St. Thomas energy inc.
We're Your Local Power Distributor

October 15, 2012

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, Suite 2700
Toronto, Ontario
M4P 1E4

Dear Ms. Walli

St. Thomas Energy Inc.
2012 Smart Meter Cost Recovery
Response to Board Staff Interrogatories
Board File No. EB-2012-0348

Please find accompanying this letter two hard copies of St. Thomas Energy Inc.'s response to the Ontario Energy Board Staff Interrogatories. Electronic version of this response will be forwarded to the Board in PDF format.

Yours truly,

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1. Letters of Comment

Following publication of the Notice of Application, the Board has received one letter of comment. Please confirm whether a reply was sent from the applicant to the author of the letter. If confirmed, please file that reply with the Board. Please ensure that the author's contact information except for the name is redacted. If not confirmed, please explain why a response was not sent and indicate if the applicant intends to respond.

STEI Response:

STEI did not reply and will not be replying to the letter. Within the letter there is a miss-understanding with regard to the Provincial smart meter mandate as well as the repayment of the stranded debt, STEI will be reassessing its educational material and may make changes to further educate customers

2. Audited Balances

STEI has stated it had installed 100% of its smart meters by December 31, 2011, and that the audited balance as of December 11, 2011 for the installations is $3,485,033. Please state the percentage of the expected total actual cost for smart meters this balance represents.

STEI Response:

This balance represents 100% of total actual costs for smart meters.

3. Smart Meter Model – Tab 2 – Smart Meter Costs

STEI has shown no capital or OM&A costs for 2012. This will result in the SMIRR being understated. Please explain STEI's proposal.

STEI Response:

STEI did not include additional smart meter capital and OM&A costs in 2012 as the smart meter installation program was completed in 2011. Any additional costs related to replacement capital and on-going OM&A costs have been included in 2012 operations.

4. Smart Meter Model – Tab 3 – Cost of Capital Parameters

STEI has provided the cost of capital parameters for historical years and 2012 in the Tab 3 Cost of Capital Parameters in the Smart Meter Model V 1.17 (the "model").

a. The following table shows the costs for short term debt ("STD"), Long Term Debt ("LTD") and Return on Equity ("EQ") that STEI requested and what the Board allowed in STEI's 2011 cost of service ("CoS") application, EB-2010-0141:

2011 CoS		
Exhibit 5 Tab 1 Schedule 1 [EB-2010-0141]		
STD	4.00%	2.43%
LTD	56.00%	5.48%
EQ	40.00%	9.66%
Exhibit 12 Tab 1 Schedule 12 [EB-2010-0141}		
STD	4.00%	2.46%
LTD	56.00%	5.60%
EQ	40.00%	9.58%

Please explain the reason STEI proposed using the cost of capital parameters it proposed in EB-2010-0141 rather than those approved by the Board. If this was an error, please correct the cost of capital parameters.

b. STEI used the maximum/PILs rates for the years 2006, through to and including a forecast for 2012. These are summarized in the following table.

Maximum Aggregrate Federal & Provincial Corporate Tax Rates

Year	2006	2007	2008	2009	2010	2011	2012
Rate	36.12%	36.12%	33.50%	33.00%	31.00%	28.25%	26.25%

Please confirm that these are the rates corresponding to the taxes or PILs underpinning each of the historical years, and the taxes/PILs that STEI forecasts it will pay for 2012. In the alternative, please explain the tax rates input and their derivation.

STEI Response:

a. *This was an error and STEI will make the necessary corrections* to the smart meter model to align with the Board approved rates per Exhibit 12 Tab 1 Schedule 12, EB-2010-0141.

b. *STEI's application is based upon the above noted confirmed tax rates. STEI is not anticipating PIL's for 2012 as STEI is* ***forecasting a loss for 2012*** *as a result of the negative PIL ruling and the timing of the smart meter cost recovery application.*

