Jay Shepherd
Professional Corporation
120 Eglinton Avenue East
Suite 500
Toronto, Ontario M4P 1E2

BY EMAIL, RESS and PERSONAL DELIVERY

December 30, 2009
Our File No. 2090068

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2008-0230 – Sudbury – Draft Rate Order

We are counsel for the School Energy Coalition in this proceeding. These are SEC's comments on the Draft Rate Order filed by the Applicant with the Board on December 16, 2009.

For ease of understanding, these comments are divided into four sections. First, we deal with the implications of the delay in the in-service date of the new CIS. Second, we look at the change in the depreciation expense, and certain components of it that do not appear to us to be consistent. Third, we look at how the Applicant proposes to deal with water billing expenses. Fourth, we deal with an apparent misunderstanding relating to audit expenses.

Notwithstanding dividing the issues into subject areas, we have numbered the paragraphs (no relation to the numbering in the Applicant's Draft Rate Order) for convenience.

The New CIS

1. ***Decision.*** The Decision provides exceptional relief for the Applicant with respect to the cost of the new CIS. That cost, now (after an update) forecast to be $1,525,000, is exempted from the half year rule for amortization of capital assets [page 28 of the Decision]. The capital cost is reduced by $320,860 [page 26], which is to be allocated to, and borne by, the City's water billing customers. The remaining $1,204,140 is to be borne by the electricity customers.

(416) 804-2767
jay.shepherd@canadianenergylawyers.com
www.canadianenergylawyers.com

2. The Applicant is concerned that if the half year rule is applied, it will have insufficient amortization of the CIS, which they say has a five year expected life, given the four year period of the IRM. The Board responds by allowing 38/48th of the cost to be included in rate base during the four year IRM period, representing the number of months it will be in service during the IRM period. That amount is then divided by 4 by the Applicant to get the amount to be amortized each year, which would be $238,440. (We have noted in para. 20 below that this application of a 25% depreciation rate appears to be incorrect, and a 20% rate should be used.)

3. ***Change of Circumstances.*** The Draft Rate Order notes that, due to events that have transpired since the evidence in this matter was led, the new in-service date of the CIS is March 2010. Therefore, the Applicant argues, the Decision cannot be implemented precisely in accordance with its terms. Instead, the Applicant argues that the CIS should be backed out of the approved capital expenditures budget, but the favourable treatment of amortization should be maintained. Instead of 38/48th of the cost being amortized during the IRM period, it should be 33/48th, reflecting the five month delay.

4. We note that the narrative on pages 13 and 14 does not refer to the much larger impact of this proposed change. As seen at Appendix B, pages 11 and 12, the capital cost of the CIS is proposed to be now entirely excluded from the CCA calculation, increasing taxable income in the Test Year by $602,070 (50% of $1,204,140), and therefore increasing rates by about $295,014, being the grossed-up PILs on that reduction. Thus, a five month delay in the CIS results in a reduction in amortization of $31,478, but an increase in grossed-up PILs of $295,014, for a net increase in rates, each year for four years, of $263,536, or a total of $1,054,144 over the IRM period.

5. ***Proper Remedy in Change of Circumstances.*** In our submission, an Applicant may not submit new evidence in the process of preparing a Draft Rate Order. The rules of the Board are clear, that new evidence must be introduced by way of a Motion for Review of the Decision. No motion has been filed.

6. This makes practical sense as well. The Board's cost of service regime is based on a forward test year. The delays in this process have resulted in a decision at the end of the rate year, but that does not change the fundamental nature of the process. The Applicant forecast that it would bring its CIS in-service prior to the end of the calendar year, and the Decision accepted that forecast. The fact that the Applicant's forecast turned out to be incorrect is irrelevant to the Decision and how it is implemented.

7. To see how that makes sense, one only has to consider what would happen if the Applicant did take the correct approach, and file a Motion for Review. It would be alleging in that motion new evidence that changed the facts on which the Decision was based. Is it in the interests of the regulatory process for utilities to be entitled to, on a selective basis, move to vary decisions because their forecasts turned out to be incorrect? Clearly not. The result would be, for all practical purposes, historical test year ratemaking.

8. The problem is, in fact, even more serious than that. If the Applicant filed a Motion for Review on the basis that subsequent facts made the rates no longer just and reasonable, the intervenors would be

entitled to explore whether there were any other subsequent facts that were material to the rates. For example, intervenors would, on the same principle, be entitled to ask that actual OM&A and capital spending for the year be disclosed. If those amounts were less than Board-approved, the same rationale that would allow the Applicant to change the treatment of the CIS would apply to that other spending as well. The result – clearly not one that promotes regulatory efficiency – would be a complete resetting of rates on an actual rather than a forecast basis.

