ONTARIO ENERGY BOARD

FILE NO.:	**EB-2007-0713**

VOLUME:	**1**	
DATE:	**February 4, 2008**	
BEFORE:	**Paul Vlahos**	**Presiding Member**
	Bill Rupert	**Member**

EB-2007-0713

THE ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an application by Hydro Ottawa Limited pursuant to section 78 of the *Ontario Energy Board Act*, *1998* for an Order or Orders approving or fixing just and reasonable rates for 2008.

Hearing held at 2300 Yonge Street,
25th Floor, Toronto, Ontario, on Monday,
February 4, 2008, commencing at 9:32 a.m.

Volume 1

BEFORE:

PAUL VLAHOS	Presiding Member
BILL RUPERT	Member

A P P E A R A N C E S

MAUREEN HELT	Board Counsel
HAROLD THIESSEN WADE FROST FIONA O'CONNELL	Board Staff
JERRY FARRELL	Hydro Ottawa Ltd.
ROBRRT WARREN	Consumers Council of Canada
MICHAEL BUONAGURO	Vulnerable Energy Consumers Coalition
JOHN DeVELLIS	School Energy Coalition

I N D E X   O F   P R O C E E D I N G S

E X H I B I T S

U N D E R T A K I N G S

Description	Page No.

NO UNDERTAKINGS WERE FILED DURING THIS PROCEEDING

Monday, February 4, 2008

--- On commencing at 9:32 a.m.

MR. VLAHOS: Please be seated. Good morning, everyone.

As part of Hydro Ottawa's application for 2008 rates, the company sought approval for the cost consequences flowing from a change in accounting policy regarding the capitalization of overhead costs.

The company's proposal was accepted by all parties to the settlement proposal, other than the School Energy Coalition, and the Board has agreed to hear this matter and that is the reason that we are here today.

With me is Member Bill Rupert. My name is Paul Vlahos, for the record. Could I have appearance, please?

APPEARANCES

MR. FARRELL: Gerry Farrell for the applicant, Hydro Ottawa.

MR. DeVELLIS: Good morning, Mr. Chairman. John DeVellis for the School Energy Coalition, and I have been asked to enter an appearance for Mr. Buonaguro on behalf of VECC and Mr. Warren on behalf of the Consumers Council of Canada.

They couldn't be here today, but they just asked me to say they do support the settlement.

MR. VLAHOS: Thank you, sir.

MS. HELT: Maureen Helt, counsel for Board Staff. With me, I have Harold Thiessen, case manager, Board Staff; Wade Frost, Board Staff; and Fiona O'Connell, Board Staff.

MR. VLAHOS: Thank you, Ms. Helt.

Mr. Farrell, I guess we will turn it over to you. Any preliminary matters, or if you are ready to produce your witnesses to be sworn at this time?

PRELIMINARY MATTERS:

MR. FARRELL: I think that the preliminary matter would be limited at this point to marking documents that have been filed electronically with the Board, but not assigned an exhibit number, per se. I think Ms. Helt can do that. I have given her hard copies for the Board's public record.

MS. HELT: Yes, thank you. We have the settlement proposal that was approved on January 24th to be marked as Exhibit N1.1.

EXHIBIT NO. N1.1: SETTLEMENT PROPOSAL

MR. FARRELL: This, I should add, Mr. Chair, is the revised version that was revised to take into account your comments and mine during the settlement hearing.

MS. HELT: Next, we have the PriceWaterhouseCoopers opinion dated January 8th, 2008 to be marked as K1.1.

EXHIBIT NO. K1.1: PRICEWATERHOUSECOOPERS OPINION, DATED JANUARY 8, 2008

MS. HELT: The next exhibit is the updated list of witnesses, which is in the prefiled evidence. It has already been marked as Exhibit A1, tab 11, schedules 1 and 2. I don't think there is a need to mark this as a new exhibit number. We can refer to it as the prefiled number.

There are three further exhibits. To be marked as

K1.2 will be the Enersource Hydro Exhibit J, schedule E.

EXHIBIT NO. K1.2: ENERSOURCE HYDRO EXHIBIT J, SCHEDULE E.

MS. HELT: The next exhibit is the Enersource Hydro Exhibit B, schedule 2, tab 1, forecast charge parameters, to be marked as Exhibit K1.3.

EXHIBIT NO. K1.3: ENERSOURCE HYDRO EXHIBIT B, SCHEDULE 2, TAB 1, FORECAST CHARGE PARAMETERS.

MS. HELT: The next exhibit is Enersource Hydro, Exhibit A, schedule 3, tab 1, entitled "Summary of the Application", to be marked as Exhibit K1.4.

EXHIBIT NO. K1.4: ENERSOURCE HYDRO EXHIBIT A, SCHEDULE 3, TAB 1, ENTITLED "SUMMARY OF THE APPLICATION"

MR. VLAHOS: Thank you, Ms. Helt.

MS. HELT: Those are the exhibits of Hydro Ottawa.

MR. RUPERT: Mr. Farrell, I didn't bring with me the revised settlement agreement. Am I going to need that this morning, at all, from your perspective, or Mr. DeVellis?

MR. FARRELL: I don't believe so, sir. What we filed for the record electronically was the revised version, and then what I call a blacklined version or revision marked version, just so people could see whether or not the changes that we made were in fact satisfactory. I have heard from no one that they are not.

But we don't intend to refer to it, other than the one part where the witnesses will be adopting the evidence in the issue we are here to debate today.

MR. RUPERT: Thank you.

MR. DeVELLIS: Since we are introducing documents, I have also submitted a compendium of documents that I have given to my friend and to Board Staff. I wonder if we can enter that as an exhibit at this point.

MS. HELT: Yes. We can mark the compendium of documents of the School Energy Coalition as Exhibit K1.5.

EXHIBIT NO. K1.5: COMPENDIUM OF DOCUMENTS OF THE SCHOOL ENERGY COALITION.

MR. DeVELLIS: Thank you.

MR. VLAHOS: We don't have copies of those, do we? Yes, we do have it. Thank you.

MR. FARRELL: For the record, I should indicate, Mr. Chairman, that Mr. DeVellis provided us with electronic versions of what is in his compendium on Saturday, and the Hydro Ottawa witnesses have reviewed them and we have discussed them, so this is not something that comes as a surprise.

MR. VLAHOS: All right, thank you for that. Okay, Mr. Farrell.

MR. FARRELL: Thank you, Mr. Chair. I am presenting a panel of three witnesses. Sitting closest to the Board is Mr. Michael Grue. He is a treasurer of Hydro Ottawa. Sitting to Mr. Grue's left is Doug Shannon, who is a director of finance of Hydro Ottawa, and sitting to Mr. Shannon's left is Lynne Anderson, who is the chief regulatory affairs and government relations officer.

I would ask that they be sworn.

HYDRO OTTAWA - PANEL 1

Michael Grue, Sworn

Doug Shannon, Sworn

Lynne Anderson, Sworn

EXAMINATION BY MR. FARRELL:

MR. FARRELL: The purpose of the appearance of these witnesses, in addition to speaking to the issue, is to, one, adopt the written evidence and responses to interrogatories that are relevant to Issue 3.4; and the second purpose is to summarize that written evidence so you don't have to be working through pages; and the third - and this is why the examination-in-chief may be a bit longer than you might have otherwise expected - is to summarize Hydro Ottawa's efforts to compare its capitalization process, as proposed, and the results of it to other electricity distributors.

And this is a process we have been engaged in since really the application was filed, and, as the witness wills tell you, it is not simple to find capitalization process evidence or data in the applications that have been filed with the Board on a cost of service basis for 2008 by the other 19 or so electricity distributors who have filed such applications.

So with that, Ms. Anderson and gentlemen, your CVs are set out in Exhibit A1.11.2. Did each of you prepare your CV?

MS. ANDERSON: Yes.

MR. GRUE: Yes.

MR. SHANNON: Yes.

MR. FARRELL: And is each CV accurate?

MS. ANDERSON: Yes.

MR. GRUE: Yes, it is.

MR. SHANNON: Yes.

MR. FARRELL: Ms. Anderson and gentlemen, the evidence relevant to Issue 3.4 as set out in the settlement proposal at page 15, was this evidence other than the PWC opinion prepared by you jointly or under your joint direction or control?

MS. ANDERSON: Yes.

MR. GRUE: Yes.

MS. SPOEL: Yes.

MR. FARRELL: Is the evidence accurate to the best of your knowledge or belief?

MS. ANDERSON: Yes, except there is one correction and an update that I would like to make to the record. If everyone would turn to Exhibit B1-3-1 attachment T, which is the KPMG report. If you would go to page ii of the executive summary. What we did notice is kind of a quirk of technology. Depending on the type of printer used to print this document, there were occasions that the title of this table, the dates would not show and I am not sure whether the versions you have in front of you show the dates or not. Given that they weren't showing in the version we were looking at we didn't notice that there was an error in the date that is shown at the title of that table.

What the table should say is "Summary of capitalized overhead costs, draft 2008 budget, as at August 1st, 2007." So if you actually had the date you would see it would say 2008. Of course it was a draft '08 budget prepared in August of 2007.

As indicated, this was the draft budget and we thought we would just highlight that the numbers that resulted in the final application before the Board and also the settlement. So if you look at that table, in the first column of that table, it says total gross OM&A and the number at the bottom of that table is $89,426,000. That was a draft budget.

