**EB-2008-0408**

**ONTARIO ENERGY BOARD**

IN THE MATTER of the *Ontario Energy Board Act*, 1998, S.O. 198, c.15, Schedule B, as amended;

AND IN THE MATTER OF the review by the Board of issues relating to the transition to international financial reporting standards and consequent amendments to regulatory instruments

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# REPLY SUBMISSIONS OF THE SCHOOL ENERGY COALITION

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**June 3, 2009**

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# 1 GENERAL COMMENTS

## 1.1 *Introduction*

***1.1.1*** On May 25, 2009 the School Energy Coalition filed detailed submissions in this matter (the "Initial Submissions"). These are the Reply Submissions as requested by the Board.

***1.1.2*** In these Reply Submissions, we are not repeating any of the commentary or analysis in our Initial Submissions. We have strictly limited this to responses to submissions by other parties. In addition, where our Initial Submissions already contain the analysis that rebuts the position taken by another party, we have not repeated that analysis. We would ask the Board to review our Initial Submissions, which were relatively extensive, in the context of the positions taken by others.

***1.1.3*** These Reply Submissions are not organized by issue, as were our Initial Submissions. Rather, we have organized these by party, so that the responses to each party are contained under one heading. We have reviewed the Board's RESS system, and there are posted there fifteen submissions by parties other than SEC. If any further submissions have been received by the Board that have for any reason not been posted, we request that the Board post those submissions, and then give SEC and all other parties the opportunity to respond to them.

# 2 RESPONSES TO THE SUBMISSIONS OF OTHER PARTIES

## 2.1 *Canadian Manufacturers and Exports ("CME")*

***2.1.1*** We note that CME has sought to provide a practical approach to making regulatory decisions affected by IFRS, in general based on the Guiding Principles and Evaluation Framework proposed by John Browne on behalf of eight intervenor groups. This approach is not identical to the more conceptual approach proposed by SEC, but is consistent with it, and as a result we support the submissions of CME in principle.

## 2.2 *Consumers Council of Canada ("CCC")*

***2.2.1*** ***Issue 3.3.*** CCC takes the position that it is better for the ratepayers to capitalize less overhead, and so in general the IFRS approach should be preferred. SEC fundamentally disagrees with this position. Capitalization is primarily about intergenerational equity, i.e. not how much the ratepayers eventually pay, but which ratepayers, over time, pay. We believe that must be done applying proper regulatory principles, and the CCC position is not consistent with that approach.

***2.2.2*** ***Issue 8.*** CCC is one of many parties (perhaps most of them) who have commented that it is unfair to deny recovery of IFRS transition costs because they are prior to this

year. We agree, but we think that the Board does not actually have the jurisdiction to order recovery of past period costs, without significantly disrupting its long-standing principles on retroactive ratemaking and recovery of prior period costs. There have been many – even more unfair - situations in the past in which prior period cost recovery was denied, in order to stay true to the principle that costs in past periods are no longer in play for regulatory purposes. This is why we have proposed a set allowance rather than simple cost recovery. If there is a predetermined allowance, the timing of the expenditure is irrelevant.

## 2.3 ***Natural Resource Gas, et al ("NRG Group")***

***2.3.1*** NRG and other small utilities, supported by BOMA/LPMA, have asked that they be allowed to seek an exemption from IFRS reporting if they are not required to comply for financial accounting purposes. In general, we agree with this suggestion.

***2.3.2*** However, we caution the Board that CGAAP will be gone after 2010. If the smaller companies have not replaced it with IFRS, it is because they will be replacing it with another financial accounting regime, which will not be identical to CGAAP. All of the same issues of consistency between old and new rules, and the impacts of changes, as well as the potential that the new system will be less robust and reliable than CGAAP, must be addressed by the Board before any exemptions could be considered.

## 2.4 ***Energy Probe***

***2.4.1*** No reply submissions.

## 2.5 ***Toronto Hydro ("THESL")***

***2.5.1*** ***Issue 2.2.*** If we understand the THESL submission, it is not that decisions have to be made today on changes to deferral and variance accounts. Rather, it is that when the IASB has come up with its rules that affect this issue, the Board should then consider how to react to those rules. If that is a correct characterization of their submissions, we agree. On the other hand, if THESL is proposing that the Board say, today, that it will be changing its rules relating to deferral and variance accounts, we believe such a statement is premature.