5. Costs Beyond Minimum Functionality

STEI has stated that it has incurred costs beyond minimum functionality. These are capital costs of $28,110 for installing 172 smart meters in the GS>50 kW class and an undisclosed amount for a 3-phase analyzer, and operating expenditures for $49,306 for Business Process Redesign and CIS System changes where required to handle mass introduction of smart meters, TOU billings and WEB presentment.

a. STEI has stated that the 3-phase analyzer was purchased as a revenue protection, customer complaint mitigation tool for the analyzer is installed prior to and after a meter change-out to verify meter readings and is an ideal tool for finding energy waste in commercial and factory buildings and equipment. Please provide additional reasons for this expenditure to be considered as a cost for implementing smart meters, as opposed to a cost that should be considered as a general investment made for revenue protection.

b. Please separately identify the 3-phase analyzer by stating the amount and on Tab 2 "Smart Meter Costs" of the model, reclassify its costs and select its Asset Type in the appropriate columns. If this is not possible, please explain.

c. Please state why the expenses for $49,306 associated with upgrading system to handle new business processes, TOU billing, and designing and implementing web presentment are not considered as capital costs?

d. Please provide a copy of STEI's capitalization policy

STEI Response:

a. STEI' previous 3-phase analyzer was unable to read smart meters and was unable to be modified to provide the required readings; as such STEI was required to purchase a new analyzer to be able to continue to provide this service to its customers.

b. The 3-phase analyzer cost of $28,110 is identified on Tab 2 – Smart Meter Costs- item 1.6.2 costs for deployment of smart meters to customers other than residential and small general service. The Asset Type has been changed from smart meter to tools and equipment. The direct cost to install the GS>50 kW per STEI's Smart Meter Cost Recovery Application, page 21, Table 6: Smart Meter Disposition Rate Rider by Class is $98,143.

c. STEI's practice has been to expense minor capital upgrades and to capitalize major "overhaul" or replacement of capital. Defining and implementing new business processes and implementing web presentment functionality were not considered tangible or intangible assets.

d. STEI's capitalization policy as submitted in its 2011 Cost of Service Application is appended to this response.

6. Customer Repairs

The Board in the Guidelines Stated:

> "*The actual costs for materials and parts to repair or replace any customer-owned equipment should be expensed and also tracked separately in a different sub-account of the Smart Meter OM&A Variance Account 1556 until disposition is ordered by the Board following a review for prudence of the smart meter costs. As the meter base remains the property of the customer, the Board determined that it would not be appropriate to have it form part of the distributor's rate base."*

a. Please state the costs of repair or replacement of any customer-owned equipment

b. Please state the total number of meter bases

c. Please confirm that these costs were recorded in a different sub-account of the Smart Meter OM&A Variance Account 1556.

STEI Response:

a. The cost to repair customer-owned equipment was $9,030.

b. STEI repaired 39 customer meter bases.

c. These costs were not recorded in a separate sub-account. The details of costs recorded in Smart Meter OM&A Variance Account 1556 were maintained on an excel spreadsheet.

Budget Variances

STEI has provided Table 3: Actual to Budget Cost Summary and Table 4: Budget Variance Summary. Board Staff would like some clarifications.

a. Please review the two tables and make any changes that are necessary to represent the variance. For example, in Table 3 item 1.6, the Budget for Capital Costs Beyond Minimum Functionality is $496,000 with a variance of ($467,890), while in Table 4 the budget variance for the same item is ($460,000).

b. Please explain the Scientific Research & Experimental Credit listed in the OM&A variance in Table 4, by stating how this credit related to smart meters, how much was budgeted and why there is a ($30,000) variance.

STEI Response:

a. *STEI is unable to find the $460,000 variance referenced in Table 4. STEI provides the following as a means of reconciling the two tables based upon item 1.6.*

Reference: August 9, 2012 Smart Meter Cost Recovery Application

Table 3: Actual to Budget Cost Summary, provides the budget variance based upon the budget determined by Util-Assist and the actual costs incurred by STEI.

Table 4: Budget Variance Summary provides at a detail level the actual variance by activity by major category. The sum of the individual items identified in Table 4 equal the budget variance in Table 3.