9. ***Result on Hypothetical Motion for Review.*** We also note that, if a Motion for Review had been filed, and the new in-service date of the CIS accepted by the Board, the depreciation treatment proposed by the Applicant in the Draft Rate Order would not be the obvious result. Providing exceptional rate relief for an asset not being brought into service until a subsequent year would turn IRM from a base year plus formula to a multi-year cost of service. The Board has expressly rejected that concept in the Report on 3rd Generation IRM.

10. Further, trying to spread both amortization and tax shelter effect over the four year IRM period would be problematic for two other reasons. First, it would only be successful if the Applicant stayed on IRM for the full four years. Given the Cost of Capital Report, that may be less likely today than it was at the time of the Decision. Second, all assets would have to have the same treatment. For example, the original Application had $2,640,000 of software coming in-service in the Test Year. During the oral hearing, $1,115,000 was deferred until 2010 (for example, the ERP package), not only reducing the 2009 capital budget, but at the same time increasing the 2009 revenue requirement by $116,675 ($273,175 increase in grossed-up PILs, less, $111,500 reduced amortization after applying the half year rule, less reduced cost of capital of about $45,000). Assuming that deferred software is coming into service in 2010, the same process of spreading cost and tax shelter over the IRM period should also be applied to that spending. The same, in fact, should be true of all capital spending expected over the 2009-2012 period, whether deferred from 2009 or not.

11. None of this, of course, makes regulatory sense, but it is the logical conclusion of the treatment proposed by the Applicant.

12. ***Conclusion.*** In our submission, evidence comes in up to the time of the hearing, but not after. A decision is made on that basis, and the Rate Order must conform to the Decision. Unless the Applicant is willing to file a Motion for Review (in which case all actual spending would be up for consideration), in our submission the Decision stands, and cannot be changed in the course of preparing the rate order.

13. In this case, that means that the amortization expense for the CIS should be decreased from $206,962 to $190,752 (after adjusting for the further error, discussed below at para. 20, in the amortization rate), and the CCA deduction for PILs purposes should be increased from $4,365,755 to $4,967,825. This results in changes to income, taxable income, PILs, and deficiency, with the latter being reduced by about $300,000. The CIS should also be included in rate base for the purposes of calculating return, which may provide an offset of about $50,000 to that reduction.

Depreciation Expense (Amortization) and CCA

14. The schedules at Appendix B, pages 9 through 12 contain amortization and CCA continuity tables. There appear to be a number of questions arising out of the calculations provided.

15. ***Fully Allocated Depreciation.*** On an as-filed basis, the Application included $485,105.18 of amortization that was not included in depreciation expense, but was instead included in transportation or stores equipment costs as part of OM&A expense. This is referred to by the Applicant as "fully-allocated depreciation". In the Draft Rate Order, the amount of "fully-allocated depreciation" is reduced to $398,591.18, a reduction of $86,514.00. Thus the reduction in the overall depreciation is not fully reflected directly in the reduction in revenue requirement. Some of the reduction is reflected in the "fully-allocated depreciation". We are unable to find in the Draft Rate Order where this change in fully-allocated depreciation has resulted in a reduction in revenue requirement.

16. ***Amortization Additions.*** We have been unable to reconcile at any reasonable level of approximation the changes in amortization expense and the changes in capital additions. We have reviewed the relative changes in capital additions and amortization additions (i.e. current year gross depreciation expense) for the main distribution system assets, accounts 1820 through 1860, which comprise the vast majority of the capital spending. The changes in cost do not appear to have the expected changes in current year depreciation.

17. By way of example, the following is the breakdown for Account 1840, which records Underground Conduit, and Account 1845, which records Underground Conductors and Devices:

Account 1840							
Record	***Opening***	***Additions***	***Accum. Dep.***	***Net Base***	***Half Year***	***Depreciation***	***Avg. % Depr.***
As-filed (Appendix B, p. 9)	$19,256,161	$1,151,584	$9,590,382	$10,817,363		$832,665	7.697%
Adjust for half year rule	$19,256,161	$1,151,584	$9,590,382		$10,241,571	$788,344	7.697%
Impact of half year rule						($44,322)	
Proposed (Appendix B, p.10)	$19,256,161	$559,514	$9,590,382		$9,945,536	$498,739	5.015%
Impact of other changes		($592,070)				($289,605)	
Account 1845							
Record	***Opening***	***Additions***	***Accum. Dep.***	***Net Base***	***Half Year***	***Depreciation***	***Avg. % Depr.***
As-filed (Appendix B, p. 9)	$16,832,956	$670,287	$8,775,851	$8,727,392		$717,629	8.223%
Adjust for half year rule	$16,832,956	$670,287	$8,775,851		$8,392,248	$690,071	8.223%
Impact of half year rule						($27,558)	
Proposed (Appendix B, p.10)	$16,708,081	$1,135,984	$8,775,851		$8,500,222	$1,012,590	11.913%
Impact of other changes	($124,875)	$465,697				$322,520	

As can be seen, after adjusting for the impact of the half year rule, the increase or decrease in capital spending in the category is not reflected in an intuitive way in the depreciation figure for the category.