***2.5.2*** ***Issue 3.1.*** SEC in our Initial Submissions have agreed with the Board Staff proposal on opening rate base under IFRS. THESL has now provided an additional twist, alerting the Board to the IASB's May 19, 2009 decision that affects this. Given that new fact, we agree that, while the initial Board policy should still be as proposed by Board Staff, the Board should plan to review that policy on its own motion once the IASB rules are in place a year from now. This is consistent with our general view that the Board should continue to be responsive to changes by the IASB and others, as they arise.

***2.5.3*** ***Issue 3.4***. THESL has proposed the establishment of a generic variance account to deal with the interaction between the recognition of gains and losses and the prohibition against group depreciation. In our submission, it is too early to make such a determination. More information will be available in the future that will allow the Board to make a reasoned decision on how to deal with this impact. A variance account is one of the tools available, once that information is known.

***2.5.4*** ***Issue 5.1.*** THESL correctly points out that the accounting treatment of pension and employee future benefit costs is still very uncertain, and gives some examples. They have also proposed a variance account to deal with certain potential changes, in particular the possible banning of the corridor method. In our submission, if and when these changes arise, it will be important for the Board to respond with a proper analysis and regulatory rule, which could at that time be a variance account. It is premature to do that now, when the accounting rule is still not known.

## 2.6 ***Union Gas***

***2.6.1*** On page 2 of their submissions, Union appears to be saying something quite similar to Hydro One, i.e. go to IFRS right now, without evidence and without further analysis. If that is the case, not only does it appear to us to be inconsistent with their position at the Technical Conference, but for the reasons we discuss below in response to Hydro One, it does not appear to be either a viable or a legal option.

***2.6.2*** ***Issue 5.1***. Although their comment on this issue is found under Issue 2.1 on page 6 of their submissions, Union appears to be advocating a comment by the Board on the regulatory treatment of deferred taxes. In our view, any statement by the Board in its Policy Report relating to deferred taxes should be very careful.

***2.6.3*** What Union seeks is a commitment that, when they establish a regulatory asset for deferred taxes on their books, that amount will be recoverable in the future from ratepayers. In fact, there are many intervening events that change the recoverability of taxes from ratepayers. For example, when a tax is deferred, it is accrued at a given assumed tax rate. In the future, if tax rates have changed, the actual tax payable may be more or less. The Board's "taxes payable" policy adjusts the rate recovery to what is actually paid, not what was accrued years before. There are many other such impacts.

***2.6.4*** In our submission, the most the Board should say in the Report is "The Board's policy on the future recovery of deferred taxes has not changed as a result of IFRS". Nothing more is required, and anything more runs the risk of being inadvertently treated as a policy change.

***2.6.5*** ***Issue 9.*** Union has proposed a particular approach to IFRS vs. CGAAP reporting. Enbridge has proposed a different approach. For the reasons we set out below, we prefer the Enbridge approach.

## 2.7 ***Ontario Power Generation ("OPG")***

***2.7.1*** No reply submissions.

## 2.8 ***Coalition of Large Distributors ("CLD")***

***2.8.1*** On the first page of their submissions, CLD appears not to understand the fundamental difference between costs determined for financial accounting purposes and costs determined for ratemaking purposes. By saying that "IFRS is quickly becoming the authoritative global standard for the determination of costs", CLD essentially discounts this key difference. In our submission, their views on the specific issues are undermined by their obvious confusion over the relationship between regulatory and financial accounting.

***2.8.2*** ***Issue 6.1***. CLD appears to characterize the Board Staff proposal on the relationship between IASB decisions and Board policy decisions as an affirmation of their "hurry, hurry" approach to IFRS, and therefore an affirmation of the CLD view that the Board should change regulatory accounting rules without any evidentiary foundation.

***2.8.3*** That was not our understanding of the Board Staff Proposal. As we understood what Board Staff was saying, it is that the Board has to continue to set rates no matter what the IASB is doing. When the IASB does something that affects regulated entities, the Board then has to assess whether it could have an impact, and if so how the Board should respond. In the meantime, the Board has to make rate decisions based on ratemaking principles, not speculation about the future actions of accounting bodies.

***2.8.4*** ***Issue 8.1.*** The addition proposed by CLD is nothing short of shocking. In effect, it suggests that, as a matter of Board policy, accounting changes will be recovered from ratepayers, no matter what the impacts and regardless of ratemaking principles. This is not credible.

## 2.9 ***Vulnerable Energy Consumers' Coalition ("VECC")***

***2.9.1*** ***Issue 3.4.*** One page 7 of their submissions, VECC have made some useful observations about the implications of the proposed customer contributions rule. We believe that these have to be addressed by the Board before the rule is finalized.