The final budget resulted in the number being 87.5 million. And then as a result of the settlement that would drop to 86.0 million. The total capitalized overheads, which is the second column there, at the bottom you would see 13.0 million. The final as filed capitalized overheads was 12.9 million. And the final percent of total gross OM&A that is capitalized, which is the final column, as filed the percentage would be 14.7 percent and per the settlement of that percentage would increase to 15 percent.

I will also note that this table is duplicated in the body of the report on page 14. I won't go through all the edits again. Basically it is the same edits on the table that is page 14 of that report as well, the same date problem, the same update to the numbers.

MR. FARRELL: Thank you, Ms. Anderson. Mr. Shannon, with Ms. Anderson's correction and update, do you say the evidence is accurate to the best of your knowledge and belief?

MR. SHANNON: I do.

MR. FARRELL: Mr. Grue, same question?

MR. GRUE: Yes, I concur with Ms. Anderson.

MR. FARRELL: Ms. Anderson, can you start off by explaining what "capitalization process" means?

MS. ANDERSON: Yes. We call this capitalization process or sometimes interchangeably called it the accounting change, but wanted to point out it encompassed two changes. The first was the amount of overhead costs that were being capitalized, but the second was that it was also a change in methodology of how allocations were done. So the first change, the amount being capitalized, resulted from an update of the cost drivers for allocating overhead costs and it was the result of a perhaps a more direct causal linkage between the overhead costs and the capital programs. This particular change did result in less cost being capitalized and therefore, of course, an increase in the OM&A expenses.

The second change, which was really a simplification of the whole process, there were a number of burdens. There are now only three burden calculations that are done in the process. The new process is more efficient, it is more transparent and it should result in greater stability year over year. But that change is more about sort of internal processes and does not impact the OM&A expenses, and therefore does not impact the revenue requirement.

What it did result in was some shifting in amongst the OM&A groupings of accounts but didn't have any impact on the overall revenue requirement.

So these two changes, we think that today is more about the first one, which is the magnitude of the capitalization of overheads but just wanted to point out that there was a second one as well.

MR. FARRELL: Mr. Shannon, could you explain why Hydro Ottawa decided to review its capitalization process?

MR. SHANNON: There were several factors that were taken into account. I guess the first and probably the most important would be the March 2007 exposure draft by the Canadian Accounting Standards Board on rate-regulated entities, and specifically the removal of exception from section 1100 pertaining to the recognition and measurement of assets and liabilities arising from rate regulation.

Also, keeping this in mind, we have had -- Hydro Ottawa did have past discussions with its past auditors, Deloitte & Touche regarding accounting guideline 19 which is essentially a reporting guideline. Their opinion was that we had actually capitalized more overhead than a non-regulated entity. However, that was acceptable based on the exemption under section 1100 for rate-regulated entities, and also considering the fact that the OEB had approved our rates based on fully costed approach of capitalizing overhead in the past.

We also recognize that entities usually look at their major accounting policies and procedures on a three- to five-year horizon, and given what I just mentioned, we hasn't looked at our capitalization process since 2003, although you will notice that the documents that have been filed indicate that the policy is dated 2005 and the procedure is dated 2004, but that was just a matter of the paperwork catching up to what actually had been implemented in 2003 in terms of our capitalization process.

So as I mentioned, it is just good practice to take a look at these, but in conjunction with the other items that I mentioned it was more important.

We also -- to Mr. Farrell's point, we also tried to get a sense of what was happening elsewhere in the industry and the only really metric we could look at was OM&A per customer. And given our low OM&A per customer that suggested we were capitalizing more OM&A than most utilities.

Finally, I would like to add that with a change on the horizon with respect to the convergence of Canadian generally accepted accounting principles with the international financial reporting standards to be adopted in 2011, our current thought is that they may be more restrictive than presently, and may actually have a greater impact in terms of the amount of indirect costs that may be capitalized by a regulated or non-regulated entity, and that really the March 2007 exposure draft, as I mentioned previously, was -- is considered by many in the accounting profession as being the first step towards moving towards international financial reporting standards.

MR. FARRELL: Just for clarity, Mr. Shannon, when you refer to section 1100 I take it you are referring to that section in the CICA handbook?

MR. SHANNON: That is correct.

MR. FARRELL: If you are happen to slip into acronyms and you refer to IFRS, you are referring to the international financial reporting standards?

MR. SHANNON: That is correct.

MR. FARRELL: Could you summarize, Mr. Shannon, the review process that Hydro Ottawa did undertake.

MR. SHANNON: We, the process actually is outlined in Exhibit B1-3-1 of the prefiled evidence, and just briefly to those various pieces of evidence, we first engaged our past auditors Deloitte & Touche -- we have current auditors for 2007, Ernst & Young. Deloitte were our auditors for the period 2003 up to December 31st, 2006. So they were very conversant with our accounting practices. We asked them to undertake a review of the industry with respect to the capitalization of indirect costs. You will find their report as attachment S to the exhibit. And their report date is June '07. Generally just summarizing what they reported to us was that they found there was a move to greater conservatism with respect to the capitalization of overheads and they also found that there was a wide range of practice in the utility is industry with no really one particular standard. Concurrently, Hydro Ottawa staff also undertook a number of web searches just to find out what was out there in terms of capitalization of overheads, and we came across two studies that have been prepared by the accounting firm KPMG, one with respect to New Brunswick Power and one with respect to Union Gas.

When we reviewed those studies, we found that they were reflective of the comment that Deloitte had said in terms of moving towards more conservatism, in that they recommended a causal linkage between indirect costs and capital activity.

So we asked the same lead who conducted those studies to participate in the review that would be conducted by Hydro Ottawa with respect to its capitalization process. That report is in attachment T, and it is dated August '07. And, really, the summary to that report is that KPMG found the overhead capitalization results developed in the study and to be adopted by Hydro Ottawa, as presented in the report, to be fair and reasonable.

Lastly, I would just like to mention that we also asked our legal counsel, Fraser Milner Casgrain, to review regulatory precedent on this issue, and they really couldn't find any particular guidance for us on this issue, again, suggesting that there may be a wide range of practice.

So that is really the summary of the review process.

MR. FARRELL: Thank you, Mr. Shannon. I should mention, Mr. Chair, that the advice that was given to Hydro Ottawa at the time - I think it is attachment U - was a report to the members of the audit committee. That report is dated August 21st, 2007. Our advice was at that time oral.

We did then put our advice in writing in the form of a memorandum to Hydro Ottawa. I have -- if anyone would like to have a copy of that, I am prepared - and so is Hydro Ottawa, more importantly - to waive the privilege that attaches to that document, if anyone would like to have it. If not, I will just keep it in my document bag.

MR. VLAHOS: Mr. DeVellis.

MR. DeVELLIS: I think I understand the gist of the advice that was given, so I don't think that we need to see the document.

MR. VLAHOS: All right, thank you. No need to file that.

MR. FARRELL: Thank you, Mr. Chair.

Mr. Shannon, could you summarize the outcome of the review process.

MR. SHANNON: Yes. First I would like to say that Hydro Ottawa did adopt the approach that was described in the KPMG report. The reason for that, and it should be noted, that the Accounting Standards Board actually did issue in August of '07 their decision to remove section 1100, exemption for rate-regulated entities, which more or less confirmed to Hydro Ottawa that its proactive approach to assessing its overhead capitalization process was in fact correct.

Based on the process, then, Hydro Ottawa Limited was able to quantify the amount of overhead costs that should be capitalized based on the removal of the section 1100 exemption. And, as mentioned by Ms. Anderson, this resulted in approximately a shift of 6-1/2 million of indirect costs from capital to operating, bringing Hydro Ottawa's OM&A customer -- OM&A, excuse me, per customer in line more with industry average.

We also reported to our audit committee on two occasions, the first in May and again in August '07, to -- just to elaborate on the review process and the outcome, and we have included those reports, which I think are very good summary reports, in attachment R and U, respectively.

Lastly, as an outcome, based on all of this information, Hydro Ottawa filed its 2008 rate application incorporating the new capitalization process, which is obviously intended to cover the 2008 test year. But as you are well aware, this remains as the base year for Hydro Ottawa until we future rebase, which likely would be in 2011.

So from our point of view, it was critical to include it in that rate application.

MR. FARRELL: Mr. Shannon, could you explain why Hydro Ottawa decided to seek an accounting opinion on the change in its capitalization process.

MR. SHANNON: Yes. As I mentioned earlier, we had engaged new auditors for the 2007 year. In discussion with those auditors, and even our past auditors -- currently the new auditors, Ernst & Young, actually suggested to us that obtaining an independent accounting opinion would be prudent to support Hydro Ottawa's accounting change and its reflection in its financial statements, and, more importantly, because those financial statements would form part of the 2008 rate application.

So given that KPMG had worked on the actual study of the capitalization process and both that Deloitte, who were our former auditors, as I mentioned, and Ernst & Young, who are our current auditors, could not really provide an independent opinion, Hydro Ottawa approached PriceWaterhouseCoopers to provide that independent opinion.

The PWC opinion, as was mentioned by Board Staff, is now filed as Exhibit K1.1. PWC's involvement actually kind of rounded out our use of the four largest accounting firms in Canada to confirm Hydro Ottawa's accounting change, in fact, was correct and should be applied as per the study.

MR. FARRELL: Now, Ms. Anderson, I mentioned at the start of this that one of the purposes of this examination-in-chief was to describe Hydro Ottawa's efforts to compare its new capitalization process to those of other electricity distributors in Ontario. Could you explain your efforts in that regard.