Using the example noted above, table 3, Capital Cost Beyond Minimum Functionality resulted in a credit budget variance of $467,890, based upon actual costs of $28,110 and a budget of $496,000.

Table 4: the budget variance is broken down into two areas identified as line items 1.6.

Under the heading, Cost Beyond Minimum Functionality, $496,000 was budgeted for remote disconnects, which STEI did not implement, resulting in a credit budget variance of $496,000. Under the section Capital Variances, item 1.6, 3-phase analyzer, actual cost of $28,110.

An example of this reconciliation is provided in Table 1: Reconciliation of Table 3: Actual to Budget Cost Summary and Table 4: Budget Variance Analysis

Table 1: Reconciliation of Table 3: Actual to Budget Cost Summary and Table 4: Budget Variance Analysis

Table	*Heading*	*Item*	*Actual*	*Budget*	*Variance*
4	*Capital Costs*	*1.6*	*28,110*	*496,000*	*(467,890)*
3	*Costs beyond Minimum Functionality*	*1.6*	*-*	*-*	*($496,000)*
3	*Capital Variances*	*1.6*	*-*	*-*	*28,110*
3	*Net Variance*	*1.6*	*-*	*-*	*(467,890)*

(Note: in response to VECC question #4 a, STEI determined that 200 remote disconnect meters were purchased but not installed at cost of $24,000.)

The same methodology applies for the remaining categories, individual items identified in Table 4 gross variance equals the net variances provided in Table 3.

b. The Scientific Research & Experimental ("SR&ED") program is a federal tax incentive program, administered by the Canada Revenue Agency (CRA) that encourages Canadian businesses to conduct research and development (R&D) in Canada. The SR&ED program gives claimants cash refunds and/or tax credits for their expenditures on eligible R&D work done in Canada. STEI applied for and received a SR&ED credit based upon eligible smart meter expenses. The SR&ED credit was then applied to the smart meter program thereby reducing the total smart meter program costs.

7. Stranded Meters

STEI has stated that the stranded meters will be left in rate base until its next cost of service application, expected in 2015. At that time STEI has stated the estimate for stranded meters as of December 31, 2014 would be $590,000. Please confirm that STEI will depreciate its stranded meters as they remain in rate base.

STEI Response:

STEI confirms that the stranded meters will continue to be depreciated while they remain in rate base.

8. Allocation of Smart Meter Funding Adder Revenues

STEI has allocated the Smart Meter Funding Adder ("SMFA") revenues for the purposes if determining the SMDA on the basis of the allocated revenue requirement. Please calculate the SMDR based assigning the amounts collected, including interest by class.

STEI Response:

The SMDR has been calculated based upon actual SMFA revenue collected by rate class as provided in Table 5: Smart Meter Revenue Allocation. The Manager's Summary should have indicated that these were actual amounts received.

9. Proposed Effective and Implementation Date

On page 23 of its Application, STEI states:

> "As a means of mitigating rate increases to the General Service < 50 kW and General Service > 50 kW classes and to align the sunset dates within a rate year, STEI is proposing that the SMDR Rider be collected over a 20-month period from September 1, 2012 to April 30, 2014, and that the 2012 SMIRR Rider be collected over an 8-month period from September 1, 2012 to April 30, 2013."

Since St. Thomas Energy filed its Application on August 9, 2012 an implementation date for new rates of September 1, 2012 is not achievable.

The calculation of the SMDR in Table 6 is based upon 2 years. By delaying the implementation date of the SMDR, STEI would be foregoing revenues from the SMDR for the period May 1, 2012 to the Effective Date for the SMDR.

a. Please re-calculate the SMDR assuming an implementation date of December 1, 2012; and

b. January 1, 2013. In doing so, please include the revenue requirement up to the implementation date.

The SMIRR is the incremental revenue requirement for 2012 and should remain unchanged.

STEI Response:

a. *STEI has provided a revised SMDR based upon a December 1, 2012 implementation date, foregone SMIRR revenues, interest charges to November 30, 2012, changes to the cost of capital and the reclassification of the 3-phase analyzer.*

STEI has provided the changes from the original August 9, 2012 filing so that Board staff can track these changes.

