NORTHLAND UTILITIES (YELLOWKNIFE) LIMITED and
NORTHLAND UTILITIES (NWT) LIMITED

Applicants

- and -

NORTHWEST TERRITORIES PUBLIC UTILITIES BOARD

Respondent

- and -

CITY OF YELLOWKNIFE and
TOWN OF HAY RIVER

Intervenors

Application for leave to appeal and appeal of a decision by the Public Utilities Board.

Heard at Yellowknife, NT, on November 2, 2010.

Reasons filed: November 24, 2010.

REASONS FOR JUDGMENT OF THE HONOURABLE JUSTICE J.Z. VERTES

Counsel for the Applicant: Loyola G. Keough

Counsel for the Respondent: John Donihee

Counsel for the Intervenors: Thomas D. Marriott

Date: 2010 11 24
Docket: S-1-CV-2010000079

IN THE SUPREME COURT OF THE NORTHWEST TERRITORIES

BETWEEN:

NORTHLAND UTILITIES (YELLOWKNIFE) LIMITED and
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Applicants

- and -

NORTHWEST TERRITORIES PUBLIC UTILITIES BOARD

Respondent

- and -

CITY OF YELLOWKNIFE and
TOWN OF HAY RIVER

Intervenors

REASONS FOR JUDGMENT

[1] This is an application for leave to appeal and an appeal of a decision, numbered 4-2010, issued by the Northwest Territories Public Utilities Board (the "Board") on March 24, 2010.

[2] At the hearing before me, I granted leave and said that reasons for that decision would be forthcoming. Those reasons are contained within this judgment. Since counsel at the hearing were ready and willing to also argue the appeal on the merits, I proceeded to hear that as well. This judgment therefore also contains my reasons for decision on the appeal.

[3] The issue put before the court is whether the Board exceeded its jurisdiction when, as part of its ratesetting exercise for the period 2008-2010, it ordered the

applicants to flow through to customers money received as a result of a tax refund for operations in 2007. The Applicants say it did and that its order amounts to retroactive ratesetting. The Intervenors argue that it is prospective ratesetting since it seeks to redress harm to current customers. The Board takes no position. For the reasons that follow, the appeal is allowed.

Background:

[4] The Board is established by the *Public Utilities Act*, R.S.N.W.T. 1988, c.24 (Supp.), to regulate public utilities in the Northwest Territories. It has jurisdiction to supervise the operations of utility companies, to approve municipal franchise agreements, and, most significantly for purposes of this appeal, to fix rates for utility services. It is part of what has been described by the Supreme Court of Canada, in *ATCO Gas & Pipelines Ltd.* v. *Alberta (Energy & Utilities Board)*, [2006] 1 S.C.R. 140, as a "regulatory compact" (at para. 63):

> Under the regulatory compact, the regulated utilities are given exclusive rights to sell their services within a specific area at rates that will provide companies the opportunity to earn a fair return for their investors. In return for this right of exclusivity, utilities assume a duty to adequately and reliably serve all customers in their determined territories, and are required to have their rates and certain operations regulated ...(citations omitted)

[5] With respect to ratesetting, the Board regulates on the basis of specific years (called "test years"). It sets the rates for specific test years and once those rates are set they are final. The only exceptions to that are if the Board's order is merely an interim one or if a deferral account is established. Neither situation applies in this case.

[6] The Act contemplates that the objective for the Board is to fix "just and reasonable" rates. That is not explicit but in several sections dealing with ratesetting, such as subsections 49(1), 51(2), 51(3) and 51(4), the Act repeats the phrase "in fixing just and reasonable rates". In doing so, the Board determines a rate base consisting of the cost of the utility's property used to provide the service and its necessary working capital and then fixes a fair return on that rate base. All parties agree that the Act requires the Board to set rates on a prospective basis, such as described in *Northwestern Utilities Limited et al* v. *The City of Edmonton*, [1979] 1 S.C.R. 684 (at p. 691): "The statutory pattern is founded upon the concept of the establishment of

rates *in futuro* for the recovery of the total forecast revenue requirement of the utility as determined by the Board."