MS. ANDERSON: Certainly. First, as Mr. Shannon pointed out, we had engaged Deloitte & Touche to do a review of practices in other jurisdictions, principally North American jurisdictions. That Deloitte report, as I mentioned, is attachment S, and at the back of it there is a table in which they did a comparison of the information that they could find.

What it did show was that, unfortunately, you can't get a lot of detailed information about capitalization approaches from financial statements of other utilities, either the quantum being capitalized or the methodology. Generally, that information, there may be some slight information, but you can't get definitive information.

So that table is there in that Deloitte report, though.

As Mr. Shannon also mentioned, we had engaged KPMG to work with us on our capitalization process review. As a result, we had looked at the two reports that they had previously worked on, one for New Brunswick Power and the other for Union Gas.

Both of these reports, those two utilities -- it did indicate that those companies were capitalizing in roughly the same range as Hydro Ottawa's new capitalization process, if not slightly less. So those two reports were sort of indicative there.

We also looked at the OEB statistical year book for 2006. It is a report the Board issues on each year on the financial statistics for LDCs. We looked at the fact that on page 10 of that report the average OM&A per customer for -- across LDCs in 2006 was $235 per customer, and, in the same year, Hydro Ottawa's OM&A per customer was only $162.

We believe that our capitalization policy was part of the reason that we were so much lower than the industry average in that respect.

We also looked at the PEG report that the Board had commissioned, PEG being the Pacific Economics Group, which was for benchmarking of costs of Ontario power distributors. That report did benchmark productivity comparisons between LDCs, but it did it solely on the basis of OM&A again.

There was something in that report that indicated a comparison of what was called excess costs, and in that report Hydro Ottawa's was compared against -- I think they called them large southern city utilities. And in that productivity benchmark, Hydro Ottawa is shown as having negative $6.3 million of excess costs in that report. In other words, our costs were 6.3 million less than the benchmark of the other large utilities.

So while we believe we do have good productivity, we think that was a strong indication that perhaps there were some differences in capitalization policies taken effect in that productivity measure, why we seem to be showing as that much more productive than the other comparators.

We went on to review all 19 rate applications filed with the Board this year for 2008 cost of service applications. All but one of those did file capitalization policies, but unfortunately, those policies typically don't provide much detail. You certainly can't gather from them the magnitude of overhead costs being capitalized, with the exception of two LDCs which did have those numbers. Those two were Enersource and Hydro One. In both of those cases, it does appear that Hydro Ottawa's proposed change in capitalization policy brings it closer in line to the amounts being capitalized by both Enersource and Hydro One.

In particular we filed, as we indicated, evidence from the Enersource proceeding where -- Enersource is an LDC that has been routinely used as a comparator with Hydro Ottawa there was a comparator and cohort study in which Enersource was compared also the PEG report I just mentioned also compared Hydro Ottawa to Enersource.

Fortunately, they are a little ahead of us the 2008 rate application process. They have already reached a complete settlement in all issues and the Board has accepted the settlement proposal in that case. There was an interrogatory filed by VECC, and I think we indicated that that is now is Exhibit K1.2 which we have filed. That interrogatory asks specifically to Enersource what were the overhead costs that they were capitalizing in 2008 and their response was that they are capitalizing $7.5 million of overhead costs.

The other two exhibits that we filed, we filed really for the simple reason of showing the relative size of Enersource compared to Hydro Ottawa. So the one exhibit showed their number of customers compared to Hydro Ottawa, and the second one showed their OM&A costs compared to Hydro Ottawa.

When we looked at those based on customer numbers Hydro Ottawa is about 1.5 times the size of Enersource. If you look at OM&A, we are about 1.4 times the size of Enersource. So if you just apply those factors to their 7.5 million being capitalized, you would get a capitalized overhead of somewhere in the magnitude of 10.4 million to

11.2 million. If I remind you, going back to our KPMG study, the number I updated at the beginning of this hearing, that Hydro Ottawa is capitalizing 12.9 million of overhead costs. So based on that factor even with our change we would be, it appears, capitalizing slightly more than Enersource. If we didn't implement this change, we would be capitalizing 19.3 million, clearly well in excess of a comparator like Enersource. So just another reason that it seemed like our change is bringing us closer in line to at least one comparator to Hydro Ottawa.

MR. FARRELL: Ms. Anderson, could you explain the effect of the change in Hydro Ottawa's capitalization process.

MS. ANDERSON: Yes. The first thing to point out is that this change doesn't affect our total costs. The total costs remain the same. What it did do was shift those costs from being capitalized into being expensed as part of OM&A.

From the company's perspective, when you expense something instead of capitalizing it, you end up with a lower rate base. With a lower rate base, you end up with a lower net income and therefore this change actually has negative financial implications to the company. We are not doing it in order to improve the net income for the company; quite the opposite. We are actually doing it because it is the right thing to do.

The other thing to consider, of course, if we are not earning a return on those costs, then those are dollars that the customer is also not paying. So if you look at that 6.5 million over the long term, over the life of the asset, as it were, if it was capitalized, the customers will pay less in the long term because they will not be paying a return on it. It will be expensed and there will be no return.

Of course, we did recognize that there was a bill impact in the year you make the change. In the year you expense it, there is a bill impact. So we did look at that. In the settlement proposal, you will see that the bill impact of the settlement including the change in capitalization for the residential customer using a 1,000 kilowatt hours was 0.8 percent on the total bill. That is including change in capitalization. For the general service customer, using 2,000 kilowatt hours, which is the other comparator that the Board typically looks at, the impact is the same, .8 percent on the total bill.

When you look at all the other classes the bill impacts are less. They are down as low as even a rate decrease for a general service customer using 200 kilowatts of about 1.7 percent.

Without the change in capitalization, there is no question that those bill impacts would be lower. They would be negative across the classes. The capitalization process change does result in a bill impact of somewhere between 1 and 1-1/2 percent on the total bill for a residential customer, and that impact is progressively less for the other classes.

So based on these bill impacts that we looked, at we did think this was an appropriate time to implement this change in capitalization because we could do it without much of a bill increase to any of the customer classes.

MR. FARRELL: Finally, Ms. Anderson, could you explain the effect of postponing the change in Hydro Ottawa's capitalization process to January 1st, 2009 which is the mandatory date that Mr. Shannon referred to.

MS. ANDERSON: Yes. The first point there is that it is -- the accounting opinion did say that the latest that we could implement this is January 1st, 2009. That is I guess the drop-dead date, as it were. That is less than a year away, so it is looming very quickly. It is our belief that deferring this for another year would just be another year that Hydro Ottawa would be somewhat of an outlier compared to all the other LDCs that we were able to look at, and other utilities for that matter.

Furthermore, we have already changed our systems. This has been implemented. Our systems have been changed. To revert back would certainly require significant amounts of work.

Finally, as Mr. Shannon talked about earlier, the most important thing to us is the fact that we are moving into third-generation incentive rate mechanism or 3GIRM, as we call it, 3GIRM, in which Hydro Ottawa's rates will be set in 2009 and 2010. We absolutely have to implement this capitalization change no later than January 1st, 2009. Therefore, if we are setting the base now, if we don't get this change implemented '08, the implications on Hydro Ottawa's finances for 2009 and 2010 are certainly extreme. We would be incurring 6-1/2 million of operating costs for which there would be no revenue.

So for all those reasons and the reasons that Mr. Shannon has indicated, we feel the appropriate time to implement this change is now January 1st, 2008. We have identified the need. It has been vetted by professional standards and it is the time to implement this change.

MR. FARRELL: Thank you Ms. Anderson.

Mr. Chairman, I realize this is a fairly lengthy examination in chief. We thought that it was important that Ms. Anderson explain and Mr. Shannon explain what they did. I have indicated to Mr. DeVellis that if he wished some time to think about this, I would ask you for an adjournment. Mr. DeVellis has indicated he is ready to go, so here we go.

MR. VLAHOS: Thank you, Mr. DeVellis.

CROSS-EXAMINATION BY MR. DEVELLIS:

MR. DeVELLIS: Thank you. And Mr. Farrell, thank you, I appreciate your offer.

MR. DeVELLIS: Ms. Anderson, good morning. I just want to start with the last part of the examination-in-chief and there are just a couple of points of clarification. You mentioned, first of all, the Enersource document. I see where the 7.5 million capitalized overhead comes from and then you mentioned a figure of 10 percent of, I guess that represents 10 percent of their total distribution expenses that are capitalized?

MS. ANDERSON: I didn't actually mention the percentage. I was simply looking at if you tried to gross that up to a comparable size to Hydro Ottawa, then you would have to apply a factor of somewhere between 1.4 or 1.5 percent to make the amount comparable to the size of the utility that we are.

MR. DeVELLIS: I thought that you mentioned some range, I thought I heard 10 percent or something.

MS. ANDERSON: No, it was $10 million. If you apply 1.4 percent to their 7.5 million, you would get around 10 million. And if you apply the 1.5 percent times size you would get to 11 million and change.

MR. DeVELLIS: Okay. And that compares to your --

MS. ANDERSON: 12.9 million.

MR. DeVELLIS: 12.9 million, I see, okay. Where did you get the gross-up factor from?

MS. ANDERSON: Sure. In the exhibits for Enersource -- we looked at the customer count for Enersource. If you look in exhibit, which was K1.3, you actually see a total of 238,914 customers. Unfortunately, that did include --

MR. FARRELL: May I stop you for a second? I might have mismarked my exhibits, but I thought that -- just so the record is clear, that the forecast change parameters, number of customers, was that K1.2 or K1.3? I apologize for having to clarify this.