STEI has also revised the SMIRR to include the cost of capital revisions and the reclassification of the 3-phase analyzer.

STEI has provided the changes from the original August 9, 2012 filing so that Board staff can track these changes.

<u>SMDR</u>

As provided in Table 2: SMDR Cost Recovery, the cost of capital changes have increased the SMDR by $787, SMIRR forgone revenue which represents 7 months from the period May 1, 2012 to November 30, 2012 has increased the SMDR by $274,102 and interest charges have increased by $8,585 resulting in a recovery of $205,580 to be collected over 17 months from the period December 1, 2012 to April 30, 2014.

Table 3: SMDR Rate Rider provides an updated rate rider by customer class.

Table 2: SMDR Cost Recovery:

SMDR Cost Recovery
December 1, 2012 Implementation to April 30, 2014

	Aug 9, 2012 Application	Oct 19, 2012 Per IR's	Revised
Total return	288,451	1,048	289,499
Amortization	300,445	1,405	301,850
OM&A	222,678	15	222,693
PILS	24,836	(1,681)	23,155
SMFA	(883,733)	-	(883,733)
Carrying charges	(30,571)	-	(30,571)
SMDR recovery/(refund)	**(77,894)**	**787**	**(77,107)**
SMIRR foregone revenue	-	-	274,102
Interest true-up 11/12's, tab 8b $9,365			8,585
Adjusted Recovery			**205,580**

Table 3: SMDR Rate Rider

Smart Meter Actual Cost Recovery Rate Rider - SMDR Calculated by Rate Class, as at December 1, 2012				
	Total	**Residential**	**GS < 50**	**GS > 50**
Allocators				
Direct Meter Cost - $'s	**2,122,504**	**1,605,609**	**418,751**	**98,143**
Direct Meter Cost - %	**100.00%**	**75.65%**	**19.73%**	**4.62%**
Number of meters installed	**16,459**	**14,632**	**1,655**	**172**
Number of meters installed	**100.00%**	**88.90%**	**10.06%**	**1.05%**
Total Return (deemed interest plus return on equi	289,499	218,997	57,116	13,386
Amortization	301,850	228,340	59,552	13,957
OM&A	231,278	205,605	23,256	2,417
Total Before PILs	**822,627**	**652,943**	**139,924**	**29,761**
PILs	23,155	18,379	3,939	838
Revenue Requirment, August 9, 2012 application	**845,782**	**671,322**	**143,862**	**30,598**
SMIRR foregone revenues 7/12	**274,102**	**207,350**	**54,078**	**12,674**
Total Revenue Requirement	**1,119,884**	**878,671**	**197,940**	**43,273**
	100.00%	**78.47%**	**17.68%**	**3.86%**
Smart Meter Rate Adder Revenues	(883,733)	(783,001)	(90,219)	(10,513)
Carrying Charge	(30,571)	(27,086)	(3,121)	(364)
Smart Meter True-up	**205,580**	**68,585**	**104,600**	**32,395**
Metered Customers - December 2011	**16,488**	**14,632**	**1,658**	**198**
Rate Rider to Recover Smart Meter Costs - 17 months		**0.28**	**3.71**	**9.62**

SMIRR

As provided in Table 4: SMIRR Cost Recovery, the cost of capital changes and the reclassification of the 3-phase analyzer have increased the SMIRR by $1,239 resulting in an annual recovery of $469,889 until April 30, 2015.

Table 5: SMIRR Rate Rider provides an updated rate rider by customer class.