18. We found similar questions on the other distribution asset categories, although the differences were smaller.

19. In our submission, the Applicant should be required to provide detailed worksheets showing the calculation of the current year depreciation expense for all major categories, both as-filed and in the Draft Rate Order, disaggregating the impacts of the half-year rule, the change in the opening balances, and the change in the projects included in the capital plan. Without this level of detail, it does not appear to us to be possible for the Board to be confident that the calculations are correct.

20. ***Depreciation on CIS.*** The CIS is to be depreciated on the basis that 38/48th of it is included in rate base in 2009. The Applicant has taken that to mean that that entire amount should be amortized over four years, even though the asset has a five year life. In our submission, the correct calculation is to take the net amount ordered by the Board and apply the proper amortization rate to it, i.e. 20%, as opposed to 25% as proposed by the Applicant. This should reduce the depreciation expense by $47,663.88, being 5% of the net capital cost allocated to ratepayers. As noted earlier, this is partially offsetting by returning to the 38/48th ratio in the Decision, rather than the 33/48th proposed by the Applicant.

21. We deal with the resulting net impact of this in the section on Water Billing, below, as it affects the allocation of costs as between the ratepayers and the City. The full calculation is in that section.

22. ***Accumulated Depreciation – Opening Balance.*** At page 24 of the Decision, the Board directed the Applicant to reduce its opening rate base by $293,906, the amount of 2008 capital spending that was not used and useful at the end of that year. The same amount was then to be added to the capital additions to rate base in 2009. The continuity charts at Appendix B, pages 9 and 10 appear to make this adjustment on the cost side, decreasing opening balance and increasing opening WIP.

23. Our first concern about this amount is that the Applicant has not shown, one pages 6-8, where these adjustments were made in the capital spending budget, and it is not clear to us that the additions on pages 9 and 10 have been adjusted to take this into account. We suspect that they have, but we cannot follow through the adjustment. We believe that information should be provided.

24. The more immediate concern is that no change was made to the opening balance of accumulated depreciation on pages 9 and 10. Removal of assets in 2008 should mean a reduction of depreciation as well. Although probably small (we estimate about $7,000), in our submission this adjustment should be made in order that the 2009 information can be reconciled properly.

Water Billing

25. Pages 5 through 7 of the Draft Rate Order filing propose a number of changes to the Board's Decision with respect to water billing. In our view, those changes do not properly reflect the Decision.

26. ***The Decision.*** Our understanding of the Decision is that four factors change the calculation and treatment of water billing and its impact on revenue requirement:

   a. At the time of the oral hearing the Applicant amended the amount of CIS software that will be used and useful in 2009, reducing it from $2,100,000 to $1,525,000, and the Board has accepted that change. Without more, this would reduce the depreciation included in the water billing calculation from $420,000 to $305,000.

   b. The Board determined that the CIS would be exempt from the half year rule, but depreciation would be calculated on 38/48th of the capital cost of the asset (i.e. $1,207,292). This would further reduce the depreciation included in the water billing calculation to $241,458.40 (at 20% per annum – see para. 20).

   c. The Board determined that the depreciation expense (and cost of capital) for the CIS should be allocated to the City at the same rate as other costs, i.e. 21%. This would mean that the depreciation of $241,458.40 would be allocated $190,752.14 to the ratepayers, and $50,706.26 to the City.

   d. The Board determined that a transfer pricing study should be done, and created a variance account so that any change in the 79/21 split between ratepayers and City, up to 50/50, could be adjusted for the Test Year and any subsequent year until the transfer pricing study is done. The variance account allows the utility to collect 79% of the combined costs from the ratepayers, but it can treat only 50% as distribution revenues. The balance ends up in the variance account pending the results of the transfer pricing study and a Board determination at the time of the next rate rebasing.