MS. HELT: That was K1.3.

MR. FARRELL: Thank you. You were right and I was wrong.

MS. ANDERSON: So you will see there is 238,000 customers. They included street lighting connections, which is not a customer, in our view, so you have to subtract that number out, and you get a number of customers of 190,000 customers.

Hydro Ottawa has 290,000 in 2008, so a simple proration would say that we are 1.5 times larger.

We did the same thing on OM&A, which is Exhibit K1.4. We looked at their OM&A of 42.1 million to Hydro Ottawa's 58.6 million and did, again, a straight proration to get a 1.4 times factor, that we are larger, and just applied that to the capitalization to look at it from a relative perspective.

MR. DeVELLIS: Why do you say those are appropriate gross-up factors to use?

MS. ANDERSON: We used them because any other factor we looked at would have been much smaller. So I could have used rate base and the factor would have been more like 1.1. It would have been much smaller. It would have looked like we were capitalizing that much more than Enersource. So we took probably the most conservative ones.

MR. DeVELLIS: Okay. The other follow-up question I had is that you mentioned a total bill impact of 0.8 per cent for residential and small general service customers, but the change in -- sorry, if you look at the distribution rate impact, it is 6.5 million on a revenue requirement of approximately 150 million. So that is about a 4 percent distribution rate impact; is that fair?

MS. ANDERSON: Correct, in that order.

MR. DeVELLIS: Thank you. And then the last follow-up question I had is you mentioned that if you weren't able to implement this change at this time that you would have $6.5 million in operating expenses that you wouldn't have any revenue for. You would still have -- they would still be in rate base and you would earn a rate of return on them, as you would any other rate base, right?

MS. ANDERSON: Right, but the revenue associated with the return on rate base and the amortization of those assets is a few hundred thousand compared to 6.5 million, so the net impact to our net income, given we have to make this change, would be in excess of 6 million a year.

MR. DeVELLIS: I guess my question is, though, if you didn't have the 6.5 million, you would go out and borrow 6.5 million and you would pay at a cost of whatever that cost is, but you are being compensated for that in your rate base with your weighted average return on capital?

MS. ANDERSON: Yes, but our net income would decrease by in excess of 6 million, because we have to make this change. Therefore, our expenses will be increasing and there wouldn't be an associated revenue, because the revenue would be associated as if it had been a capital expenditure, which would be a few hundred thousand.

MR. DeVELLIS: When you say net income, you mean your financial statement net income?

MS. ANDERSON: Correct.

MR. DeVELLIS: Okay.

MS. ANDERSON: The net income that our credit rating agencies would look at, for instance.

MR. DeVELLIS: Okay. Now I have some -- what I would like to do is go through the various documents that you referred to this morning in your direct. I have a few questions on each of them, and I will start with the PriceWaterhouseCoopers opinion.

That is Exhibit K1.1. If you can turn to page 3 of the document, about, I guess, three-quarters of the way down, the paragraph starting with "The previous policy"; do you see that? It says:

> "The previous policy and procedure was considered to result in a capitalization of amounts in excess of amounts directly attributable under paragraph 5 of section 3061 of the CICA handbook."

So my first question is: The use of the term "directly attributable", that hasn't changed; it's your understanding of what that means has changed?

MS. ANDERSON: I would say I guess my understanding of it is that when you had an exemption under section 1100 of the accounting standards for rate-regulated companies, that it essentially allowed you to expand, perhaps, a definition related to a directly attributable that wouldn't be permitted without that exemption. Therefore, that is part of the reason we are adopting an approach that requires a more direct causal linkage between the overhead costs and the capital program.

MR. SHANNON: Could I just add one thing to that? If you also refer to their report on page 5, the second paragraph, it says:

> "The change in methodology can be summarized as being one that moved from identifying directly attributable overhead costs subject, to allocation to capital projects based on a fully allocated cost approach, to a methodology that is more based on the causal linkage approach."

So, again, in conjunction with the exemption that used to exist or will not exist under section 1100 on January 1, 2009, rate-regulated entities were allowed a more expanded, if you like, definition of "directly attributable".

When you remove that exemption, we fall in line with the rest of the non-regulated entities. Therefore, "directly attributable", in our view, the definition contracts, much like the Deloitte & Touche study said, that it is getting more conservative.

So, therefore, the causal linkage approach is much more apropos with the removal of that exemption.

MR. DeVELLIS: Right. I was actually going to point you to that passage you just read. I read that to mean that you are changing from a fully allocated approach to an incremental cost approach; is that fair?

MS. ANDERSON: No.

MR. SHANNON: Well, some refer to it as incremental, but I would refer to it as being a causal linkage approach. You can much more marry up the indirect costs with the capital activity under our proposed approach than in the past. The fully allocated approach was more generous because of the exemption that was allowed.

MR. DeVELLIS: What I am hearing, then, is that the change really is -- the elimination of the exemption under the CICA is really what precipitated all of this; is that fair?

MR. SHANNON: Yes, it was one of and probably the largest factor.

MR. DeVELLIS: Okay. On the bottom of page 3 of the PriceWaterhouseCoopers report, it says:

> "In our opinion, the revised methodology with respect to capitalized overhead described above is in conformance with Canadian GAAP."

Do you see that? What they are referring to is -- well, are you no longer relying on the exemption in the CICA handbook, that that is in conformance with the GAAP rules?

MR. SHANNON: I am not quite sure what you mean by relying on the exemption.

MR. DeVELLIS: Well, if your previous capitalization policy relied on an exemption which allowed you to capitalize a greater proportion of your overhead than would normally be done by non-rate-regulated entities, if you are simply referring to the standard rule under the GAAP rules, that that would be in conformance with GAAP?

MR. SHANNON: I think we were always in conformance with GAAP, because the exemption under section 1100 basically stated that for the measurement of assets and liabilities, rate-regulated entities did not have to use section 1100. So we were allowed, if you like, an expanded version or definition of the measurement of assets and liabilities.

With the removal of the exemption, that no longer exists for rate-regulated entities, so we have to defer to more what a non-regulated entity would capitalize, in terms of indirect costs.

So from our perspective, we have always complied with GAAP, and in order to continue to comply with GAAP, on January 1, 2009, we have to -- we had to reconsider our indirect cost capitalization process, which we did.

MR. DeVELLIS: I guess what I am saying is reliance on the exemption isn't mandatory; is that right?

MR. SHANNON: Well, it is not mandatory, but -- well, mandatory; let's put it this way. Our past capitalization policy was included in our past rate application for 2006 and right up to the current rate application. So those rates were accepted and the policy was filed with the Ontario Energy Board. Those gave rise to -- there was an approval thereof our capitalization process in terms of the inclusion in rates. But with the whole change in the accounting industry going towards much more conservatism, we have to make that change, and as I mentioned, we had to align it with our 2008 rate application simply because the rate application becomes the base year for future rate mechanism adjustments until we rebase again in 2011. So we would be severely disadvantaged by not doing so as of January 1, 2008.

MR. DeVELLIS: What I am getting at is all this report says is that you were relying on the exemption in the past and that was okay, and now you are no longer relying on the exemption and that is also okay because GAAP doesn't require you to rely on the exemption?

MR. SHANNON: It is only okay in that we have changed our capitalization process to respect the fact that there will no longer be an exemption for rate-regulated entities.

MR. DeVELLIS: Right, but this report doesn't say that if you don't change your capitalization policy right now, you won't be in conformance with GAAP?

MS. ANDERSON: Actually, I believe that is what it is intending to say, is that if we don't make this change that we would no longer -- I think that is implied. We have to make the change in order to be in conformance.

MR. DeVELLIS: That is what my question is. It doesn't say you have to make the change. You are choosing to make the change, and that is in conformance with GAAP. But it doesn’t say that if you don't make the change, you won't be in conformance with GAAP?

MR. FARRELL: Can you put a time frame on that, Mr. DeVellis, because if you look at page 6 the PWC opinion and the paragraph that starts sort of midpage and you look at the last sentence:

"Accordingly, this change should allow Hydro Ottawa to report performance in a more relevant manner. Furthermore, as previously mentioned, such a change would have been required in any event by January 1, 2009."

So are you saying -- are you referring to 2008 or not? Because that clearly says it is needed to be by January 1st, 2009.

MR. DeVELLIS: Well, I was going to get to that as well, but the first point is it is not required until January 1st, 2009, so it is not necessary for 2008.

MS. ANDERSON: The exemption does not get removed until then, so that is correct. But as we have pointed out, once you have identified that you are perhaps an outlier here, generally you want to implement that change in a timely manner as soon as possible which is why we are proposing to implement it as soon as we have identified it.

MR. SHANNON: If I can add one thing to Ms. Anderson's comments as well. I think that regardless of whether the exemption was removed or not in January 1, 2009, to her point we were far outside the realm in terms of the normal OM&A per customer so this would have been a prudent thing to do regardless of the exemption being removed.

So we are just bringing ourselves in line with the rest of the industry. Coincidentally, we also see the horizon in terms of international financial reporting standards and the difficulty there that will exist with respect to regulated entities and the capitalization of overheads. We are just positioning ourselves, first to get in line; and second, probably to get more direction from the Board as to what we will do when we get to international financial reporting standards for 2011.