[7] All parties also agree on another basic tenet of ratesetting by public utility boards, that being that, in the absence of specific legislative authority to do so, boards do not have the authority to retroactively change rates: see *ATCO Gas & Pipelines (supra)*, at para. 71. Rates are raised or lowered to reflect current conditions. They are not designed to pay back past excessive profits or recoup past operating losses. The Board can take into account past experience in setting the current rates; but, it cannot design a future rate so as to enable the utility to recover a past loss or to rectify for customers some past over-compensation of the utility. In either case the Board would be engaged in retroactive or retrospective ratesetting.

[8] This case concerns one particular aspect of the utilities' overall finances, the treatment of stock handling charges. In February, 2008, both Applicants filed their respective rate applications for the test years 2008-2010. Up to that time, stock handling charges had been capitalized as part of the company's rate base and the capitalized amount added to the pool of capital cost allowances. As the review of their rate applications went on, the Applicants became aware that these stock handling charges could be claimed as tax deductions. This was because of a ruling from the Canadian Revenue Agency received by their parent company in Alberta. The Applicants decided in early 2008 to claim these deductions on their 2007 tax returns. The Applicants then amended their 2008-2010 rate filings to include the projected benefit of similar deductions in the test years.

[9] It is worthwhile to note that there was no rate application or ruling by the Board for 2007. Rates had been set for the period of 2005-2006 and these were used as the basis for the rates charged in 2007. So the 2008-2010 application was the first opportunity to review the impact of deducting these charges as opposed to capitalizing them.

[10] The amounts received back by the Applicants, as a result of taking these deductions, were relatively small. They were $19,400 for one and $3,800 for the other.

[11] On October 27, 2008, the Board issued two decisions, Decision 24-2008 and Decision 25-2008, dealing with the Applicants' 2008-2010 rate applications. Both decisions addressed the income tax deductions for stock handling charges in the same way:

> The Board notes NUL's treatment of stock handling charges for income tax purposes was different prior to the current test period. Prior to the current test period stock handling charges were not deducted for calculation of the income tax component of revenue requirement, both in the forecasts and in the actuals. As long as NUL's treatment of stock handling charges remains consistent for the forecasts as well as actuals, the Board considers customers will not be harmed. However, if NUL were to choose to follow the route of ATCO Gas and request that its prior year income taxes be reassessed by CRA to the maximum extent possible including deduction for stock handling charges then customers will be harmed if such charges were not were not flowed through to customers.

[12] Both decisions also contained a direction to the applicants that any tax refunds received as a result of claiming these deductions are to be "flowed through" to their customers. The Board's directions were as follows:

> In view of the foregoing, the Board will not direct NUL to retroactively adjust its deductions for stock handling charges respecting prior years. However, if NUL were to choose to request such deductions from CRA respecting prior years, the Board expects that any resulting income tax savings will be flowed through to NUL's customers.

[13] The Board did not say how the refunds are to be "flowed through" to the customers. But, both the Applicants and Intervenors assume that this means that the money received by the Applicants is to be paid over to the current customers.

[14] In January, 2009, the Applicants filed applications with the Board seeking a review and variance of these directions. The Applicants submitted that the stock handling charges related to a prior year, 2007, for which rates had been finalized, while the directions were contained within the Board's decisions relating to 2008-2010 rates. As such, so the Applicants argued, the Board's directions breached the principle against retroactive ratesetting and thus were outside the Board's jurisdiction.

