EB-2012-0161

ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an Application by Powerstream Inc. pursuant to the *Ontario Energy Board Act* for an Order or Orders approving just and reasonable rates for the distribution of electricity commencing January 1, 2013

FINAL ARGUMENT
ON BEHALF OF THE
SCHOOL ENERGY COALITION

November 13 , 2012

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1 INTRODUCTION AND SUMMARY

1.1 *Introduction*

1.1.1 On May 4, 2012 Powerstream Inc. filed an Application for new distribution rates, effective January 1, 2013. The process included extensive interrogatories, a technical conference, a successful ADR, and a one-day oral hearing.

1.1.2 This is the Final Argument of the School Energy Coalition on the four issues that were not settled.

1.1.3 The ratepayer groups who intervened in this proceeding have followed their normal practice of working together throughout the hearing to avoid duplication, including discussing issues and exchanging drafts or partial drafts of their final arguments. We have been assisted in preparing this Final Argument by that co-operation amongst parties.

1.1.4 We also would like to note that we have been assisted by the open and co-operative approach of the Applicant, including the provision of information as requested, and a concerted attempt on their part to ensure that the issues that remain in dispute are clear.

1.1.5 We have organized our submissions under the three general headings of Depreciation, Interest on Long Term Debt, and PP&E Account, as the four unsettled issues fall within those three categories.

1.2 *Rate Context*

1.2.1 The Argument in Chief of the Applicant reminds the Board [p. 2] that, based on the Settlement Agreement, the deficiency has been reduced from $7,826,000 to about $44,000. This would mean that an average rate increase of about 4.8%, as originally proposed, has dropped essentially to zero.

1.2.2 SEC wishes to point out a related fact. The Applicant had two factors causing their revenue requirement to go down.

1.2.3 First, the change from CGAAP to MIFRS results in an annual reduction in revenue requirement of $5.6 million [J1.1]. The ratepayers still pay that amount, but they pay it later, since in the meantime it is added to rate base. All other things being equal, this should have created a sufficiency of $5.6 million, subject to other cost increases.

1.2.4 Second, the Applicant completed a merger with Barrie, and ongoing savings from that transaction are about $6 million per year [Tr1:36]. Under the Board's policy, the Applicant can keep those merger savings during a period of up to five years without adjusting rates, but after that time the merger savings are enjoyed by the ratepayers of the merging utilities. Again, all other things being equal this should have created a further sufficiency of a further $6 million.

1.2.5 Thus, while it is true that the rate increase has dropped to zero through the Settlement Agreement, in fact there is a built-in rate increase, through these factors, of 7.2%. Even if the Board finds in favour of the ratepayers on all of the outstanding issues, there will still be a net rate increase.

1.3 ***Summary of Submissions***

1.3.1 This Final Argument contains an analysis of the unsettled issues in this proceeding. The following is a summary of that analysis.

1.3.2 ***Full Year Depreciation***. SEC submits that there is no justification for the Applicant's claim for full year depreciation on 2013 capital additions, for three reasons:

(a) It is contrary to Board policy, a policy which has been reviewed in detail in the last few months, and remains unchanged on this point.

(b) It considers only one of the impacts of rebasing followed by IRM, and thus misstates the overall effect.

(c) It would result in an unnecessary difference between the accounting and regulatory values of assets.

Adjustment of the depreciation to be in line with the Board's policy results in a reduction in revenue requirement of $2,527,000.

1.3.3 ***Opening Rate Base.*** The Applicant changed its depreciation method in 2010, from half-year rule to monthly in-service, without obtaining an accounting order approving the change. As a result, its depreciation was reduced in 2010 through 2012 by about $1,762,000, and its rate base on December 31, 2012 was increased by that amount. This difference should be refunded to ratepayers, with interest at the weighted average cost of capital, for the same reason that the PP&E Deferral Account adjusts for the impact on rate base of another accounting change, from CGAAP to MIFRS.

1.3.4 ***Depreciation Forecast***. Powerstream says they plan to use the monthly in-service method for depreciation on capital additions in 2013 and subsequent years. However, they propose to forecast using the half-year rule, which consistently (and probably systematically) produces a higher figure. SEC submits that the depreciation forecast should use the method that will actually be used. This results in a reduction of 2013 depreciation expense of $509,000.