MR. VLAHOS: Mr. Shannon, you either have to speak a little louder or be closer to the microphone.

MR. DeVELLIS: Mr. Chairman, I think I might have been a little too hasty earlier in rejecting Mr. Farrell's offer of an adjournment. Much of the direct examination has changed the scope of my cross-examination, so I wonder if I could impose on, or ask the Board's indulgence for an early break to review my notes.

MR. FARRELL: That is fine by me.

MR. VLAHOS: So the adjournment you request, Mr. DeVellis, is not with the previous offer, you just need a bit more time?

MR. DeVELLIS: Yes, I wouldn't say an adjournment. I just mean a regular morning break would be fine.

MR. VLAHOS: Just tell us how long you need, sir.

MR. DeVELLIS: 15 minutes.

MR. VLAHOS: We will give you more than that if you wish. Let's return at 11 o'clock.

MR. DeVELLIS: Thank you, sir.

--- Recess taken at 10:27 a.m.

--- Upon commencing at 11:08 a.m.

MR. VLAHOS: Please be seated. Mr. DeVellis.

MR. DeVELLIS: Thank you, Mr. Chairman. Thank you for your indulgence.

Good morning again, panel. Can I ask you to turn to your budget memo -- sorry, not your budget memo. Your memo that is attached to Exhibit K1.1. It is the memo dated December 19th, 2007, at paragraph 22 on page 6. Do you have it? Okay.

I just refer you to the last sentence of that paragraph -- or last two sentences:

> "As mentioned earlier, there appears to a move towards more conservative accounting standards in Canada and in many other jurisdictions, in particular, under IAS 16. Therefore, it is possible that some indirect costs which are currently capitalized under GAAP by non-rate-regulated entities cease to be eligible for capitalization in the future, thereby compounding the impact on rate-regulated entities."

Now, I get the impression from that paragraph that this accounting change that you are talking about is still under consideration; is that correct?

MR. SHANNON: The exposure draft was -- the removal of the section 1100 was confirmed by the Accounting Standards Board in August '07. So what this paragraph is attempting to say - may be not as clear as it should be - but that with the removal -- or with the transition to international financial reporting standards, there -- for regulated or non-regulated entities, there isn't a lot of specificity --

it isn't specific as to whether indirect costs will be allowed from a capitalization perspective.

So this would further compound the problem, because we are currently bringing ourselves into line through the removal of exemption 1100 and the study that we undertook, because there will no longer be an exemption for rate-regulated entities.

Our current study will bring us into line with non-regulated entities, but as we move towards international financial reporting standards, it looks like those reporting standards are even more restrictive than Canadian generally accepted accounting principles, which means there could be a further reduction of indirect costs being capitalized.

MR. DeVELLIS: Okay. So what you are referring to in this paragraph is some additional change, in addition to the exposure draft?

MR. SHANNON: Exactly.

MR. DeVELLIS: Can I ask you to turn to the Deloitte report. That is Exhibit B1, tab 3, schedule 1, appendix S. If you turn to page 3 of that document. This was done in June of 2007?

MS. ANDERSON: Correct.

MR. DeVELLIS: Do you have page 3 there?

MR. SHANNON: Yes.

MR. DeVELLIS: So what they have done is they look at the GAAP provisions, and then on the top of page 3, they say:

"Based on these paragraphs, an argument can be made that a portion of general and administrative costs should be capitalized in order to allow for a recovery of a cost of capital on these expenses, and not just in the year of occurrence."

And then a little bit later on, on that page, they discuss the CICA exposure draft, and then, again, mentions or repeats, I guess, what you have just said, that:

"Canadian standards are expected to converge with international standards by 2011, which is likely the reason for the exposure draft. International accounting standards do not allow for rate-regulated accounting, and generally companies following international standards cannot apply any special rate-regulated accounting even if they own utilities in the United States."

I guess on the basis of that they review what is done in other jurisdictions. And then they conclude on page 8, the bottom of page 8:

"However, at this time, it is still permissible to capitalize reasonable allocations of general and administrate costs as a result of rate-regulated provisions."

What are we to make by that conclusion?

MR. SHANNON: I beg your pardon?

MR. DeVELLIS: What are we to make of that conclusion? Why are they saying it is still permissible?

MR. SHANNON: Well, I think the date of the report being June '07, they are currently saying, at that particular point in time, without the removal of the exemption, it is still permissible to capitalize reasonable amounts of general administrative costs.

And "reasonable" to us would be in accordance with, you know, the amount of capitalized overhead that has been included in our previous rate application and approved through the OEB.

As I mentioned earlier, we are conforming with GAAP as a rate-regulated entity, and we will continue to conform to GAAP when they remove the exemption in January 1, 2009 by having adopted a more conservative approach.

MR. DeVELLIS: Are you saying that this report was -- the reason they say it is currently still acceptable is because it was done before the exposure draft was confirmed?

MR. SHANNON: That is correct. It is dated June '07, so they didn't know which way the exposure draft was going to be -- whether it would be confirmed or not, in terms of the removal of the exemption.

MR. DeVELLIS: Okay. I am just wondering why they wouldn't say, But if the exposure draft is confirmed, then it would no longer be acceptable?

MS. ANDERSON: I think perhaps one thing to clarify is we are not eliminating all of the capitalization of overhead costs with this change. We are simply moving from one that, as we indicated, was more fully allocated costs to one that had a direct causal link to the capital program.

Clearly, there are still amounts -- even with this change that we are doing, there are still amounts of overhead costs that are being capitalized as a result of the change. It is just that they now have a more direct causal link to the capital program.

MR. SHANNON: If I could add, I think in the earlier references you made, in terms of moving to international financial reporting standards, those reporting standards are not clear that any administrative or --

MR. VLAHOS: Mr. Shannon, I have a bit of difficulty hearing you, sir.

MR. SHANNON: In terms of the earlier references that were made, the indication is that moving to international financial reporting standards will even be more restrictive with respect to general and administrative costs, and there may in fact be none allowed for allocation to a capital activity, whether you are rate-regulated or non-rate-regulated.

So when we move to the very end of their report and they look at that one-line summary, I think it is encapsulating many things, one of which is the movement to international financial reporting standards, as well, and the further restriction on the ability to capitalize overhead and admin costs to a capital activity.

But that is still somewhat of an unknown now, because obviously we are not at 2011 and there will be much discussion as to what will be allowed and not allowed by 2011.

MR. DeVELLIS: And then on the next page, on page 9, appendix A of the Deloitte report, there is sort of a comparison between Hydro Ottawa's practice and those of other utilities. Along the top row, you have the kind of costs that are capitalized. Is that what those DM, DL, et cetera, indicate?

MR. SHANNON: That is correct, direct material, direct labour, and then various forms of overhead.

MR. DeVELLIS: Which are the capitalized costs that are at issue? Is it OH3 and OH4? There are definitions at the bottom. I guess my question is: What are the categories you are saying that no -- that Hydro Ottawa no longer wishes to capitalize?

MR. SHANNON: They would be contained within the OH3 and OH4 categories.

MR. DeVELLIS: So then if you look at - sorry - the Canadian utilities, it looks like you are in line with Alberta Power and BC Hydro, not in line with Hydro Quebec and NB Power. And there is a note about NB Power earlier in the report. For the rest, it is not conclusive.

MS. ANDERSON: I think as we indicated, much of this is not inclusive (sic), even the ones that you mentioned. There is a note that says financial statement disclosure is not specific.

MR. DeVELLIS: Okay. Same with the top ten US utilities. For most of them, it is not conclusive or you have a checkmark under OH3 for some of them?

MS. ANDERSON: Correct, because the review was from the financial statements and as we indicated, oftentimes the financial statements are not specific.

MR. DeVELLIS: Now, can you turn to the KPMG report, that is the next tab over, B1, Tab 3, schedule 1, appendix T. My general question with respect to this report is that there doesn't seem to be any reference to the rate-regulated exemption at all in this report.

MS. ANDERSON: I guess one of the approaches that we took in working with KPMG was that we were working with them to find an approach that we felt was appropriate under the conditions or the study approach that was documented here. They weren't necessarily doing -- this is not an accounting opinion in the same way that the PWC memo is. This was a report of the -- a reasonable approach for doing allocation of overhead costs.

MR. DeVELLIS: You see on page 7, at the bottom of page 7, they've -- under the heading "B: Hydro Ottawa's internal guidelines," it appears they have taken your definition as a starting point for their analysis; is that fair?

MR. GRUE: If I might say, this section here really all it is is taking our internal policy and guidelines and this is our definition of what we should be contributing of overheads to capital.

MR. DeVELLIS: The Canadian accounting guidelines that you have been referring to and we have been discussing all morning, this is something that would apply to all distributors in the province; is that right?

MR. SHANNON: Sorry, the accounting procedures handbook?

MR. DeVELLIS: No, the accounting changes to the CICA handbook we have been discussing, this is something that would apply to all distributors in the province; is that right?

MR. SHANNON: That is correct.

MR. DeVELLIS: Can I ask you to turn to our compendium of documents now, Exhibit K1.5. The first document at Tab 1 is an excerpt from the transcript. I believe it was the settlement presentation from your last rate proceeding in February 2006.

MS. ANDERSON: Actually, I believe that was actually an oral hearing on that issue.

MR. DeVELLIS: Okay, I apologize. The section that I want to refer to starts on page 27, and I believe this is Mr. Farrell talking on behalf of Hydro Ottawa. The issue was with respect to line losses and there was a proposal by Pollution Probe for a change in the way that line losses are treated; do you recall that?