[15] In March, 2009, the Applicants requested the Board to defer consideration of their review and variance applications pending the outcome of an identical dispute before the Alberta Utilities Commission. The Board agreed to do so

[16] On November 12, 2009, the Alberta Utilities Commission issued Decision 2009-215 respecting the treatment of tax refunds received by ATCO Electric Ltd. for similar deductions claimed for prior years. The reasons of the Commission will be discussed in further detail later in these reasons but, in summary, the Commission considered itself to be bound by the principle against retroactive ratemaking, the principle of prospectivity, and the principle of regulatory certainty, and therefore precluded from directing ATCO Electric, either directly or indirectly, to return these funds from prior years to current customers. I was told that this decision has not been appealed or judicially reviewed.

[17] The Board reviewed the Alberta decision and continued with consideration of the review and variance applications. On March 24, 2010, the Board issued Decision 4-2010 in which it dismissed the Applicants' request to vary its earlier directions. This is the subject-matter of this appeal.

Decision 4-2010:

[18] In its decision, the Board started by noting that the rates established for the 2005-2006 period, being the rates that were in place in 2007, were based on the assumption that stock handling charges cannot be deducted for tax purposes. Rather, those charges were capitalized as part of the companies' rate base and the capitalized amount added to the pool of capital cost allowances. It also noted that the Applicants, after they became aware of the deductibility of these charges, had the discretion as to whether to claim the stock handling charges as a deduction for 2007 and prior years but chose to claim only for 2007.

[19] These two points led to what I think are the main arguments supporting the Board's decision.

[20] First, the Board stated that there are certain methodological underpinnings to the establishment of rates. Two of those relate to the calculation of income taxes and capital cost allowance deductions. Any retroactive change in the methodology used in

the establishment of rates, without regard to its impact on future rates, is, in the Board's view, a violation of the principle of prospectivity. In dismissing the Applicants' argument that the Board's directions amount to retroactive ratemaking, the Board wrote:

> The Board considers the amount of Capital Cost Allowance (CCA) that is claimed as a deduction in one time period versus another, for tax purposes, is a timing issue. If more CCA is claimed in a past year, then less Un-depreciated Capital Costs pools would be available for use in future years resulting in a reduction in the CCA deductions in future years. Since CCA claims in a past year impact future year tax calculations, the Board considers any potential adjustments to future customer rates to reflect the carry over effects of past deductions to be not a retroactive adjustment of historical rates but rather a prospective adjustment to restore the integrity of prospective rate making.

[21] Second, the Board was persuaded by the argument advanced by the Intervenors in this case that, since the claiming of stock handling charges as a deduction is solely within the discretion of the Applicants, there is no shared risk as between the utilities and the customers. In other words, this is a purely one-sided benefit. It is not an "efficiency" saving but merely a windfall due to a fortuitous tax ruling and, because claiming higher deductions in one year has an impact on the amount of tax due in future years because of the reduction in capital cost allowance available, the risk results in harm to the customers.

[22] Therefore, the Board was not convinced that its earlier directions were either inconsistent with prospective ratemaking or violated the principle prohibiting retroactive ratemaking.

Application for Leave to Appeal:

[23] Section 78(1) of the *Public Utilities Act* restricts appeals to questions of law or jurisdiction and an appellant must first obtain leave to appeal.

[24] The parties agree on the test to be applied to determine whether leave should be granted: *North West Co.* v. *Town of Fort Smith*, [2007] N.W.T.J. No. 6 (S.C.), at para. 16; *Atco Electric Ltd.* v. *Alberta (Energy and Utilities Board)*, [2003] A.J. No. 117 (C.A.), at para. 17. The Applicants must demonstrate that the appeal raises a serious

arguable point. Subsumed within this test are four criteria: (1) whether the point on appeal is of significance to the practice; (2) whether the point raised is of significance to the action; (3) whether the appeal is *prima facie* meritorious; and, (4) whether the appeal will unduly hinder the progress of the case. Also taken into consideration is the standard of review that will apply should leave be granted.

[25] In my view, as I will explain more fully later, the appeal raises a question of jurisdiction. Assuming that the Board had the power to embark on an examination of how, if any, these tax deductions and refunds were to be treated, the issue is whether the Board exceeded its jurisdiction by imposing directions that were tantamount to retroactive ratemaking. And, if it is a jurisdictional issue, then the Board must be correct in law. Thus the issue is significant to the practice.

