

## Technical Conference Transcript

1 MS. SABHARWAL: It is just a little confusing because  
2 it is calling both those numbers the same, and the PILS  
3 model doesn't usually show additions as taxes. It just  
4 doesn't.

5 MS. SABHARWAL: Yeah, we can update this.

6 MS. DJURJEVIC: We'll make it undertaking JT1.16.

7 **UNDERTAKING NO. JT1.16: TO UPDATE THE CALCULATION.**

8 MS. SABHARWAL: My next question is about an  
9 interrogatory that was asked in the MAADs application, and  
10 that question is for Grimsby.

11 In the MAADs application, an interrogatory was asked.  
12 It was interrogatory NPEI number 2K, and they specifically  
13 asked if GPI will receive the tax benefits such as NWTC's  
14 non-capital losses from the transaction, and if so, to  
15 specify the benefits including the amount and how such  
16 benefits will be allocated to customers.

17 And the response was that all of it will go to the  
18 benefit of the GPI customers.

19 MR. CURTISS: Is there a question in there?

20 MS. SABHARWAL: My question is: Are you aware that  
21 you agreed to do that?

22 MR. CURTISS: Absolutely. That is on record. That  
23 was based on the best information we had at the time that  
24 we filed our MAAD an application based on all the advice  
25 that we received in order to support our MAAD.

26 And obviously we are in a different place right now  
27 based on new information that's come to us in this  
28 proceeding.

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1 The other point I'd like to make is that the focus of  
2 the MAAD application is not rates. We specifically stated  
3 in a number of places in our MAAD application that rates  
4 would be the subject of this proceeding and be --

5 MS. SABHARWAL: But you also said that it will be part  
6 of the next cost-of-service application that you would be  
7 using these losses. Next -- GPI's application, the Board  
8 for --

9 MR. CURTISS: As I said, that was based on the best  
10 information we had at the time, and now we have new  
11 information. That's changed our position.

12 MS. SABHARWAL: And new information being that -- what  
13 the KPMG report says or something different?

14 MR. CURTISS: That's correct.

15 MS. SABHARWAL: But can I still request a PILS model  
16 incorporating non-capital losses into GPI's PILS  
17 calculation, please? It may be exact same what I asked  
18 before. If it's exact same that's fine.

19 MS. DOMOKOS: Sorry, would you please repeat what you  
20 would like to get?

21 MS. SABHARWAL: The PILS model incorporating non-  
22 capital losses into GPI's PILS calculation.

23 MS. DJURDJEVIC: And to the extent that that is  
24 repetitive of JT1.15, then the response, I guess, would be  
25 that is addressed in JT1.15.

26 MS. SABHARWAL: If it's exact same, that's fine.

27 MR. SIDLOFSKY: I think that will probably be your  
28 answer, but I think just to save the undertaking I think

**Grimsby Power Incorporated**  
**Review of Rate Setting Implications of Tax Loss Carry Forwards**  
**June 2016**

“Although the Board accepted the position in the 2006 DRH that loss carry-forwards should be taken into account in setting 2006 rates, the Board does not believe that position is applicable in all rates cases before the Board. It is clear from the highlighted sentence in the Report of the Board that the Board attaches some significance to the reasons for losses. It is also clear from that sentence that approval of the 2006 DRH position on loss carry-forwards was taken without the opportunity to hear any evidence on what might have led to the losses.”<sup>8</sup>

Discussing specifically the losses at GLPL that were in question in proceeding EB-2007-0744, the Board went on to note:

“The Board finds that pre-2007 losses of the distribution business should not be used to eliminate the tax provision for the 2007 test period. The Board reiterates its view that the benefits of a tax loss should be realized by the party – shareholders or ratepayers – that bore the expenses or losses that gave rise to the tax loss. Since the Board has denied recovery of the amount accrued for rate mitigation in account 1574, the resulting losses should not be attributed to ratepayers but rather to GLPL, which sustained those losses and should retain the related tax benefits.”<sup>9</sup>

#### **1.4.4 Conclusion**

As the shareholder covered the losses incurred since incorporation of NWTC, including the additional interest in excess of the deemed interest, and as no PILs were included in the transmission rates, based on the “benefits follow costs” principle, I believe that the benefits of the NWTC tax loss carry-forward balances as at December 31, 2015 should be for the benefits of the shareholders and not for the customers, as the costs that gave rise to the tax losses were borne by NWTC.