MS. ANDERSON: Yes.

MR. DeVELLIS: If you turn to the bottom of page 28. What Mr. Farrell says, on behalf of Hydro Ottawa, beginning at line 24 is:

> "There should be a coordinator approach. In other words, an industry-wide basis. There is no

compelling reason to take a Band-Aid approach and one that in particular ignores the complexity of the issue."

If you go to the bottom of page 29:

"There is no need, in my submission, to pre-empt the Board process by rushing ahead with measures for Hydro Ottawa. We need measures that apply across the industry."

You see that?

MS. ANDERSON: Yes.

MR. DeVELLIS: Now, I realize this is not the same issue, but it seems to me you have identified an issue that would apply to all distributors in the province and why shouldn't the Board take the same approach as Hydro Ottawa advocated with respect to line losses and look at this from a generic perspective and consider the impact on all distributors?

MS. ANDERSON: First of all, to look at the distribution loss issue, you first have to understand that there is complete consistency in the industry on how we do treat line losses. It goes to the very heart of what it means to be a distributor in the fact that our cost of power revenues and our cost of power expenses are set equal. It goes to whether or not we incur commodity risk. So it is a fundamental issue to being a distributor. We are all marching on step in this issue.

What we were being asked, as part of this proceeding, was to step out of line, to do something that would make us incur commodity risk that no other LDCs were being asked to do. What we were saying is if you are going to make a change to this particular issue, it should be done so that everyone remains marching in step.

With the issue we are looking at today, all of our reviews indicate that we are not marching in step with the rest of the industry, that, for the most part, any that we have looked at we have been capitalizing more overheads. We are trying to bring ourselves more in line. So that if the Board subsequently does hold some kind of review of what is going to happen with IFRS for 2011, then at least we have brought ourselves more in line with the rest of the industry as opposed to be where we appear to be right now as an outlier.

So I see complete consistency here. We were trying to be consistent. Here, they were trying to ask us not to be. Now we are coming to the Board saying, Yes we would like to bring ourselves more in line.

MR. DeVELLIS: I guess there are two issues here. There is the issue of whether you are out of line with the rest of the industry, and the issue of whether you have to make this change because of changes to accounting policy which affect all of distributors equally.

Do you agree with that?

MS. ANDERSON: Yes.

MR. DeVELLIS: In so far as the change is driven by a change in accounting policies, that is something the Board will have to look at. Would you agree with me?

MS. ANDERSON: Certainly, I would expect the Board to review the implications of change in accounting policies, yes.

MR. DeVELLIS: And in so far as your change is driven by that, then shouldn't it be something that waits for that process to roll out?

MS. ANDERSON: I guess what I would say is this change is happening in a few months' time. The process is about to affect us come January 1st, 2009, and I think the Board before it has a really very good sample size in front of it. There are 19 LDCs that have filed cost of service applications through this process. All of them had access to the same accounting standards. All have professional auditors that look at their books. All of them had the accounting procedures handbook which indicate that is a change was looming. And if none of those 19 indicated that there was any issue for them, Hydro Ottawa indicated that there was, it gave us a fairly good comfort that it is because there wasn't an issue for them to the same extent come January 1st, 2009 that there was for Hydro Ottawa and that we are an outlier here.

MR. DeVELLIS: Can you turn to Tab 2 of our compendium. This is an excerpt from Toronto Hydro Electric System Limited's interrogatory responses. Toronto Hydro was asked to provide capitalization policy for other capitalization expenses. The actual appendix A to the document, page 1, Toronto Hydro says, under "Authority":

"This policy is in accordance with the OEB's

"Accounting Procedures Handbook for electric
distribution utilities, as well as the CICA
handbook."

My question is there is no mention of any change in accounting policies in there.

MS. ANDERSON: That could be -- what we suspect is because they weren't capitalizing things to the extent that we were. Our -- perhaps our policy doesn't specifically mention that there is a change, either. This is their policy that they have adopted. I am not sure.

MR. DeVELLIS: It says a change in accounting policy. They wouldn't even reference it in their response, that, you know, we have considered this change, but it doesn't apply to us?

MS. ANDERSON: I can't answer for Toronto Hydro why they would or wouldn't comment on a change.

MR. DeVELLIS: That is fine. Then in the next tab, we have an excerpt from the OEB's Accounting Procedures Handbook. There is a reference in article 310, and the pages aren't numbered sequentially, but article 310 is about the middle of the tab, right after 230. It is page 9 of article 310. Do you have that?

MS. ANDERSON: Yes.

MR. DeVELLIS: There is a reference there to proposed changes to accounting standard for rate-regulated enterprises. First of all, this is the Accounting Procedures Handbook revised July 31st, 2007. That is on the first page.

What the document says at the end of the first paragraph:

"If these proposals are adopted in new accounting standards, it may have effect on accounting and financial reporting for rate-regulated entities..."

MR. VLAHOS: Mr. DeVellis, could you please slow down when you read? I want to make sure the reporter picks up every word.

MR. DeVELLIS: Thank you.

MR. VLAHOS: Thank you.

MR. DeVELLIS: "If these proposals are adopted in new accounting standards, it may have effect on accounting and financial reporting for rate-regulated entities, including electricity distributors."

And then on the next page, the last paragraph of page 10, it says:

"It is important to note that if these proposed changes are adopted, they are not expected to impact financial reporting into 2007 and 2008 calendar years for electricity distributors. The ACSB proposes implementation applicable to interim and annual financial statements relating to fiscal years beginning on or after January 1st, 2009."

So it is clear that the Board is aware of this proposed change; would you agree with me?

MS. ANDERSON: Yes.

MR. DeVELLIS: And they haven't made any changes to the Accounting Procedures Handbook as a result of it?

MS. ANDERSON: At the time that this was issued, no. As you see, it was still a pending change.

MR. DeVELLIS: Right. And this is something that the Board is aware of and something the Board has said may affect rate-regulated entities. Don't you think it is something that the Board will have to address, given what they have said here and given it is something that will affect all distributors in the province?

MS. ANDERSON: Well, it may or may not affect all distributors in the province, depending on what they have been capitalizing in the past. What we have brought before the Board is something that shows clearly that it does affect Hydro Ottawa. We have accounting opinion to that effect, that it does affect Hydro Ottawa.

The very fact that this was released in 2007 gave us further comfort that all the LDCs in the province were aware that something was coming. It wasn't just from the Accounting Standards that they had to read, but it was also coming from the Board in their new release of the Accounting Procedures Handbook.

So one would expect, as professional organizations, that they would all look into their accounting approaches for capitalization, and particularly the 19 that were filing cost of service applications. If they had deemed it to be an issue for them, then they would have filed a change. That seems a reasonable assumption for a professional organization.

You mentioned Toronto Hydro's policy earlier. They are three times our size. They have many very qualified accountants who have specialties in the fields. One would think that with the same information before them, if it had been an issue for them, it would have been in their 2008 rate application, but it was not.

MR. DeVELLIS: Your evidence for your position that it affects Hydro Ottawa differently is -- the evidence that you referred to earlier, is the differences in your OM&A per customer and other benchmarks?

MS. ANDERSON: Certainly a review of what others have been doing. Certainly there are other things that we can't place on the record, verbal conversations we have had with other LDCs unfortunately that I can't present, but it all gave us quite a lot of information that we were an outlier in this impact.

The KPMG studies that we had looked at also showed -- move ourselves in line. Clearly the Enersource information showed that, as well. Hydro One, we have looked at their application and the amount they are capitalizing, as well, and, again, it appeared to be less than what we were doing.

MR. DeVELLIS: Other than the Enersource example which you have provided, there is no direct evidence of your capitalization -- the amounts that Hydro Ottawa capitalized versus other utilities?

MS. ANDERSON: Well, certainly the KPMG, the two reports that we did mention with New Brunswick Power and Union Gas, certainly there are those two reports that we did look at that indicated they were capitalizing a percent of their overhead costs as a percent of their gross OM&A somewhere in the same order of magnitude as Hydro Ottawa's revised approach, or, actually, slightly less.

MR. DeVELLIS: Thank you, panel. Those are my questions.

MR. VLAHOS: Thank you, Mr. DeVellis. Ms. Helt, do you have any questions?

CROSS-EXAMINATION BY MS. HELT:

MS. HELT: Yes, Board Staff does have a few questions for the panel.

Firstly, Board Staff would like to briefly clarify the record regarding the customer impact of this proposed change in capitalization. I believe it was in your evidence, Ms. Anderson, that you indicated the bill impact, including the changes due to the settlement agreement and including the capitalization change, is 0.8 per cent for a residential customer using 1000 kilowatt hours per month; is that correct?

MS. ANDERSON: That is correct.

MS. HELT: You also mentioned the general service customer using 2000 kilowatt-hours per month?

MS. ANDERSON: Correct, to the same impact.

MS. HELT: All right. Are there any other representative classes?

MS. ANDERSON: Certainly we did look at the bill impacts across all classes of the settlement proposal, including the change in capitalization, and a general service customer using - this is in the less than 50 kilowatt class - using 12,000 kilowatt-hours per month, the bill impact is minus 1.5 percent, for -- I think I mentioned the general service greater than 50 class customer using 200 kilowatts, minus 1.7 per cent.

A general service greater than 1500 class customer using 2000 kilowatts is about 0.5 per cent, and a large-use customer using 6000 kilowatts, the impact is minus 0.6 percent on the total bill. That is the total bill impact including the capitalization.