27. In our submission, the combined result of these elements of the Decision is to change the table on page 7 of the Applicant's Draft Rate Order filing to read as follows:

Meter reading	$230,600
Cashiers	$82,978
Customer Account	$1,834,492
Market Services	$95,501
Overhead	$248,596
Depreciation	$190,752
Total costs in rates	$2,682,919
City Water Billing	$780,383
Total	$3,463,302

28. The above calculations adjust the depreciation to the amount allowed by the Board, then allocate 21% of that amount to the City for the purposes of the calculation. In our submission, it is half of that amount, i.e. $1,731,651, that should be credited to the variance account at the beginning of each year, in keeping with the expressed intent of the Decision.

29. ***Comparison to the Proposed Approach.*** We note that the Applicant has taken a different approach, treating the allocation of 21% of the capital cost of the CIS as a capital re-allocation, but not adjusting any of the amounts in the table. Aside from the fact that the depreciation expense is therefore incorrect, the other problem is that, if a 79/21 split is not the ultimate Board decision, the Applicant's approach would prevent the Board from applying any adjustment to the annual cost of the CIS.

30. It is submitted that an adjustment that reflected only some costs, and not the capital component, would not be just and reasonable, and thus cannot be what the Board intended in the Decision. While on our approach the Board would still have to do a manual calculation at the time of its rebasing decision to reflect the cost of capital implications of any change, at least by making the adjustment more explicit, as here, part of the implications of the capital cost are more easily adjusted. It is also more consistent with the Board's Decision, which clearly contemplates that the amount being adjusted in the variance account includes the depreciation component.

31. ***Variance Account.*** The Applicant has proposed a monthly accrual of the variance account credit. In our view, that is not consistent with the Decision. In our submission, the appropriate entries are the following:

    a. Effective July 1, 2009, debit distribution revenue and credit the variance account $865,826, representing the 50% amount - $1,731,651 as recalculated above – for half of the 2009 calendar year.

    b. Effective December 31, 2009, credit other revenue and debit the variance account $390,192, being the amount actually received/receivable from the City for the six months ended December 31, 2009 (i.e. half of $780,383). This will leave a balance in the variance account for 2009 of $475,634. After adjusting for meter reading costs, this is the difference between allocating 21% and allocating 50% of the total costs to the City for half a year.

    c. Effective January 1, 2010, debit distribution revenue and credit the variance account $1,731,651, being 50% of the total costs in this category for the full year.

    d. Each month, commencing January 1, 2010, credit distribution revenue and debit the variance account $65,032, representing 1/12th of the $780.383 annual cost of water billing borne by the City. By the end of the year, the net balance accrued in the account for the year will be $951,268, which again is the difference between allocating 21% and allocating 50% of the total costs to the City for the year 2010. This would be repeated each year until the account is cleared.

    e. When the transfer pricing study is complete, debit the variance account and credit OM&A expenses with half of the cost of the study.

32. We note that the annual difference in the variance account balance between what the Applicant has proposed and what we think is correct is $69,844, which is 29% of the full depreciation amount of

$241,458 on the CIS. The effect of the revised approach we are proposing is that this portion of the revenues collected from the ratepayers is subject to the results of the transfer pricing study, in the same way as the other annual costs of the service.

33. We also note that the City billing adjustments for subsequent years should not be changed in the event that the City pays more. The adjustments reflect amounts included in setting rates, so until there is a change in rates to reflect new assumptions, the entries should be fixed amounts.

OM&A

34. ***Audit Expenses.*** It would appear to us that the Applicant has misunderstood the Board's comments on page 17 of the Decision. The Applicant believes it has satisfied the Board's requirements by shifting $50,000 of IFRS expenses from OM&A to a deferral account. This is not how we read the Decision.

35. The Decision determines that $100,000 for the utility's financial audit is excessive, and $50,000 is more appropriate. This reduction has nothing to do with IFRS, and should be in addition to the IFRS change. The confusion comes, we think, from the fact that the Board approved a $100,000 amount, but that amount includes, we believe, the $50,000 of special audit expenses that was also in the budget.

36. Therefore, we believe that OM&A should be reduced by a further $50,000.

Conclusion

37. In our submission, the effect of the above changes is to reduce the deficiency by about $400,000 per year, and thus reduce rates by an average of about 1.8%.

38. Procedurally, we believe that the process would be enhanced by a revised rate order filing from the Applicant, showing the responses to our comments, if any, and showing the detailed calculations where those are required. If there are aspects of our comments with which they disagree, it would be most efficient, in our view, if those were raised in the context of the corrections that they agree should be made. We would like an opportunity to review the additional details provided prior to the Board issuing an final rate order, since at least with respect to the changes in depreciation, it has not been possible for us to do a complete review based on the information we have seen so far.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.

Jay Shepherd

cc: Bob Williams, SEC (email)
Wayne McNally, SEC (email)
Interested Parties (email)