***2.9.2*** ***Issue 7.1***. VECC raises the issue, on page 12, of the impacts of accumulated changes during IRM. Other parties have also alluded to this, including in particular a detailed commentary by BOMA/LPMA. In several areas, including capitalization and depreciation policies, this is highly relevant, and so this should be an additional consideration for the Board. On page 15 they have suggested a working group to consider how to deal with this, and we believe that is probably a good idea.

## 2.10 *Industrial Gas Users' Association ("IGUA")*

***2.10.1*** IGUA notes that several parties seem intent on raising the impact of IFRS on utility risk profile, even though it is out of scope. We saw even more of that in the written submissions, including in particular PWU and others. We agree with IGUA that it would be inappropriate for the Board to make any comment on this issue in the Policy Report, given that those of us that accepted the Board's scope decision did not engage this issue.

***2.10.2*** If the Board wishes to consider that issue in the future, SEC supports that, although we agree with Enbridge that there are information flows and accounting rule changes coming over the next few years that probably need to be available before this inquiry can take place.

## 2.11 *Building Owners and Managers Association and London Property Management Association ("BOMA/LPMA")*

***2.11.1*** Prior to the date for the Initial Submissions, BOMA/LPMA shared their draft submissions with other ratepayer groups, and we have largely included our response to those submissions in our Initial Submissions. We therefore have no reply submissions.

## 2.12 *Electrical Distributors Association ("EDA")*

***2.12.1*** ***Issue 5.1.*** The EDA has proposed some kind of true-up mechanism for PILs. This is an area in which the EDA has for years tried to get true-ups, generally without success. In this case, they appear to be calling for a PILs true-up, but it is not clear that they are proposing that the financial statement impacts be trued-up as well. If that is true, this true-up is not in principle appropriate.

***2.12.2*** If, on the other hand, they are proposing a full true-up of all IFRS impacts during IRM (increased O&M due to lower capitalization, for example, as well as the PILs impact of that change), that is a much more serious issue. The rate impacts could be very significant, and the change to the Board's concept of how IRM works would be quite fundamental.

***2.12.3*** SEC does not, in general, agree with true-ups of the type proposed. However, at an even simpler level, it does not appear to us that such a significant change in IRM, with a material rate impact, should be made without a thorough review.

## 2.13 *Hydro One*

***2.13.1*** The general approach of Hydro One to IFRS is to ask the Board to change the accounting rules for ratemaking, and therefore change rates in potentially substantial ways, a) without knowing what the new accounting rules will be, and b) without knowing the rate impacts they are approving.

***2.13.2*** In making this submission, Hydro One challenges the proposals of SEC and others – both ratepayers and utilities - that the Board take a more measured and careful approach. The basis of their challenge is two-fold. First, CGAAP will be gone, and the world will come to an end. Second, they are legally obligated to use the new rules starting in 2010, so they need Board decisions right away.

***2.13.3*** Our Initial Submissions deal with the Hydro One attitude to IFRS in some detail, so we will not reiterate our comments here. However, we do have specific responses to their two main points.

***2.13.4*** Will CGAAP still be around after 2010? No. SEC is not proposing that regulatory accounting continue to be "CGAAP with modifications" after 2010. Rather, what we are proposing is that utilities not change their current regulatory accounting on key issues until the Board has the opportunity, and the information, to make a principled decision to change rates. Hydro One seems to think we have a brief for CGAAP, but that is not only wrong, but really quite irrelevant. What is relevant is whether rate decisions are made in a principled way.

***2.13.5*** On the second point, the timing issue, Hydro One is in an awkward position. Anything the Board decides in this consultation process that relates to regulatory filings is already too late for them, and anything the Board decides that relates to financial reporting systems does not really kick in for at least two and a half years.

***2.13.6*** On the regulatory side, they have already said that, in July, they will be filing their 2010/2011 rate application, which will be on an IFRS basis. Thus, for the purposes of their near term planning, nothing the Board could possibly do will help them in any way. It is already too late for them, since if they have not made their own internal decisions about IFRS already, they could not be in a position to file a rate application next month.

***2.13.7*** On the financial reporting systems side, the first annual financial statement that must be IFRS compliant will be released in March or April of 2012, covering the year ended December 31, 2011. We already know that the IFRS rules that will apply will be those in place on December 31, 2011, and that there are many changes to the IFRS rules expected between now and then. Therefore, whether the Board makes regulatory pronouncements in 2009, or even in 2010, will not matter very much, until the rules at the end of 2011 become clear. It is only at that point that Hydro One and other regulated entities know what they need to report, and therefore what information they need to collect.