MR. VLAHOS: Sorry to interrupt, Ms. Helt. Where would the schools fit into those rate classifications?

MS. ANDERSON: Schools would be at the very large end of the general service less than 50 class, so that would be, we assumed, a customer around 12,000 kilowatt-hours, which was a minus 1.5 percent bill impact, and then perhaps in the general service greater than 50 class, we estimated the 200 kilowatt range minus 1.7 percent.

There could be some larger schools than that, but none of them fall into the two large classes.

So it is the two, the general service less than 50 class, the general service greater than 50.

MS. HELT: Thank you. Would you be able to estimate the bill impact on these same customers if the capitalization change was not implemented?

MS. ANDERSON: I have a rough estimate here. What we haven't done, because there could be implications to cost allocation, because with our methodology there is shifting of some costs as well, so I can give you a rough estimate for each of those classes.

Without the change in capitalization, the bill impact for residential 1000 kilowatt-hour would be minus 0.5 percent, roughly; the general service less than 50, 2000 kilowatt-hour customer minus 0.2 percent; the general service less than 50 kilowatt, 12,000 kilowatt-hour customer minus 2.5 per cent.

For the general service greater than 50, less than 1500 class, which is -- that was the 200 kilowatt-hour customer, it would be minus 2.1 per cent; for the general service greater than 1500, the impact minus 0.1 percent; and the large use, minus 0.7.

As I am quoting off all these numbers, I am thinking, Why don't I file this page? Would that be helpful? What it actually shows is the impact, then, of the capitalization ranging somewhere between 1.3 percent, I guess a smaller residential customer is a slightly larger impact, anywhere from minus 1.3 to as low as 0.4 or even 0.1 percent.

MR. VLAHOS: Ms. Anderson, where are you reading from? Is that something in the evidence?

MS. ANDERSON: It is a reference document we had to look at bill impacts. I am certainly willing to file it if that is helpful.

MR. VLAHOS: I am just wondering if perhaps you can give it to Staff now to be photocopied, if one of the staff would kindly volunteer to photocopy this.

MS. ANDERSON: My colleague notes that in the sheet that we are passing around, there was a typo when something was saying kilowatt hours, it should have been kilowatts, and we are just correcting that. It will be a lot easier for the record.

MS. HELT: Perhaps I can just follow up with one other question, then, while we are waiting for the document to be photocopied.

Earlier today, Mr. DeVellis asked about an impact of I think it was 4 percent in distribution-only impact. Could you clarify or define that impact again. It is 4 percent of what, exactly?

MS. ANDERSON: What we provided here was the impact on the total bill, so it included the distribution, the commodity of the transmission. So it is the bill that the customer sees, assuming the commodity basically stays frozen. So, yes, the distribution portion of the bill is typically, well, it could be small for a large customer, it could be 10 percent.

But for a residential, it could be more like a quarter of the bill, so the actual distribution portion would be going up more. It is the total bill impact that is I have quoted.

MS. HELT: Thank you. Those are the questions of Board Staff. Thank you.

MR. VLAHOS: Thank you, Ms. Helt.

QUESTIONS FROM THE BOARD:

MR. RUPERT: I have a couple of questions on the existing policy and the background. Maybe the easiest way is to go to the PWC opinion, which is now Exhibit K1.1.

On page 3 of the opinion, there is a paragraph that Mr. DeVellis had asked you about earlier. It starts after point B and it says, the first sentence says:

> "The previous policy and procedure was considered to result in the capitalization of amounts in excess of amounts 'directly attributable' under paragraph 5 of section 30.61."

So I take it from that, the way I read PWC's opinion is if they were asked to consider an equivalent policy for an ordinary commercial enterprise that wasn't regulated, they would conclude it was not in accordance with GAAP. Is that a fair reading of what they are saying?

MR. SHANNON: That would be my understanding.

MR. RUPERT: And they go on to say then:

> "However, as described in paragraph 6 to 9 of the attached memo, this policy and procedure is accepted as part of the regulatory regime of Hydro Ottawa and therefore was considered to be in accordance with GAAP based on the exception in section 1100."

What they are referring to, I think, is if you go back to the attached memo, is specifically paragraph 9. This is a document you prepared at Hydro Ottawa, this attached memo?

MR. SHANNON: That is correct.

MR. RUPERT: Paragraph 9 is the one that indicate that is section 30.61 doesn't give a lot of definition to the term "directly attributable", but goes on to state at the bottom of page 2 over to page 3 that section 1100 of the handbook may provide a basis for this.

And so I assume that PWC was taking that as sort of the agreed-upon facts of the situation that they were asked to give an opinion on. They were asked for an opinion on the new policy, and in terms of the old policy, was it fair to say they were taking this as an accepted fact or did they do, themselves, any independent work about whether or not the existing policy qualified under old section 1100?

MR. SHANNON: The only kind of independent related work they would have done is that in accordance with the generally accepted auditing standards to provide this opinion, they would have had to have Deloitte & Touche as our former auditors attest that the facts and statements that went into this memo are correct.

And as I mentioned earlier, Deloitte & Touche had forewarned us that if it had not been for the exemption under section 1100, Hydro Ottawa would have been considered to be capitalizing more indirect costs that would have been applicable for a non-regulated entity.

MR. RUPERT: Then if I go down to the accounting guideline 19, which is -- requires certain disclosures about differences between normal GAAP, I will call it, and GAAP as it is for rate-regulated entities, that is not in the evidence, I don't think, but that was issued, I believe, by the CICA probably sometime in 2005 and I think it was applicable for fiscal years ending on or after December 31st, 2005. That would have been, therefore, applied to Hydro Ottawa's financial statements for 2005 and 2006, right.

That guideline, as you folks know well, requires that when rate regulation has caused an entity to account for a transaction or event differently than it would have in the absence of rate regulation, that certain disclosures are required in the notes to the statements, including the specific financial statement items affected; the rationale for the treatment; and how the item would have been reflected in the absence of rate regulation.

This has been amended since but not in that respect. As far as I know, that paragraph is the same.

So when I go back to your 2005 or 2006 financial statements in Hydro Ottawa, I see a lot of things disclosed on deferral accounts, on taxes payable, accounting and so on, and I couldn't find anything that disclosed that there is a difference between GAAP for normal commercial companies and the accounting policies in Hydro Ottawa for capitalization of overhead. Did I miss it or...

MR. SHANNON: No, you didn't miss it. Actually, it became a reporting deficiency in terms of our external auditor's comment, but it wasn't significant enough not to not qualify their opinion. So we got an unqualified opinion.

The background to this was that the emphasis was on identifying how much in addition we were capitalizing as a regulated entity as opposed to a non-regulated entity. We didn't have an estimate at that point in time until we undertook the KPMG study to determine the causal link. So we discussed that with Deloitte & Touche. We also looked at what other entities in the utility industry were doing and many of them weren't disclosing as well because they couldn't identify.

So knowing full well that we weren't fully complying with accounting guideline 19, we chose not to state a number we couldn't support. So we simply just didn't -- we couldn't report the difference.

MR. RUPERT: Well, then, stepping back even further or at least further in 2006. Your rate application for 2006 rates, and I believe if I read this material correctly, you are saying that it is the inclusion of that policy and use of that policy in preparing the numbers that went into that rate application that the Board has blessed that policy; is that what you are saying?

MR. SHANNON: That is correct.

MR. RUPERT: Is it just the existence of some paper in an application or was it something explicit that the Board directed the company to do as a result of this? So is it just a question of - I will call it - non-disapproval?

MS. ANDERSON: Yes, certainly we did file the capitalization policy and the cost allocation and we did indicate that we were using a fully allocated cost approach in that evidence. We did, in that case, have a settlement on virtually all of the issues, so as a result, that particular issue was not heard specifically by the Board. It was just didn't become an issue raised by either Board Staff or the intervenors at that time.

MR. RUPERT: I just wonder, again, as a matter of the context and background, if it was included in a filing but subject of a settlement agreement. There is no record, as best I can tell, of the Board, through its Accounting Procedures Handbook or a rate decision, explicitly referring to this policy. It wasn't mentioned in your financial statement notes, as you just described. So it seems to have been fairly well in the background, and yet now it seem that is the Board's non-disapproval of this has taken on a life of its own; that the Board has said, Do it this way, in effect.

MS. ANDERSON: I think it gets to the fact that our rates were set based on it and therefore the revenue that we would be expecting to get through rates would be covering the -- in 2006 and 2007 would be covering the old policy and so it is kind of a question of a flow of revenues.

MR. RUPERT: Just to take further, then, your view on section 1100. Mr. DeVellis was asking you about other distributors. Except for this one item in your financial statements, except for this one policy, are you of the view at Hydro Ottawa that everything else you do in your accounting that may flow from Board regulatory decisions would survive after January 1, 2009?

You have come forward with one change in policy. I am not aware you have raised any questions about anything else in accounting. So things like all the deferral and variance accounts that the Board authorizes that are not mentioned in the CICA handbook anywhere, you are saying those would still survive under the regime under section 1100, as amended, but not this policy?

MR. SHANNON: I think in terms of -- this particular policy is a difficulty because of the measurement aspect, and with the change or the removal of the exemption, to me it is basically telling us that we have to follow a primary source of GAAP.

In other areas that deal with rate-regulated entities, deferral accounts, et cetera, there still is no particular primary source of GAAP in Canadian generally accepted accounting principles. We would have to defer or can defer to other similar accounting principles, and one that is often quoted, is the FAS 71 in the States with respect to regulated entities and the recognition of regulatory assets and liabilities.