[26] The issue is obviously significant to the action since it is determinative of the action. So determination of this point will not hinder progress of the action.

[27] The Intervenors argued that the appeal is insignificant since the practical effect of the Board's directions are immaterial. By that they mean that the amount of dollars at stake amount to an insignificant part of the Applicants' total revenue requirements. But, of course, the Applicants respond that it is the principle that counts, not the dollars. This appeal is essentially about the jurisdiction of the Board in exercising its ratesetting powers.

[28] I agree with the points made by the Applicants. Hence, I granted leave to appeal.

Standard of Review:

[29] It is trite law to state that a tribunal has only those powers that are expressly or implicitly conferred on it by its constituent statute. Either the Board had the jurisdiction to issue the directions, or it did not.

[30] The first issue that must be addressed, therefore, is the standard of review. However, as stated in *Dunsmuir* v. *New Brunswick*, [2008] 1 S.C.R. 190, it is not necessary to perform an analysis of this issue if the standard of review for the type of question in issue has already been determined by the jurisprudence.

[31] Questions of jurisdiction are reviewed on a standard of "correctness": *ATCO Gas & Pipelines (supra)*, at para. 21. As previously mentioned, s.78(1) of the Act limits appeals to questions of law or jurisdiction. This generally calls for the application of the correctness standard: *Prairie North Regional Health Authority* v. *Kutzner*, [2010] S.J. No. 650 (C.A.), para. 31.

[32] Section 17 of the Act, however, states that the Board has exclusive jurisdiction for all matters in which jurisdiction is conferred on it by the Act and its decisions shall not be questioned or reviewed by judicial review or any other process. Section 19 provides that the Board's determination on a question of fact is conclusive and binding. These constitute privative provisions and therefore any question of fact is not subject to appeal.

[33] The Intervenors argued that the applicable standard of review is reasonableness since the issue, the direction to "flow through" to customers the benefits associated with any income tax reassessments, is one that calls for the special expertise enjoyed by the Board.

[34] There is no doubt that the Board is a specialized tribunal. But, in this case, the question is whether the Board exceeded its jurisdiction. If, as in the case of *Calgary* v. *Alberta (Energy and Utilities Board)*, [2010] A.J. No. 449 (C.A.), a case relied on by the Intervenors, the Board's jurisdiction is decided in its favour, then a review of its decision would be on the standard of reasonableness. But here the fundamental question is jurisdictional. Therefore correctness is the standard.

[35] When I speak of jurisdiction I am cognizant of the Supreme Court's admonishment that only "true" questions of jurisdiction attract the correctness standard of review. This was emphasized by Bastarache and Lebel J.J., writing for the majority, in *Dunsmuir (supra)*, at para. 59:

> Administrative bodies must also be correct in their determinations of true questions of jurisdiction or *vires*. We mention true questions of *vires* to distance ourselves from the extended definitions adopted before *CUPE*. It is important here to take a robust view of jurisdiction. We neither wish nor intend to return to the jurisdiction/preliminary question doctrine that plagued the jurisprudence in this area for many years. *"Jurisdiction" is intended in the narrow sense of whether or not the*

> *tribunal had the authority to make the inquiry. In other words, true jurisdiction questions arise where the tribunal must explicitly determine whether its statutory grant of power gives it the authority to decide a particular matter.* The tribunal must interpret the grant of authority correctly or its action will be found to be *ultra vires* or to constitute a wrongful decline of jurisdiction. An example may be found in *United Taxi Drivers' Fellowship of Southern Alberta* v. *Calgary (City)*, [2004] 1 S.C.R. 485. In that case, the issue was whether the City of Calgary was authorized under the relevant municipal acts to enact bylaws limiting the number of taxi plate licences. That case involved the decision-making powers of a municipality and exemplifies a true question of jurisdiction or *vires*. These questions will be narrow. We reiterate the caution of Dickson J. in CUPE that reviewing judges must not brand as jurisdictional issues that are doubtfully so. [Emphasis added; citations omitted.]