1.3.5 ***Interest on Long Term Debt***. The Applicant asks the Board to treat as non-callable debt that, in fact, is callable. Further, the Applicant had an opportunity to re-finance that debt at a lower rate in 2012, and made no effort to do so. For these reasons, SEC submits that the interest rate on the debt held by shareholders should be reduced from 5.58% to the Board's deemed rate, currently 4.41%. This would reduce interest on long term debt (subject to adjustment to the new rate) by more than $1.9 million.

1.3.6 ***PP&E Deferral Account.*** The Board's policy on the adjustment of PP&E from CGAAP to MIFRS does not consider the implications of CWIP, and normally that is not a material concern. In this case, the effect of ignoring CWIP that closes to rate base after December 31, 2012 is to make more than $7 million of spending unrecoverable. SEC believes this is unfair. SEC proposes that, with corrections to the calculation and structure of recovery, the CWIP overhead adjustment amount should be recoverable by the Applicant from the ratepayers over four years.

2 DEPRECIATION

2.1 *Full Year Depreciation on Additions*

2.1.1 The first of the issues relating to depreciation is the request by the Applicant to have full year depreciation included in rates for capital additions during the 2013 Test Year. The purpose, says the Applicant, is to reflect the fact that in 2014 and beyond, the 2013 capital additions will attract full year depreciation, but that amount will not be included in rates.

2.1.2 Use of full year depreciation increases revenue requirement by $2,527,000 [JT1.5].

2.1.3 It is submitted that there are three reasons why this is not a reasonable proposal.

2.1.4 ***Board Policy.*** First, the Board's policy is to use the half-year rule for capital additions in a rebasing year. This policy has been applied to almost every LDC in the province by now, despite numerous complaints by the LDCs of the alleged (and incorrect) effect that Powerstream is highlighting.

2.1.5 Further, the Board has recently completed the Renewed Regulatory Framework for Electricity consultation, EB-2010-0377/8/9, during which the Applicant and others argued in favour of making an adjustment to the IRM model to account for this supposed effect [Tr1:53]. SEC and others argued against such a change.

2.1.6 In the end, the Board did not change its approach on this question. 4th Generation IRM has changes from 3rd Generation IRM, but this is not one of them. Further, for utilities that have significant capital spending needs, a Custom IR option – essentially multi-year cost of service – is offered to ensure that all impacts of multi-year planning are taken into account.

2.1.7 It is submitted that, to order full year depreciation in the face of this recent Board policy document would be inappropriate unless there was a compelling case that the position of the Applicant is unusual in this respect. No such case has been proposed. The Applicant admits that this is a problem common to many LDCs [J1/4.2]

2.1.8 ***Incomplete Analysis.*** The second reason for denying this proposal is that it looks at only one of the several impacts of IRM followed by COS. The other impacts, admitted in cross-examination, include but are not limited to:

(a) Assets going out of service in 2013, and having a full year impact in 2014 [Tr1:44];

(b) Assets going out of service in 2014, and having a partial year impact in that year [Tr1:44];

(c) Assets for each of 2013 and 2014 that will be fully depreciated, even though they remain in service [Tr1:45];

(d) CCA for 2013 additions will be half year, but in 2014 will be full year [Tr1:49];

(e) Customer additions in 2013 are assumed at a half year impact, but in 2014 will have a full year impact [Tr1:50]; and

(f) Capital spending in 2013 for things like subdivisions will create incremental revenues in 2014 [Tr1:51].

2.1.9 These impacts are not insignificant. We have no estimate for the last one, although clearly it could be a significant number in a high growth utility. However, we do have rough estimates of the others:

(a) For the first three, assets ceasing to be depreciated or going out of service, the impact on revenue requirement is likely in the range of $1,000,000 [Tr1:46], although SEC estimates it is likely more.

(b) The CCA impact is a $2.6 million increase in CCA in 2014, which is expected to reduce grossed-up taxes, and therefore revenue requirement, by about $900,000 [Tr1:49].

(c) The incremental revenues from a full year of 2013 customer additions is estimated to be $1,200,000 [J1.2.

2.1.10 It is therefore clear that, without even taking into account the last item in 2.1.8 above, the impacts that the Applicant did not consider total $3,100,000 in reduced revenue requirement, i.e. more than the requested increase in revenue requirement for full year depreciation.