It is more along the line of not how to measure it, but more if the asset is approved by a regulator and if the future revenue stream is there to ensure that the asset is not impaired, then you can recognize it.

So I think to your point, I mean, it is this particular one that stands out at this point in time.

MR. RUPERT: I don't want to drag this out any further, but are you saying that the company would have access to FAS 71 after January 1, 2009 in respect to, say, deferral accounts and supporting the continued recognition of those, but that this particular policy wouldn't even be supportable under FAS 71? Your old policy would not even be supportable under FAS 71?

MR. SHANNON: I don't believe so, because I think we defer to a primary source of GAAP, which would basically say, you know, the elimination of the exemption is fall in line with all non-regulated entities, and if GAAP is good enough for them, it should be good enough for us. We shouldn't have to defer to FAS 71.

MR. RUPERT: What are you planning to do in your 2007 financial statements, if I can ask, with respect to disclosure on this point?

MR. SHANNON: In terms of the --

MR. RUPERT: On this particular policy.

MR. SHANNON: Well, certainly we now can quantify the amount in terms of accounting guideline 19. So I would think we would address the reporting. We haven't completed our financial statements as of the moment, but my understanding is we would then go back and reassess our ability to apply with accounting guideline 19, and I think we have an amount we could now quantify and realistically highlight the difference between a regulated and a non-regulated entity and the capitalization of indirect costs.

MR. RUPERT: Those are all my questions. Thank you.

MR. VLAHOS: Thank you, Mr. Rupert. Mr. Farrell, any redirect?

MR. FARRELL: No, thank you, sir.
MR. VLAHOS: No, thank you?
MR. FARRELL: Yes. No, thank you.
MR. VLAHOS: All right. All I picked up was the "thank you". Well, thank you. Ms. Helt, maybe we should give this an exhibit number.
MS. HELT: Yes. The bill impact document prepared by Hydro Ottawa dated 2008/02/04 to be marked as Exhibit K1.6.
EXHIBIT NO. K1.6: BILL IMPACT DOCUMENT PREPARED BY HYDRO OTTAWA DATED 2008/02/04.
MR. VLAHOS: Thank you. So this completes the evidentiary portion of this issue. The panel is excused. The witness panel is excused with our thanks.
Mr. DeVellis, what is the possibility of completing this issue today by way of oral submissions? And we will be looking at you to actually start the submissions and Mr. Farrell to have reply submissions.
MR. DeVELLIS: I thought the last day when we discussed this, I had raised the issue of having some time to consult the transcript before submissions, and then returning either to do submissions in writing or oral.
MR. VLAHOS: Mr. DeVellis, we can't hear you, sorry.
MR. DeVELLIS: I apologize. The last day when we discussed this, I had raised the issue of having some time to consult the transcript prior to preparing submissions, and I would still appreciate that opportunity, and then we would return at another date for argument or do the argument in writing, depending on people's schedules. I

think we were discussing some dates, and then there was conflicts with other Board processes, and then that was a difficulty in terms of oral argument.

I, with the Board's indulgence, would prefer to be able to consult the transcript prior to doing submissions.

MR. VLAHOS: Mr. Farrell?

MR. FARRELL: I take it from your comments, Mr. Chair, that given the nature of the hearing, a single issue oral hearing, that you wouldn't be looking to me for argument-in-chief, but, rather, simply to reply to Mr. DeVellis's submissions?

MR. VLAHOS: That is correct, sir, yes.

MR. FARRELL: Tomorrow is the date for the argument of the other two -- written argument of the two issues, so while that work is under way, if we come back tomorrow, which I think is what is the implication of Mr. DeVellis's comments, then I think we can live with that.

We would have preferred to do it today. Maybe, can the -- can I ask the court reporter through you, Mr. Chair, whether she would like to predict when the transcript might be available?

THE COURT REPORTER: Within two hours after the hearing.

MR. VLAHOS: With that, Mr. DeVellis, with the availability of the transcript, were you thinking of an oral argument or a written? Do you have a preference?

MR. DeVELLIS: Well, I think this is something that can be done in writing, and that would sort that would avoid the need for all of us to reconvene again. So from a practical perspective, I would suggest it be done in writing.

MR. RUPERT: Mr. DeVellis and Mr. Farrell, if it is in writing, how much time do you both think you need to -- I guess would we have to have first an argument from Mr. Farrell, followed by your submission, Mr. DeVellis, in reply, or could we do it more quickly?

I am just wondering how much time we are going to take to get to writing.

MR. FARRELL: I am assuming, if it is in writing, that the process that Mr. Vlahos mentioned would have Mr. DeVellis file, and then I would file a reply, as opposed to an argument-in-chief followed by Mr. DeVellis, followed by reply, whereas on the other two issues that are subject to written hearing, there is an argument-in-chief, there is an intervenor argument, and then there is a reply argument.

So we are getting into the overlapping deadlines, I think.

MR. VLAHOS: Mr. DeVellis, on the assumption that there is a written argument, then, when are you prepared to commit to in submitting that argument?

MR. DeVELLIS: I wouldn't need more than a day or two.

MR. VLAHOS: That is fine. Can you give us a date, sir?

MR. DeVELLIS: Say, by Wednesday; Wednesday of this week.

MR. VLAHOS: Okay. And, Mr. Farrell, on the assumption you will receive that on Wednesday, when would you reply by?

MR. FARRELL: Friday.

MR. VLAHOS: Friday, okay. So that coincides happily with submissions on the other two issues, isn't that correct, if I am right?

MR. FARRELL: The other two issues are -- argument-in-chief is due tomorrow, Tuesday.

MR. VLAHOS: Sorry.

MS. HELT: Perhaps I could clarify. The Hydro Ottawa argument-in-chief is due February 5th, tomorrow, Tuesday; the intervenor reply argument Friday, February 8th; and then the Hydro Ottawa reply Tuesday, February the 12th.

MR. VLAHOS: Okay. So I was correct on the date. It is just the wrong argument.

MR. DeVELLIS: Mr. Chairman, can I make a suggestion that we just keep the schedule consistent with the other argument, and so Mr. Farrell present his oral argument on the other issues tomorrow -- sorry, written argument on the other issues tomorrow, and then I, in my reply submissions on Friday, would include my submission on this issue, and then Mr. Farrell's reply submissions would reply to mine on the Tuesday, on everything.

MR. VLAHOS: Mr. Farrell, how does that sound?

MR. FARRELL: I think that is doable. The only caveat I might add is I might make two written arguments, one on this and the other on the other, because I have started on the one and it is a question of jiving them.

MR. VLAHOS: Mr. DeVellis, can you just compromise, if you like, by having Thursday so that it would give one extra day? Because it is a brand new issue, and when we set the argument schedule, in all fairness, this was not contemplated. So if you commit, sir, to bring yours in by Thursday then it will give Mr. Farrell and company an extra day.

MR. DeVELLIS: That is fine. I only suggested Friday because it was consistent with the other dates, but Thursday is fine.

MR. VLAHOS: So is that okay, Mr. Farrell, then?

Mr. DeVellis will make his submissions, written submissions by Thursday, February the 7th, and then your reply is due February 12th.

If that doesn't work, sir, we can give you an extra day for that specific issue, but you can make that call today if you like and ask for it.

MR. FARRELL: Let me just put the two of them together, if I can. We will file our argument-in-chief on this issue and what I am thinking of as the combined issues tomorrow. Mr. DeVellis will file his --

MR. VLAHOS: Sorry, sir, not this issue, no. You are not going to file argument-in-chief on this issue.

MR. FARRELL: Okay, sorry. So if he files his submission on February 12th[h] – sorry, I am writing this down wrong. February 7th.

MR. VLAHOS: Right.

MR. FARRELL: That is fine by us. I would also just comment that it would allow the other parties to the settlement proposal who are in agreement with Hydro Ottawa to comment, if they wished, on Friday which is the intervenor argument on the so-called combined issue.

MR. VLAHOS: Okay. So that seems to work all around, then.

MR. FARRELL: Yes.

MR. VLAHOS: So we will adopt that. And reply argument, then, February 12th, and if it is not sufficient for you to cover that issue, Mr. Farrell, then you may want to ask for an extra day on that because this is an additional issue we have, thrown into the mix.

MR. FARRELL: I think the 12th is doable, Mr. Chair.

MR. VLAHOS: The 12th is fine. We will go with that. Anything else, Ms. Helt?

MS. HELT: No, there is nothing further.

MR. FARRELL: I just want to clarify, Mr. Chairman, if we -- if I or Mr. DeVellis or anybody else wants to refer to, for example, the accounting guideline ACG 19, we can do so -- or anything else in the CICA handbook or the Accounting Procedures Handbook without putting it on the record? In other words, having it be an exhibit.

MR. VLAHOS: Ms. Helt.

MS. HELT: I think it would be helpful to actually have it on the record. And so perhaps we should --

MR. FARRELL: It is going to be on the record in writing if I choose to use it. I just don't have to introduce it as an exhibit today, is what I am suggesting.

MR. VLAHOS: It is a public document. It is available through the appropriate source, so I don't think it is necessary to produce that as an exhibit.

MR. FARRELL: Thank you.

MR. VLAHOS: Okay. With that, thank you all, and have a good day. We are adjourned.

--- Whereupon the hearing adjourned at 12:02 p.m.