[36] The distinction between the "narrow" and "wide" meanings of jurisdiction was explained by Professors Jones and de Villars in their text, *Principles of Administrative Law* (5th ed.), at p. 140:

> In its broadest sense, "jurisdiction" means the authority to do every aspect of an *intra vires* action. In a narrower sense, however, "jurisdiction" means the power to commence or embark on a particular type of activity. A defect in jurisdiction "in the narrow sense" is thus distinguished from other errors - such as a breach of a duty to be fair, considering irrelevant evidence, acting for an improper purpose, or reaching an unreasonable result - which take place *after* the delegate has lawfully started its activity, but which cause it to leave or exceed its jurisdiction.
>
> ...
>
> It is important to remember that virtually all grounds for judicial review of administrative action depend upon an attack on some aspect of the delegate's jurisdiction (in the wider sense) to do the particular activity in question. Consequently, it is equally important to remember that any behaviour which causes the delegate to *exceed* its jurisdiction is just as fatal as any error which means that it never had jurisdiction "in the narrow sense" even to commence the exercise of its jurisdiction [Italics in original; footnotes omitted.]

[37] It is in the last sense of jurisdiction, as described above, that I understand the issue in this case. The Applicants argue that, while the Board may have had the authority to consider the fact that there was a tax refund, the Board *exceeded* its jurisdiction in making the directions it did. The standard of review for this is, as I

have said, correctness. If, however, the Board did not exceed its jurisdiction, the question then is whether these directions fall within the range of reasonable outcomes.

Submissions on the Appeal:

[38] The essence of the Applicants' argument is that the directions amount to retroactive ratemaking since they were made in the context of the 2008-2010 test years rate application whereas the tax refund applies to a prior year (2007). The 2007 rates were “final” and any attempt to reallocate funds from that period amounts to a revision of those rates. In simple terms, it would require the Applicants to give money received from tax refunds for a prior year to current customers.

[39] The Applicants' argument characterized the directions as an “adjustment” to the utility's revenue requirements for the prior year. How is this? Counsel simplified it for me by explaining that lower taxes means a lower cost base which in turn means lower revenue requirements which results in lower rates. Hence it is an implicit adjustment to the 2007 rate structure to have these funds flow through to the customers.

[40] The Applicants placed great reliance on the Alberta Utilities Commission Decision 2009-215 (referred to previously). In their view that decision addressed exactly the same issues as addressed by the Board in this case and held that any flow through of tax refunds to customers is prohibited by the principle against retroactive ratemaking.

[41] The Intervenors took the position that the Alberta Commission's decision did not deal with the same issues and, even if it did, that Commission came to the wrong conclusions.

[42] In their submission, the income tax deductions claimed by the Applicants have resulted in a reduction of the undepreciated capital cost balances available to offset future taxable income and thus lower income tax expenses. Consequently customers will pay a higher amount of income tax expense through rates in future years. Both the Alberta Commission and the Board in this case came to similar findings in this regard. Counsel for the Intervenors noted that the Board expressly stated that the

customers have been “harmed” and the only way to rectify this is to flow through the tax refunds. Counsel described this as a non-reviewable finding of fact.

[43] The difference as between the Alberta Commission's decision and the Board's, in the Intervenors' submission, is that the Alberta Commission was considering various formulas, such as readjusting capital cost balances, while the Board was dealing with a straightforward cause-and-effect scenario, i.e., the deductions in the past cause harm in the present. Thus it is not an exercise in retroactive ratemaking but prospective ratemaking since it merely restores the integrity of the methodology used to set rates.

[44] Counsel also noted that the Alberta Commission did not simply leave the issue when it decided that it could not order a flow-through of the tax refunds in that case. It directed that a deferral account be established to include all income tax deductible capital costs on a go-forward basis.