2.1.11 In short, for Powerstream there is no loss associated with capital additions in a rebasing year.

2.1.12 This is, indeed, why for utilities with major capital programs, multi-year cost of service is the sensible option. There are many impacts of those capital programs. It is not good ratemaking to isolate one, without considering others with material effects.

2.1.13 ***Mismatch.*** The third reason for denying this proposal is much simpler. The Applicant proposes to include in rates an amount for depreciation that is not the amount they actually plan, today, to claim at the end of the Test Year. We can understand why the

Board might consider allowing rate recovery of an amount different than what will actually be spent. However, that would only happen in exceptional circumstances, as it is fundamentally contrary to cost of service ratemaking principles. No exceptional circumstances have been proposed in this case.

2.2 ***Monthly In-Service Method - General***

2.2.1 This issue starts with the fact that, when rates for Powerstream were last rebased in 2009, the depreciation method used for capital additions was the half-year rule, and rates were set on that basis [Tr1:55].

2.2.2 In 2010, the Applicant went to the monthly in-service method for recognizing depreciation for capital additions. This is a more accurate method [Tr1:57] that reflects the actual additions closed to rate base in each class for each month. An asset that becomes used and useful in January has 12 months of depreciation, but one that closes in December has only one month of depreciation.

2.2.3 When the Applicant made this change, they did not get an accounting order or other approval of the Board [Tr1:55].

2.2.4 The result of this change is that depreciation in each of 2010 and 2011 was reduced, and thus closing rate base in each year was higher than it would have been under the half-year rule. That is the first issue related to monthly in-service.

2.2.5 In addition, the Applicant has forecast 2012 and 2013 using the half-year rule, but tells the Board that it will actually use a different method, the monthly in-service method, for both of those years. The Applicant claims that this is the intent of Board policy [AIC, p. 10]. If this forecasting method is not the most accurate available, any 2012 error will again impact closing rate base. Any 2013 error will impact the depreciation cost included in revenue requirement.

2.2.6 SEC supports the use of the monthly in-service method, because it is a more accurate method of reflecting the cost of capital additions. However, SEC believes that the use of this method can only be approved on the basis that it is implemented fairly.

2.2.7 The initial, and general, question is whether the Applicant is free – as they argue - to have rates set on one basis, then use a different method for calculating actual depreciation, and therefore rate base going forward.

2.2.8 SEC submits that this is not, and cannot, be correct. If it were true, it would allow utilities to use accounting changes to collect from the ratepayers twice for the same cost. First, they would collect on one basis when rates are set, and then by reducing their depreciation they increase rate base, which will also be collected from ratepayers in the future.

2.2.9 The clearest example of this was utilities that had their rates rebased using full year depreciation for capital additions, which often happened in 2006 through 2008. When they shifted to the half-rule rule during IRM, the Board consistently declined to allow them to recover the resulting increase in rate base. It would have been double counting.

2.2.10 Here, the numbers are smaller, but the principle is identical. Utilities should not be allowed to use accounting changes to collect the same cost twice from the ratepayers. That is inconsistent with the Board's regulatory approach.

2.2.11 Both of the issues that arise as a result of this change in accounting are based on this same concept: accounting consistency is required for fairness. The past impact of the accounting change is reflected in the Test Year opening rate base. The future impact of the accounting change is reflected in the method for forecasting Test Year depreciation.

2.3 ***Monthly In-Service Method – Opening Rate Base***

2.3.1 The Applicant has taken less depreciation since its last rebasing than the depreciation they would have taken had they used their approved methodology. For 2010 and 2011, we know the amount of that differential. For 2012, it has to be forecast. All three years will have an impact on the rate base on December 31, 2012, and therefore the opening rate base for the Test Year.

2.3.2 ***2010 and 2011***. The Applicant has calculated the difference between depreciation using the half-year rule, as approved by the Board, and the actual depreciation claimed by the utility, for each of 2010 and 2011. In 2010, the monthly in-service method produces depreciation $750,000 less than half-year rule, and in 2011 that difference is a further $513,000 [IR EP #32]. Net profits for the utility over those two years were increased by $1,263,000, but that increased profit was reflected in a higher rate base on December 31, 2011, by the same amount.

2.3.3 On average, over those two years, total depreciation using monthly in-service for the capital additions was 98.53% of total depreciation if using the half-year rule for those same capital additions.