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<sup>8</sup> EB-2007-0744, Decision and Order – October 30, 2008, pages 42, 43

<sup>9</sup> EB-2007-0744, Decision and Order – October 30, 2008, pages 43, 44

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1 MR. JANIGAN: In the last two weeks you've been  
2 retained?

3 MR. PICARD: Yes.

4 MR. JANIGAN: Okay. Specifically, can you advise why  
5 this issue was not raised in the initial application?

6 MR. PICARD: I cannot. I don't know what the --

7 MR. JANIGAN: But to the best of your knowledge, it  
8 was raised for the first time when you gave an opinion?

9 MR. PICARD: Yes.

10 MR. JANIGAN: And once again, you were not involved in  
11 any aspect of the amalgamation proceedings themselves?

12 MR. PICARD: No.

13 MR. JANIGAN: Okay. I note that you quote the OPPB  
14 from the Great Lakes Power decision in 1.4.3 of your  
15 report, and you also cite the OPG decision of November  
16 20th, 2014.

17 MR. PICARD: Uh-hmm.

18 MR. JANIGAN: Do you believe there is any conflict  
19 between those two decisions?

20 MR. PICARD: There are different facts, because in  
21 the case of OPG, they were including the PILS.

22 MR. JANIGAN: Uh-hmm.

23 MR. PICARD: And so therefore, you know, the decision  
24 was therefore if you have included PILS, the taxes carried  
25 forward should belong to the ratepayers. It is a different  
26 issue.

27 MR. JANIGAN: You believe that is a key fact in this  
28 matter?

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1 MR. PICARD: Yes.

2 MR. JANIGAN: Okay. And with respect to the  
3 transaction itself, you are aware that all of the assets of  
4 NW -- why do I always forget that acronym? -- NWTC has all  
5 the assets of -- NWTC became distribution assets of GPI.

6 MR. PICARD: I think they became deemed to be assets,  
7 right.

8 MR. JANIGAN: And in your position, the shareholders  
9 of GPI are in exactly the same position as NWTC when it  
10 comes to the tax loss carry forward after the transaction  
11 has taken place?

12 MR. PICARD: Can you specify what you --

13 MR. JANIGAN: Well, before the transaction takes  
14 place, your opinion is that NWTC is the beneficiary of any  
15 tax loss carry forward.

16 MR. PICARD: Correct.

17 MR. JANIGAN: And your belief is after the  
18 transaction --

19 MR. PICARD: I think that's right.

20 MR. JANIGAN: -- the shareholders of GPI are now in  
21 the same shoes as NWTC?

22 MR. PICARD: That's correct.

23 MR. JANIGAN: Okay. I think those are all my  
24 questions, thank you.

25 MS. DJURJEVIC: Thank you, Mr. Janigan. Mr.  
26 Rubenstein, do you have anything?

27 **EXAMINATION BY MR. RUBENSTEIN:**

28 MR. RUBENSTEIN: Just a few questions.

## Board Findings

The Board directs OPG to reduce its 2014 income tax provision to recognize and carry forward its regulatory tax loss in 2013. This finding is consistent with Board policy as indicated in the Board's 2006 Electricity Distributor's Rate Handbook (the "Handbook") and in subsequent Filing Requirements.<sup>104</sup> The Board understands the policies contained in the Handbook and the Filing Requirements apply to electricity distributors, not directly to OPG as an electricity generator, yet finds that the underlying Board policy should be applicable to OPG in this application.

The rate regulation of the electricity distribution sector shows a history of tax loss carry-forwards being routinely used in the rate setting process for distributors. This approach is completely consistent with Board policy for tax losses to be applied to reduce income tax to be included in rates, and there is no reason for OPG to be treated any differently in this instance.