[45] The Intervenors' counsel also made the argument that, since these tax refunds were received in 2008, and the Board was considering this issue as part of the 2008-2010 rate application review, it may consider these funds to be part of the revenues of the Applicants for a fiscal period under review (as permitted by s.51(2)(a) of the Act) or as part of the utilities' working capital (as required by s. 49(2)(b) of the Act). Thus there would be no requirement to restate the 2007 cost base or revenue requirements.

[46] Finally, the Intervenors made the point that if utilities keep changing the underlying basis of accounting or tax calculations then there would be no regulatory certainty. In this case, the rates were set on the basis that stock handling charges were 100% capitalized. The utilities have, after-the-fact, changed that to reflect 100% of these costs as tax deductible.

[47] In response, the Applicants point out that any “harm” suffered by current or future customers will be off-set by the fact that customers will benefit from the expensing of these costs since that will lower the amount of taxes payable. So, while the utilities benefit from the deduction taken for 2007, the customers will benefit in the test years and every year thereafter due to the increased tax deductions being claimed by the utilities.

[48] Applicants' counsel also painted the Board's (and the Intervenors') attempt to frame the directions in reference to capital cost allowances and undepreciated capital cost base as merely an attempt to do indirectly what cannot be done directly (a point emphasized by the Alberta Commission in its decision). Any alternative technique or method to either justify or reallocate the refunds to the customers is equally objectionable on this ground.

Analysis:

[49] As I noted earlier, all parties agree that the Board, in exercising ratesetting powers, is required to do so prospectively and is prohibited from engaging in retroactive ratemaking. I think it would be helpful to set out some definitions since various terms are often used interchangeably and in different contexts. In the *Calgary* v. *Alberta* case (*supra*), Hunt J.A. gave a helpful description of the meaning of "prospective", "retroactive" and "retrospective", in the context of utility regulation (at paras. 46-49):

> A brief overview of some central principles of ratemaking, including the related concepts of retroactive and retrospective ratemaking, is necessary. Generally, ratemaking and rates must be prospective: *Coseka Resources Ltd.* v. *Saratoga Processing Co.* (1981), 31 A.R. 541 at para. 29, 16 Alta. L.R. (2d) 60 (C.A.). A utility's past financial results can be used to forecast future expenses, but a regulator cannot design future rates to recover past revenue deficiencies: *Northwestern Utilities Ltd. and al.* v. *Edmonton*, [1979] 1 S.C.R. 684 at 691 and 699 *("Northwestern Utilities"*).
>
> Retroactive ratemaking "establish[es] rates to replace or be substituted to those which were charged during that period": *Bell Canada* v. *Canada (Canadian Radio-Television and Telecommunications Commission*), [1989] 1 S.C.R. 1722 at 1749 ("*Bell Canada 1989*"). Utility regulators cannot retroactively change rates ("*Stores Block"* at para. 71) because it creates a lack of certainty for utility consumers. If a regulator could retroactively change rates, consumers would never be assured of the finality of rates they paid for utility services.
>
> Retrospective ratemaking, in contrast, imposes on the utility's current consumers shortfalls (or surpluses) incurred by previous generations of consumers. It is generally prohibited because it creates inequities or improper subsidizations as between past and present consumers (who may not be the same)...

> Sometimes *retrospective* ratemaking is referred to as *retroactive* ratemaking. This is because rates imposed on a future generation of consumers, while prospective, create obligations in respect of past transactions, and in this sense they are retroactive...

[50] The *Calgary* case also illustrates, in its review of pertinent jurisprudence, that the only way in which expenses or surpluses from one year can be reallocated in a subsequent year, or rates can be changed after-the-fact, is by use of deferral accounts or interim rates. Neither applies in this case, as I previously mentioned.