Table 4: SMIRR Cost Recovery

SMIRR Cost Recovery
December 1, 2012 Implementation to April 30, 2015

	Aug 9, 2012 Application	Oct 19, 2012 Per IR's	Revised
Total return	200,061	1,052	201,113
Amortization	238,809	937	239,746
OM&A	-	-	-
PILS	29,780	(750)	29,030
Adjusted Recovery	**468,650**	**1,239**	**469,889**

Table 5: SMIRR Rate Rider

Smart Meter Actual Cost Recovery Rate Rider - SMIRR Calculated by Rate Class				
	Total	**Residential**	**GS < 50**	**GS > 50**
Allocators				
Direct Meter Cost - $'s	**2,122,504**	**1,605,609**	**418,751**	**98,143**
Direct Meter Cost - %	**100.00%**	**75.65%**	**19.73%**	**4.62%**
Number of meters installed	**16,459**	**14,632**	**1,655**	**172**
Number of meters installed	**100.00%**	**88.90%**	**10.06%**	**1.05%**
Total Return (deemed interest plus return on equity)	201,113	152,136	39,678	9,299
Amortization	239,746	181,361	47,300	11,086
OM&A	-	-	-	-
Total Before PILs	**440,859**	**333,496**	**86,978**	**20,385**
PILs	29,030	21,960	5,727	1,342
Total Revenue Requirement	**469,889**	**355,457**	**92,705**	**21,727**
	100.00%	**75.65%**	**19.73%**	**4.62%**
Smart Meter Rate Adder Revenues	-			
Carrying Charge	-			
Smart Meter True-up	**469,889**	**355,457**	**92,705**	**21,727**
Metered Customers - December 2011	**16,488**	**14,632**	**1,658**	**198**
Rate Rider to Recover Smart Meter Costs		**2.02**	**4.66**	**9.14**

b. *STEI has provided a revised SMDR based upon a January 1, 2013 implementation date, foregone SMIRR revenues, interest charges to December 31, 2012, changes to the cost of capital and the reclassification of the 3-phase analyzer.*

STEI has provided the changes from the original August 9, 2012 filing so that Board staff can track these changes.

STEI has also revised the SMIRR to include the cost of capital revisions and the reclassification of the 3-phase analyzer. The SMIRR is unchanged from response 9 a.

SMDR

As provided in Table 6: SMDR Cost Recovery, the cost of capital changes have increased the SMDR by $787, SMIRR forgone revenue witch represents 8 months from the period May 1, 2012 to December 31, 2012 has increased the SMDR by $313,259 and the interest charges have increased by $9,365 resulting in a recovery of $245,517 to be collected over 16 months from the period January 1, 2013 to April 30, 2014.

Table 7: SMDR Rate Rider provides an updated rate rider by customer class.

Table 6: SMDR Cost Recovery:

SMDR Cost Recovery
January 1, 2013 Implementation to April 30, 2014

	Aug 9, 2012 Application	Oct 19, 2012 Per IR's	Revised
Total return	288,451	1,048	289,499
Amortization	300,445	1,405	301,850
OM&A	222,678	15	222,693
PILS	24,836	(1,681)	23,155
SMFA	(883,733)	-	(883,733)
Carrying charges	(30,571)	-	(30,571)
SMDR recovery/(refund)	**(77,894)**	**787**	**(77,107)**
SMIRR foregone revenue	-	-	313,259
Interest true-up 11/12's, tab 8b $9,365			9,365
Adjusted Recovery			**245,517**

Table 7: SMDR Rate Rider

Smart Meter Actual Cost Recovery Rate Rider - SMDR Calculated by Rate Class, as at January 1, 2013				
	Total	**Residential**	**GS < 50**	**GS > 50**
Allocators				
Direct Meter Cost - $'s	**2,122,504**	**1,605,609**	**418,751**	**98,143**
Direct Meter Cost - %	**100.00%**	**75.65%**	**19.73%**	**4.62%**
Number of meters installed	**16,459**	**14,632**	**1,655**	**172**
Number of meters installed	**100.00%**	**88.90%**	**10.06%**	**1.05%**
Total Return (deemed interest plus return on equity)	289,499	218,997	57,116	13,386
Amortization	301,850	228,340	59,552	13,957
OM&A	232,058	206,299	23,334	2,425
Total Before PILs	**823,407**	**653,636**	**140,002**	**29,769**
PILs	23,155	18,381	3,937	837
Revenue Requirment, August 9, 2012 application	**846,562**	**672,017**	**143,939**	**30,606**
SMIRR foregone revenues 8/12	**313,259**	**236,981**	**61,806**	**14,473**
Total Revenue Requirement	**1,159,821**	**908,998**	**205,745**	**45,078**
	100.00%	**78.37%**	**17.74%**	**3.89%**
Smart Meter Rate Adder Revenues	(883,733)	(783,001)	(90,219)	(10,513)
Carrying Charge	(30,571)	(27,086)	(3,121)	(364)
Smart Meter True-up	**245,517**	**98,911**	**112,405**	**34,201**
Metered Customers - December 2011	**16,488**	**14,632**	**1,658**	**198**
Rate Rider to Recover Smart Meter Costs - 16 months		**0.42**	**4.24**	**10.80**