2.3.4 ***Bridge Year 2012***. The Applicant was asked whether this is a systematic bias in spending, such that a similar pattern could be expected for 2012 [Tr1:58], and they said they couldn't say there was. The two years, they said, would not be predictive of other years.

2.3.5 SEC therefore asked Powerstream to go back to prior years, and try to find a year in which this back-loaded capital additions pattern was not seen. In J1.3, the Applicant said that they did not have any records to compare the two methods, other than 2010 and 2011.

2.3.6 It is possible, however, to look at the capital additions pattern for 2012. In J1.4, the Applicant has provided the capital additions for each month from January through September. Even assuming that the remainder of the capital budget is equally spread over the last three months, the same back-loaded spending pattern is obvious in 2012 as well. The calculation is seen in the following table:

Forecast of Monthly In Service Depreciation for 2012				
Month	***CapAdds***	***%***	***Months***	***Net %***
January	$4,363	5.11%	12	5.11%
February	$4,937	5.78%	11	5.30%
March	$3,018	3.53%	10	2.95%
April	$6,651	7.79%	9	5.84%
May	$5,543	6.49%	8	4.33%
June	$8,938	10.47%	7	6.11%
July	$4,313	5.05%	6	2.53%
August	$5,198	6.09%	5	2.54%
September	$2,939	3.44%	4	1.15%
October	$13,164	15.42%	3	3.85%
November	$13,164	15.42%	2	2.57%
December	$13,164	15.42%	1	1.28%
Totals	$85,391			43.55%
Half Year Rule				50.00%
Ratio				87.09%

2.3.7 What this calculates is the weighted average in-service date for 2012, and shows that the depreciation on these assets using the monthly in-service rule should be 87.09% of the depreciation using the half-year rule. (We note that, even if all of the remaining capital additions closed to rate base in October, monthly in-service depreciation would still be only 94.8% of half-year depreciation.)

2.3.8 It is clear, therefore, that for the only other year for which data is available, this same pattern is seen.

2.3.9 J1.4 has insufficient granularity to do an actual calculation of the difference in depreciation between the half-year rule and monthly in-service, because that would require that the monthly data be broken down by depreciation rate. However, it is submitted that since we do have the calculations for 2010 and 2011, which show that total depreciation using monthly in-service is 98.53% of total depreciation using half-year rule, it is possible to make a reasonable estimate of the difference for 2012. That figure would be $499,000, based on total depreciation of $33,918,000.

2.3.10 Since the Board already knows that the actual depreciation that the Applicant will take in 2012 is that much less than the depreciation assumed in the rate base continuity, the Board knows that actual rate base at the end of 2012 will be a further $499,000 higher than the Applicant has forecast. Eventually, the ratepayers will be asked to pay this again.

2.3.11 ***Method of Adjustment***. SEC believes that there are three steps necessary to regularize this situation as of the start of the Test Year:

(a) The Board should approve the use of the monthly in-service methodology, a more accurate approach, and allow its use by Powerstream starting in 2010.

(b) Opening rate base for the Test Year should be increased by $499,000, to reflect the fact that depreciation will in fact be less in the bridge year than the amount set forth in the Application. This will also impact closing rate base in the Test Year, since the depreciation differential is not caught up until the very end, when the assets are eventually fully depreciated or taken out of service. This step is necessary to ensure that regulatory and accounting rate base do not start out different due to a difference in accounting methodology.

(c) This leaves a total of $1,762,000 of under-depreciation over the period 2010 through 2012, increasing the utility's profits for those years, and increasing the opening rate base in 2013. SEC proposes that this should be adjusted in exactly the same manner as the other accounting change that is being adjusted in this Application, i.e. CGAAP to MIFRS. In the same way, that accounting change during IRM changed the amount of opening rate base in the Test Year. In the same way, SEC proposes that the new opening rate base – which is consistent with accounting rate base – be retained, and the difference between the two be refunded to ratepayers over four years, with interest at the weighted average cost of capital. This would exactly mimic the PP&E Deferral Account, since it is seeking to accomplish an identical purpose, but for a different accounting change.

2.3.12 SEC submits that, by adjusting opening rate base, accounting and regulatory books are kept as much in sync as possible. By refunding the $1,762,000 to ratepayers, the Applicant is prevented from recovering that amount in rates twice. By including the weighted average cost of capital, the Applicant effectively earns return on its artificially increased rate base only after it has refunded the increase to ratepayers.