[51] What the present case demonstrates are aspects of both "retrospective" and "retroactive" ratemaking, as those terms are used above. "Retrospective" because the Board, by its directions, is benefitting present customers from a gain incurred in a past year. "Retroactive" because, in taking the refunds away from the utilities and passing them on to the customers, the Board is in effect restating the utilities' rate base and revenue requirement for that past year.

[52] The Board itself seemed to recognize these principles in an earlier decision, number 4-2008 issued on January 30, 2008, dealing with an issue from the review of the Northwest Territories Power Corporation's 2006-2008 rate application. There, the Board issued a directive requiring the Corporation to refund to customers $345,000 that was, in the Board's term, "over-collected"for certain expenses between the 2001-2002 and 2005-2006 test year periods. As I understand it, the Board asserted that the Corporation had claimed certain expenses when setting the rates for those years but did not carry out all the work related to those expenses, resulting in savings in those years but the potential for higher expenses in future years when the work has to be done. The Corporation asked the Board to review this direction. In its decision, the Board vacated the direction "as a matter of law" after reviewing submissions regarding retroactive ratemaking.

[53] To start, I do not accept the Intervenors' argument that, just because the tax refunds were received in 2008, they can be considered by the Board as revenues applicable to the fiscal year for which the Board is considering setting rates. The amounts are directly referable to operations in 2007 and not to the test years under consideration by the Board. Similarly, the consideration of the working capital of the

utilities is the need to consider the “necessary” working capital for the period in question, not what may simply be available.

[54] Since much emphasis was placed in argument on the Alberta Utilities Commission Decision 2009-215, I will review it in more detail.

[55] The Alberta decision was made in the context of ATCO Electric's application for approval of its 2009-2010 general tariff. In it ATCO identified the retention of income tax refunds, as a result of deductions for various costs (including stock handling charges), for 2006, 2007 and 2008 in the amount of $6 million. These costs were previously treated as capital additions for income tax purposes and formed part of the undepreciated capital cost which was then available to lower taxable income over a period of years through a yearly capital cost allowance deduction. In late 2007, however, ATCO became aware of the ability to deduct these items. Once that was identified, ATCO included provision for these deductions in its 2009-2010 tariff application.

[56] Various consumer groups intervened on the rate application and argued that, in order to receive the refunds, the undepreciated capital cost balances were reduced by the amount of the deductions thereby reducing the capital cost allowance in future years. These groups therefore asked that either the $6 million be flowed through to customers, or that the undepreciated capital cost balance be set at the level existing prior to ATCO's claim for the refunds, or that an adjustment be made to the rate base for 2009-2010.

[57] ATCO argued that all of these methods would amount to retroactive ratemaking since it would involve the Commission in adjusting or restating prior years' revenue requirements after the rates for those years had already been fixed. ATCO also argued, as the Applicants do here, that customers benefit in the long term due to its ability to take these deductions in future years.

[58] As I mentioned previously, the Alberta Commission considered the principle of prospectivity, the prohibition against retroactivity, and the need for regulatory certainty, and allowed ATCO to keep the money realized as a result of these deductions. The Commission held that these principles would be undermined if the refunds were to be paid to customers. It reasoned that the rates were finalized for the

years to which the refunds related and all the alternatives considered were simply a mechanism to reallocate the refunds. Also, to make any of the adjustments proposed by the consumers would be simply doing indirectly what could not be done directly.

[59] The Commission acknowledged that, yes, the customers may have lost some benefit as a consequence of ATCO claiming the deductions but to do as the consumer groups proposed would offend the well-established regulatory principles previously mentioned. It referred to past situations to show that issues arising from the difference in treatment of capital versus expense as between tax and regulatory accounts are not new. And, the Commission also commented on the difference between the tax regime, where there may be reassessments and retroactive changes, and the regulatory regime where certainty is the norm (at para. 68):

> The Commission notes the conflicting incentives and imbalance that arise between shareholders and customers when customer rates are finalized but income tax reassessments and refunds may be requested and received by a utility outside of the test years. While the income tax legislation and its regulations allow for retroactive changes to be made in the calculation of income tax expense resulting in an income tax refund to the benefit of shareholders, the Commission must adhere to the principle against retroactive ratemaking, the prospectivity principle and the principle of regulatory certainty.