10. Smart Meter Model Update

The interrogatories have necessitated updates to the Application.

a. Please file an updated model incorporating the changes arising from the interrogatories: and

b. Please provide updated calculations showing the determination of the SMDRs and SMIRRs arising from the interrogatories.

STEI Response:

a. *STEI will file an updated model. The updated model incorporates the cost of capital correction and the reclassification of the 3-phase analyzer from smart meter to equipment and tools. STEI is unable to update the model to accommodate the interest charge change as requested by VECC as the model is protected and does not recognize the 2012 OM&A interest. The interest calculations provided in response to Board staff question 9 are based upon results from the smart meter model tab 8 b.*

b. STEI has provided revised SMDRs and SMIRRs calculations and rate riders based upon the December 1, 2012 and January 1, 2013 implementation dates in response to Board staff question 10 a. and b.

CAPITALIZATION POLICY

INTRODUCTION

St. Thomas Energy Inc. ("STEI" or the "Company") has established a capitalization practice (as documented in the notes to the audited financial statements) regarding the methodology that it employs to identify, recognize and measure those expenditures that meet the criteria for categorization of property and equipment on its balance sheet based on guidance in section 3061, Property, Plant and Equipment, of the CICA Handbook and the Ontario Energy Board's Accounting Procedures Handbook.

REFERENCE DOCUMENTS

This practice was established in consultation with the following standards:

a. OEB Accounting Procedures Handbook for Electric Distribution Utilities, Article 410 – Property, Plant and Equipment

b. Canadian Institute of Chartered Accountants ("CICA") Handbook, section 3061 – *Property, Plant and Equipment*

c. CICA Handbook, section 3063 – *Impairment of Long-Lived Assets*

d. CICA Handbook, section 3064 – *Goodwill and Intangible Assets*

The capitalization practice does not incorporate any changes in accounting policies that may arise as a result of the implementation of International Financial Reporting Standards.

DEFINITIONS

a. Asset

Assets are economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained.[1]

Assets have three essential characteristics:[2]

i. they embody a future benefit that involves a capacity, singly or in combination with other assets, in the case of profit-oriented enterprises, to contribute directly or indirectly to future net cash flows, and, in the case of not-for-profit organizations, to provide services;

ii. the entity can control access to the benefit; and

iii. the transaction or event giving rise to the entity's right to, or control of, the benefit has already occurred.

b. Betterment

The cost incurred to enhance the service potential of an item of property, plant and equipment is a betterment. Service potential may be enhanced when there is an increase in the previously assessed physical output or service capacity, associated operating costs are lowered, the life or useful life is extended, or the quality of output is improved. [3]

c. Cost

Cost is the amount of consideration given up to acquire, construct, develop, or better an item of property, plant and equipment and includes all costs directly

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[1] From CICA Handbook, section 3061 – *Property, Plant and Equipment*

[2] Ibid

[3] Ibid

attributable to the acquisition, construction, development or betterment of the asset including installing it at the location and in the condition necessary for its intended use.[4]

d. Intangible Asset

An intangible asset is an identifiable non-monetary asset without physical substance.[5] It would include such assets as patents, trademarks, copyrights, land rights and software.

e. Maintenance Expenses

Also referred to as a repair expense. The cost incurred in the maintenance of the service potential of an item of property, plant and equipment is a repair or maintenance expense, not a betterment. If a cost has the attributes of both a repair and a betterment, the portion considered to be a betterment is included in the cost of the asset.