2.4 ***Monthly In-Service Method - Forecasting***

2.4.1 The remaining question is the amount of depreciation for the Test Year. The Applicant proposes to forecast based on the half-year rule, and then actually claim depreciation based on monthly in-service. The inevitable result will be a new divergence between accounting and regulatory PP&E, which would then have to be adjusted in the same way on the next rebasing.

2.4.2 In our submission, this is about forecasting properly. The only evidence before the Board is that a forecast using the half-year rule will overstate the depreciation, and therefore the revenue requirement. Rates will therefore not be just and reasonable.

2.4.3 It would be much better if there were more than three years of evidence of the pattern of spending, but the Applicant was invited to provide more, and did not. The evidence the Board does have, while limited, is consistent, and also consistent with common sense.

2.4.4 Therefore, it is submitted that the same ratio of 98.53% should be applied to the depreciation for the Test Year, with the result that depreciation, and revenue requirement, should be reduced by $509,000. This is a demonstrably more accurate forecast of Test Year depreciation than the approximation using the half-year rule that the Applicant has proposed.

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3 INTEREST ON LONG TERM DEBT

3.1 *Introduction*

3.1.1 The Applicant's shareholders hold $166.1 million of debt owing by Powerstream. This debt bears interest at a rate of 5.58%, which rate was established some years ago, and until recently has been less than the Board's long term debt rate for variable rate or callable debt.

3.1.2 It is common ground that the promissory notes in question contain a provision allowing the holder to call for payment 90 days after demand. That would make the debt callable, and invoke the Board's cost of capital policy, which applies the deemed rate to callable debt. The Applicant argues that the notes are "effectively" non-callable due to subordination arrangements currently and previously in place.

3.1.3 It is also common ground that the notes have an interest rate adjustment clause, which provides for adjustments to the interest rate by mutual agreement, considering among other things the Board's deemed rate. There is a dispute as to whether this clause makes the debt variable rate debt.

3.2 *Subordination vs. Callability*

3.2.1 SEC accepts that, under subordination agreements that have been in place for several years, the shareholder debt is subordinated, first to the EDFIN debt, and now to the new $200 million trust indenture.

3.2.2 In our submission, that does not make this debt non-callable. A subordination agreement means there is a step required before the debt can be called. That is not unusual, and the Board has no evidence that at any time the "barrier" presented by that subordination was tested.

3.2.3 We have had an opportunity to review the submissions of Energy Probe on this point, and we agree with their analysis.

3.2.4 However, it our view it is really simpler than that. The promissory notes intentionally include a right to call the debt. The shareholders of the Applicant certainly know the Board's policy on callable debt. If in fact the debt is non-callable, it would have been simple for the shareholders to remove the callability clause, and make them non-callable. Then there would be no issue about whether they were callable or not, and, all other things being equal, the full 5.58% above-market interest rate could be recovered from ratepayers.

3.2.5 This is consistent with the nature of the capital markets, reflected in the Board's policy. Money that is lent to you for a term, where the lender cannot call for repayment, is more valuable than money that can be called on demand. The borrower is willing to pay more, and the lender wants a higher return to reflect the inability to change investments in the future. Because the borrower has locked in their rate, they have certainty and do not have market risk. Because the lender has locked in their rate, they are unable to move the money to a higher rate instrument when interest rates change. This is the bargain presented in the market by non-callable debt.

3.2.6 In our submission, the Board should reject the argument that the debt is "effectively" non-callable. If that were the reality, the shareholders could have easily locked in their rate, and the utility and its shareholders could have locked in as well. The shareholders have elected to retain their right to call the debt, and in doing so – refusing to provide a true long term commitment – they should be taken to have accepted the consequences of that decision in terms of rate recovery.

3.3 ***Interest Rate Adjustments***

3.3.1 Other parties may argue that the clause providing for changes in interest rates means this is variable rate debt. SEC believes this is a more complicated issue, and in light of our view on callability, we believe that it is not necessary for the Board to determine that point. Therefore, we make so submissions.

3.4 ***Refinancing***

3.4.1 We note that in 2012 the Applicant refinanced its main external debt, the EDFIN loan of $200 million, at 3.99%. It is clear – and probably common ground – that the Applicant could have refinanced the shareholder debt as well, certainly at a rate lower than the 5.58% interest rate they were paying.