***2.13.8*** Of course, it sounds like that is somewhat unfair to the utilities. They have to keep track of transactions in 2010 and 2011 using the new rules, but they don't know what the new rules are until the end of 2011. That is in fact unfair, and it will in fact create challenges for regulated entities, but those are challenges coming from the IASB, not

from Board policies or actions. The Board is not in a position to change these issues associated with the IASB schedule. All the Board can do is ensure that its regulatory rules, as they are established, are as good as possible. The last thing the utilities need is the Board saying "Let's do this", then responding to an IASB exposure draft by saying "No, we mean this", and then responding to the final rule by saying "On second thought, what about this".

***2.13.9*** It is submitted that Hydro One has provided the Board with no reason to rush its decision on these complex issues. It is one thing to say that you should cancel a committee meeting because a train is in view, coming down the tracks at you. It is quite another thing to say that the Board should simply ignore all of its ratemaking principles to impose an entirely new accounting regime that is still under development, because the uncertainty is making utilities nervous. When a major change such as this is being proposed, an overwhelmingly compelling case for urgency should be presented if the Board is to short-circuit careful and thoughtful decision-making. Hydro One has, by their own evidence, no urgency, compelling or otherwise.

***2.13.10*** Perhaps the most important reason for this is that Hydro One is viewing this as an administrative issue for utilities, rather than as a rates issue. If the Board reviews their submissions on pages 4-6, where they talk about why this or that rule should be adopted by the Board, they will see that Hydro One never once considers ratemaking principles. In each and every case, without exception, the analysis is about administrative efficiency.

***2.13.11*** Hydro One's view appears to be that it is irrelevant whether IFRS produces good rates. If rates go up, authorize a transition to the higher rates, but the Board should abdicate its ratemaking jurisdiction to the IASB on all but a very few issues. And, by the way, it should do so right now, with limited information. Needless to say, we disagree.

***2.13.12*** In the course of reviewing the binder of all the submissions, quite by chance the Hydro One submissions were followed immediately in the binder by those of Enbridge. The difference is quite instructive.

***2.13.13*** The Hydro One submissions are predicated on a rush to a decision, with no real concern that rates will be impacted, but a great deal of concern about administrative ease. Enbridge, on the other hand, counsels caution, warning the Board that there may be many unexpected consequences of the adoption of IFRS for regulatory purposes. Enbridge notes that both utilities and their ratepayers may be impacted by the change in material ways, and the Board's role in balancing those impacts fairly will be a difficult one, in which having good information will be critical to good decisions. But Enbridge also emphasizes that only a few issues need to be determined right away. For most of issues, there will be a lot of additional information soon, and it is after that information is available that the Board should decide on most issues.

***2.13.14*** Both Hydro One and Enbridge are large utilities with experienced and knowledgeable

staff. Arguably, Enbridge has more experience in the nuances of regulation, since they have been subject to OEB regulation for decades longer than Hydro One. But, even if that were not the case (we have, from time to time, disagreed with Enbridge in regulatory matters), it is submitted that Enbridge's approach, focused more on getting a good answer than getting a fast answer, is more consistent with the Board**'s** philosophy of ratemaking, i.e. get it right, and if getting it right takes a little longer, be patient and take the necessary time.

***2.13.15*** In our submission, Enbridge is 100% correct when it says, at pages 4-5 of their submissions:

*"While EGD recognizes and commends Board Staff's efforts to address changes resulting from the adoption of IFRS, the Board's responsibility to protect the interests of the ratepayer, and the financial viability of the utilities, may not be properly served if the changes resulting from the adoption of IFRS are addressed based on partial or incomplete information. Recognizing that the financial ramifications to utilities cannot be appropriately established based on the current available information, EGD encourages the Board to view the current process as an interim step towards making a final determination of ratemaking impacts from the adoption of IFRS, once complete information is available and has been reviewed by the Board and stakeholders."*

***2.13.16*** Enbridge does not ask the Board to rush blindly to a conclusion. It accepts that a more patient and thoughtful approach will produce a better answer based on a firmer foundation (i.e. a reasonable amount of evidence), and there is no reason to rush. We agree.

## 2.14 ***Enbridge Gas Distribution ("Enbridge")***

***2.14.1*** We have, above, noted with approval the approach of Enbridge to these issues, and contrasted it with the less thoughtful approach proposed by Hydro One. This is our primary comment on the Enbridge submissions. However, we also have a few responses to some of their specific submissions.