f. Property, Plant and Equipment

Property, plant and equipment are identifiable tangible assets that meet all of the following criteria:

i. are held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance or repair of other property, plant and equipment;

ii. have been acquired, constructed or developed with the intention of being used on a continuing basis; and

iii. are not intended for sale in the ordinary course of business.[6]

g. Distribution Asset

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[4] Ibid

[5] CICA Handbook, section 3064 – *Goodwill and Intangible Assets*

[6] Ibid

Per the OEB Act, 1998, a distribution asset is used to distribute electricity; includes any system, structure, equipment or other things used for that purpose.

h. Service Potential

Service potential is used to describe the output or service capacity of an item of property, plant and equipment and is normally determined by reference to attributes such as physical output capacity, associated operating costs, useful life and quality of output.[7]

i. Useful Life

Useful life is the period over which an asset, singly or in combination with other assets, is expected to contribute directly or indirectly to the future cash flows of an enterprise.[8]

PRACTICES AND POLICIES

STEI has adopted the following policies regarding the recognition and measurement of its property and equipment.

j. Allowance for Funds Used During Construction ("AFUDC")

The Accounting Policy Handbook promulgated by the OEB requires local distribution companies to apply an AFUDC to all capital projects exceeding twelve months in duration. The AFUDC is calculated using the costs incurred on a project and a quarterly rate established by the OEB.

[7] Ibid

[8] Ibid

k. Amortization Expense

The Company has established an accounting practice detailing the amortization method and useful life for each class of capital assets.

l. Asset Pools

Similar assets are grouped by their nature for amortization purposes. The amortization method allocates the combined cost of the assets over their estimated useful life on a rational and systematic basis. The useful life of the asset pool is the estimated average life of the individual assets in the pool.

m. Capitalization Threshold

In its determination of which expenditures get classified as capital additions and which get classified as repairs and maintenance expenses, STEI considers the criteria in sections 3(a) and 3(b) of this practice in addition to the dollar amount of the expenditure. Generally, expenditures less than $1,000 are classified as repairs and maintenance expenses regardless of whether they meet the definition of assets.

This practice stems from the recognition that the administrative costs involved in capitalizing, tracking and depreciating capital assets may outweigh the benefits inherent in the accuracy of the Company's financial information. The Company notes that the use of a capitalization threshold is common in both the utility sector and industry in general, and the Company has considered the materiality thresholds established by organizations of like size.

n. Costs

For greater clarity, the Company shall include the following in the cost of construction of its property and equipment, where applicable:

i. the cost of direct labour incurred on the project ;

ii. materials and supplies used on the project;

iii. installation costs including design and engineering fees, legal fees, survey costs, site preparation costs, freight charges, insurance costs, testing and preparation charges;

iv. amounts paid to external contractors in respect of the project;

v. construction or building permits;

vi. allowance for funds used during construction;

vii. and internal equipment charges;

The labour costs include the estimated benefits attributed to the hours that the individuals work on the project.

Internal equipment usage costs are calculated for each vehicle or piece of equipment in the fleet, and include the costs associated with usage (maintenance, insurance, fuel and depreciation).

The Company does not allocate the costs of indirect overhead or general administrative overhead to its property and equipment.

o. Major Spare Equipment

Spare transformers and meters are accounted for as property, plant and equipment if they are held in STEI. Spares are held and dedicated for the specific purpose of backing up plant in service. It is expected that these items are not intended for resale, have a longer period of future benefit compared to inventory items, are an integral part of the distribution plant, and are expected to be placed in service. Transformers and meters held in reserve or as spares are to receive the same treatment as the related assets in service. In practice, STEI does not hold any inventory but rather the affiliate, St. Thomas Energy Services Inc. ("STESI") will hold all spare parts inventory order to properly support and service STEI. The cost of STESI carrying this inventory on behalf of STEI is incorporated in the fixed fee identified in the Service Agreement included under the Exhibit 1, Tab 2, Section 4, Attachment 1.