[60] In my opinion, the issues addressed by the Alberta Commission are the same ones that were before the Board in the present case. And, in my respectful view, the Commission was correct in its analysis.

[61] The Board based its decision on what it characterized as a "retroactive change in the methodological underpinnings used in the establishment of prospective rates" and seemed to say that if such a change had an impact on future rates it would be in violation of the principle of prospectivity. I must admit to some difficulty in understanding what exactly the Board is saying if I keep in mind that rates are set within the parameters of an application for specific test years. It is the methodology used to set rates for the test years in question that determines the rates (not some past or potential future methodology).

[62] The Board said, in its decision, that "any potential adjustments to future customer rates to reflect the carry over effects of past deductions (is) not a retroactive

adjustment". I agree. But the point is that the adjustment is done to future rates, not by reaching back to a past year and flowing through benefits from that year to customers in a future rate period.

[63] The 2008-2010 application before the Board took into account the potential savings from the deductions that the Applicants are now able to take. Whether those savings actually off-set the reduction in available capital cost allowances is not the point (and the evidence on this was far from clear). The point is that the methodology used in the rate application under consideration is consistent with the changes in tax treatment and internally consistent.

[64] I agree with the Intervenors' counsel when he argues that the 2007 tax refunds cannot be considered as an "efficiency gain". They came about due to a change in federal tax policy as opposed to any efficiencies introduced by the utilities. But, if it is a windfall then the solution is not to provide one to the 2008-2010 customer base. The solution is to concentrate on developing appropriate rates for the test years based on current knowledge.

[65] Any attempt to deal with the refunds received for 2007 within the context of the 2008-2010 rate application is, in my opinion, tantamount to retroactive ratemaking. Calling it a "prospective adjustment" is merely doing indirectly what cannot be done directly. It is axiomatic that the courts will look to the substance of what is being done, and not merely the form, and strike down any attempt to do indirectly what a tribunal's enabling statute does not allow to be done directly: see, for example, *Reference re Agricultural Products Marketing Act*, [1978] 2 S.C.R. 1198 (at p. 1291).

[66] It may well be, as the Intervenors' counsel suggested, that the Board in this case, as opposed to what was done in the Alberta case, was trying to strike a better balance between the interests of consumers and those of the utilities. The difficulty is that in its attempt to do so the Board exceeded its jurisdiction by engaging in what I previously described as both retroactive and retrospective ratemaking.

Conclusions:

[67] Leave to appeal is granted and the appeal is allowed. Decision 4-2010 is hereby set aside and an order will issue granting variance of Board Decisions 24-2008 and

25-2008 by vacating the direction to flow through to customers any benefits from tax deductions for stock handling charges in prior years.

[68] On the matter of costs, if the parties are unable to agree they may file written submissions to me within 60 days of the date of these reasons for judgment.

J.Z. Vertes
J.S.C.

Dated this 24th day of November, 2010.

Counsel for the Applicant: Loyola G. Keough

Counsel for the Respondent: John Donihee

Counsel for the Intervenors: Thomas D. Marriott

Docket: S-1-CV-2010000079

IN THE SUPREME COURT OF THE
NORTHWEST TERRITORIES

BETWEEN:

NORTHLAND UTILITIES (YELLOWKNIFE) LIMITED and NORTHLAND UTILITIES (NWT) LIMITED

Applicants

- and -

NORTHWEST TERRITORIES PUBLIC UTILITIES BOARD

Respondent

- and -

CITY OF YELLOWKNIFE and
TOWN OF HAY RIVER

Intervenors

REASONS FOR JUDGMENT OF
THE HONOURABLE JUSTICE J.Z. VERTES