***2.14.2*** ***Issue 4.1***. Enbridge proposes a method of dealing with IFRS-driven depreciation changes during IRM. IRM has, of course, a mechanism – the Z factor – for recovering large uncontrollable cost increases. If IFRS depreciation changes, which are clearly uncontrollable cost increases, meet the materiality and other requirements for a Z factor, then there is already a built-in route for recovery. If Z factor treatment is not applicable, then it is difficult to understand how IFRS depreciation changes should be treated more favourably than a freak storm, or a terrorist attack on gas lines, or something else that is equally covered under the Z factor rules. Why would IFRS be an exception to those well-defined rules?

***2.14.3*** ***Issues 9 and 10.*** Enbridge has proposed filing and reporting requirements under which certain years would be CGAAP, certain others would be IFRS, and others would

be both. In general, their proposal seems like a pragmatic – if considerably less than perfect - response to a difficult question.

***2.14.4*** However, we do believe that it would be a good idea for the Board to circulate the Enbridge proposal to all of the Board's case managers, and all of the audit staff, to ask whether the transition proposal will result in sufficient year over year comparable data (that is, data prepared on a similar basis) to do reasonable trend analysis, variance analysis, and the other aspects of regulatory review. If this limited comparable information creates a problem with regulatory scrutiny (and we think it might), the Board should extend the overlap period for another year, or two, as required by the Board Staff personnel actually reviewing rate applications and RRR data.

## 2.15 ***Power Workers' Union ("PWU")***

***2.15.1*** PWU characterizes the position of the ratepayer groups as default = status quo. This is a misunderstanding of the position of SEC and others. The question is actually not "Which is the default?". The point of departure between the ratepayer groups and the utilities/PWU is over the question "How should the Board make rate decisions?"

***2.15.2*** What we have proposed is that there should be no default position. If the Board makes a change to rates, it should make it consciously, based on evidence and analysis. A default is only required in circumstances in which the Board decides not to apply proper ratemaking principles to a decision. Thus, the proposal to make IFRS the default comes within that category. As we have noted above in our responses to Hydro One, that proposal, also made by PWU and many utilities, invites the Board to make rate decisions a) without knowing what new rule is being adopted, and b) without knowing the rate impact of the new rule. In our submission, this is poor ratemaking, and contrary to law.

***2.15.3*** It is interesting that, at page 7 of their submissions, the PWU specifically challenge the proposals of SEC to make rate decisions in a reasoned and careful way. They say:

*"The proposed evaluations cannot be completed at this time solely because the quantitative rate impacts of individual policy changes towards IFRS-based regulatory accounting cannot yet be ascertained. If this information were presently available, there would be no impediment to completing the proposed evaluations."*

***2.15.4*** With respect, that is precisely the point. The basis on which a decision could reasonably be made is not yet available. PWU and others believe that the appropriate response is to make the decision anyway, without knowing the result. If utilities made decisions about operating their distribution systems before they gathered information on the consequences of their decisions, this Board would roundly – and correctly - criticize them for poor management. What is poor management in the context of operating decisions is poor regulation in the context of regulatory decisions.

***2.15.5*** PWU go on to argue that the rate impacts of individual accounting changes are not relevant to the Board's decisions. In support, they quote SEC's comments at the Technical Conference agreeing that, in theory, two rules that produce different results can still both produce just and reasonable rates. Not only does the proposed conclusion – "Rate impacts are not relevant to what rule is better" – not flow at all from the quoted exchange, but in any case the fact that something could in theory be true is not really indicative of the real world.

***2.15.6*** The example the PWU gives is actually the perfect one in this context. They say that the parties have already reached a conclusion on the use of regulated net book value as opening PP&E in 2011, without knowing the rate impacts of that. In fact, that is incorrect. The rate impacts are well known: zero. It continues the status quo. Further, the two reasons why there is such a consensus around this point are a) historical cost is the fundamental basis for rate recovery under proper ratemaking principles, and b) the alternative approaches to PP&E would involve material rate impacts with no apparent justification. The analysis that leads to the Board Staff Proposal on this point is exactly the analysis that SEC has proposed for all issues.

# 3 OTHER MATTERS

## 3.1 *Process and Participation*

***3.1.1*** We thank the Board for inviting us to participate in this process. We hope these submissions are useful, and we would appreciate the opportunity to continue to be actively involved in all future consideration by the Board of issues relating to the transition to IFRS**.**

## 3.2 *Costs*

***3.2.1*** The School Energy Coalition hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this process. It is submitted that the School Energy Coalition has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible, including in particular taking the lead, jointly with CME, in bringing together eight ratepayer groups to retain expert assistance jointly, thus reducing costs and, hopefully, increasing the effectiveness of ratepayer participation.

All of which is respectfully submitted.

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