OPG referred to two decisions in which the Board did not apply the policy, namely OPG's EB-2007-0905 decision and Great Lakes Power's EB-2007-0744 decision. The Board finds that the circumstances in these two cases were unique and are not comparable to OPG's current circumstances.

The Board's findings in the EB-2007-0905 decision address the fact that OPG was not regulated by the Board prior to 2008, when the tax loss occurred. The Government set OPG's rates in 2005, 2006 and 2007. The Board's EB-2007-0905 decision in 2008 did not reference the policy in the Handbook. The Board finds that the circumstances in OPG's first payment amounts proceeding were unique and the Board's finding in that case resulted from the absence of information and the Board's uncertainty regarding OPG's tax calculation.

The Board is not convinced that there are any "regulatory tax losses" to be carried forward to 2008 and later years, or if there are any, that the amount calculated by OPG is correct....The Board does not have the information necessary to determine the tax benefits which should be carried forward to offset payment amounts in 2008 or later periods.<sup>105</sup>

<sup>104</sup> A requirement to identify any loss carry-forwards and when they will be fully utilized has been included in the Board's Filing Requirements for electricity distributors' cost of service applications since 2012. With the issuance of the 2012 Filing Requirements (for 2013 rates), the Board included any remaining relevant sections of both the 2000 and 2006 Electricity Rate Handbooks.

<sup>105</sup> Decision with Reasons, EB-2007-0905, pages 169-170

- Cross subsidization would occur because rates would be based on a tax expense that would be lower than it would have been absent the non-distribution businesses;
- There would be retroactive altering of the conditions assumed by the investor at the time investments were made in the non-utility operations; and
- Shareholders of GLPL would be denied the same treatment available to other shareholders under the *Income Tax Act*.

### Board Findings

The Board finds that the 2007 test year tax provision should be calculated without regard for corporate tax loss carry-forwards that arose due to losses in GLPL's non-distribution businesses.

The Board agrees with GLPL that it has been the Board's policy to apply the stand-alone principle when assessing the tax provisions of regulated businesses. In the Board's view, fairness in ratemaking requires adherence to the principle that a party who bears a cost should be entitled to any related tax savings or benefits.

Prior to release of the *2006 Electricity Distribution Rate Handbook* ("2006 DRH"), the Board considered arguments related to a somewhat similar question – Who should benefit from the tax deductions for expenses that are not included in the determination of a distributor's rates? The Report of the Board on the Handbook states that:

*... the Board rejects the proposal by Schools, and concludes that tax savings arising from disallowed expenses, including purchased goodwill and charitable donations, will not be allocated to ratepayers. Ratepayers have not paid for the expense through rates, and therefore are not entitled to the tax benefit.*<sup>25</sup>

The principle that the Board relied on in accepting the 2006 DRH treatment of disallowed expenses is equally applicable in this case. The pre-2007 expenses and losses of GLPL's unregulated businesses were borne by GLPL's shareholder, not ratepayers. It would be fundamentally unfair to take such tax losses into account when

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<sup>25</sup> RP-2004-0188, May 11, 2005, p. 55.



setting rates for regulated service. To abandon the stand-alone principle in this case would give rise to the inappropriate result that rates for regulated service would be affected by the income or loss of a non-regulated business.

*Benefit of pre-2007 tax losses in GLPL's regulated business*

As noted earlier, GLPL's evidence is that there are no pre-2007 loss carry forwards in the distribution business on a stand-alone basis. The reason for that result appears to be that, in years before 2007, GLPL included in its calculation of taxable income the annual increase in deferral account 1574. Board staff submitted that "if the values accumulated in account 1574 are not permitted for recovery in rates, it appears the GLPL distribution division would have incurred operating losses in years prior to the test year." In the staff's opinion, the existence of such prior year regulatory tax losses would make it unnecessary for a tax allowance to be recovered from customers in 2007.<sup>26</sup>

The second tax issue raised by staff is whether, in the event the Board disallows recovery of a deferral account balance, the regulated distribution business itself would have pre-2007 losses that should be used to eliminate any 2007 tax provision.

GLPL argued that, in the event the Board disallows recovery of the balance in account 1574, loss carry-forwards arising pre-2007 should be for the benefit of GLPL's shareholder. GLPL noted that any pre-2007 losses that arise in the event of the Board's denial of recovery of account 1574 must be due to variations in load or expenses compared to the amounts on which GLPL's then existing rates were based. Ratepayers would not have paid any amount due to unfavourable variations in load or expenses. Based on the stand-alone principle, GLPL argued that ratepayers should not be entitled to any benefit of those losses and that applying such pre-2007 losses to reduce the 2007 regulatory tax provision would constitute retroactive ratemaking. Board staff did not comment in its submission on whether the reason for the pre-2007 losses is relevant to whether the losses should be used to eliminate 2007 taxes.

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<sup>26</sup> In its submission, Board staff also argued that GLPL has overstated its regulatory tax provisions in 2006 and earlier years by voluntarily including the annual increase in account 1574 in taxable income. Staff submitted that GLPL's action of recognizing the increase in account 1574 as taxable income in 2006 and earlier years is not something a stand-alone business would consider necessary or would consider to be prudent tax management. In effect, the staff seemed to be arguing that GLPL should be considered to have loss carry-forwards for regulatory purposes whether or not the Board disallows recovery of account 1574. Because the Board has determined that GLPL will not be permitted to recover the balance in account 1574, it is not necessary to consider and make a finding on this alternative staff argument.



## 7.2.2 Capital tax exemptions

### i) Federal Large Corporation Tax (LCT) Exemption

Where the applicant is the only regulated entity in a corporate group, the full LCT exemption must be claimed by the applicant for purposes of its 2006 OEB tax calculation.

Where the distributor is a member of a larger corporate group that includes other regulated entities, the exemptions will be prorated among the regulated entities.

### ii) Ontario Capital Tax Exemption

Where the applicant is the only regulated entity in a corporate group, the full OCT exemption must be claimed by the applicant for purposes of its 2006 OEB tax calculation.

Where the applicant is a member of a larger corporate group, the full provincial capital tax exemption will be prorated among the regulated entities in that group.

### iii) Non-distribution activities within an applicant

When distribution and non-distribution functions are being undertaken in the same legal entity by an applicant, the full federal LCT exemption and provincial capital tax exemptions must be claimed by the applicant for purposes of its 2006 OEB tax calculation.

## 7.2.3 Loss carry-forwards

A distributor expecting to have any loss carry-forwards still available on December 31, 2005 must disclose the amount of those loss carry-forwards in the 2006 application, and apply them in full to reduce the taxable income calculated in the 2006 regulatory tax calculation. These amounts are to be entered in the 2006 OEB Tax Model.

If a distributor has within its legal entity a business other than a distribution business, loss carry-forwards must be allocated between the distribution and the non-distribution business on a reasonable basis. The applicant shall include in Schedule 7-1 a description and justification of that allocation method and calculation.

GPI - 4 Scenarios

TC PILs WF Draft (Reg Assets in, NWTC out)		NWTC In Reg Assets In		NWTC In Reg Assets Out		NWTC Out Reg Assets Out	
<b>Bridge Adj. TI</b>							
NI for Tax purp.		589,098	589,098	-94,758	-94,758	-94,758	
Losses applied		-234,927	-373,573	-373,573	-373,573	-234,927	
Historic Taxable Income		354,171	215,525	-468,331	-468,331	-329,685	
<b>Bridge Tax Provision</b>		<b>93,855</b>	<b>57,114</b>	<b>-124,108</b>	<b>-124,108</b>	<b>-87,367</b>	
Loss CFWD Bridge		0	391,821	391,821	391,821	0	
<b>Test Yr. Adj. TI</b>							
NI for Tax purp.		181,257	255,253	255,253	255,253	255,253	
Losses applied		0	-78,364	-78,364	-78,364	0	
Test Yr. Taxable Income		181,257	176,889	176,889	176,889	255,253	
Test Yr. Tax provision		65,351	63,776	63,776	63,776	92,030	
							<b>28,254</b>

Impact of LCF (inclusion or exclusion) in revenue requirement is \$28,254