3.4.2 Powerstream did not even approach the shareholders with this possibility. In failing to do so, in our submission the Applicant failed to act prudently. A prudent utility in that situation would have identified the fact that they were over-paying interest relative to market by millions of dollars every year, and would have looked for ways to reduce that cost, either by refinancing, or by renegotiating the interest rate on the notes. They did neither.

3.4.3 That having been said, there is insufficient evidence on the record in this proceeding to demonstrate what interest rate would have been payable if this debt had been refinanced or renegotiated. It may have been as low as 3.99%, or it may have been higher, particularly if it remained subordinated. Alternatively, it may have been included in the Trust indenture, but then the $366.1 million debt might have had a slightly higher rate than 3.99%. There is simply insufficient evidence for the Board to make this determination.

3.4.4 Therefore, while SEC would prefer to make the submission that a market rate should apply to the shareholder debt, lacking evidence the only reasonable rate is the Board's deemed rate. That is the default rate for callable debt.

3.5 ***Conclusion***

3.5.1 SEC therefore submits that the Board's deemed rate for callable debt, for Test Years commencing January 1, 2013, be applied to the $166.1 million of debt held by the shareholders of the Applicant.

4 PP&E DEFERRAL ACCOUNT

4.1 *The Problem*

4.1.1 The issue to be addressed is whether the Applicant should be allowed to recover, either through the PP&E Deferral Account, or through some other means, the amounts included in December 31, 2012 CWIP that, under CGAAP, would have been capitalized, but under MIFRS are expensed.

4.1.2 SEC was represented on the consultative that worked on the IFRS transition issues. The PP&E Deferral Account was a way of ensuring that, if a utility converted to IFRS while under IRM, the impacts of that change on PP&E were recorded, and a mechanism was implemented to ensure both the utility and the ratepayers were kept whole in the process.

4.1.3 There were two main impacts of MIFRS related to PP&E:

(a) Depreciation rates would have to be adjusted, typically resulting in less depreciation, and therefore higher year end PP&E.

(b) The amount of overheads capitalized was severely restricted, typically resulting in higher OM&A, and lower year end PP&E.

4.1.4 The PP&E deferral account sought to correct for these changes. The method was to take two snapshots of the PP&E as of the end of the IRM period, one under MIFRS and one under CGAAP. If rate base as of the end of the IRM period was higher under MIFRS (as was usually the case), that meant that the combined expenses for depreciation and overheads during IRM were lower than they would have been under CGAAP. The utility would have enjoyed higher profits due to the change.

4.1.5 Since going forward the MIFRS rate base would be used, it is that PP&E figure that was retained. If it was higher than CGAAP, that would mean the ratepayers would pay for that rate base twice. To fix that, the excess collected would be refunded to ratepayers over the next IRM period. Interest at WACC would be added, since until the refunds were complete rate base (and therefore cost of capital) would be overstated. If rate base were lower under MIFRS, a similar adjustment would be made the other way, entirely symmetrical, to make the utility whole and recover the difference from ratepayers.

4.1.6 Inherent in the solution was the assumption that the difference in PP&E at the end of the IRM period would be exactly equal to the difference in overheads plus depreciation during the IRM period. It was only precisely fair if that were true.

4.1.7 During the discussions in the consultative, the implications of this solution if CWIP was material were not discussed, probably because all parties assumed the impact of CWIP on the adjustment would not be material.

4.1.8 In the case of this Applicant, CWIP is material. Included in the CWIP as of the end of the IRM period would have been $7.2 million of capitalized overheads, under CGAAP. However, because the CWIP is calculated on a MIFRS basis, that amount was not in the CWIP total. Instead, it was charged to OM&A during the IRM period.

4.1.9 This is a problem, because the "snapshot" as of the end of the IRM period did not capture this. The snapshot looked only at PP&E, which is a rate base concept and does not include CWIP. The Applicant had a real increase in OM&A during the IRM period due to this accounting change, but that increase was not reflected in the PP&E at the end of the period. The assumption that the change in PP&E, and the change in expenses during IRM, were the same, was untrue.

4.1.10 Without a correction, the effect would be that the Applicant would never recover this amount in rates. It would be included in OM&A in the IRM period due to MIFRS, but not included in the rates for that period, which were set using CGAAP. It would be deducted from the CWIP as of the end of the IRM period, and not included in the capital additions when the CWIP was closed to rate base. It would be completely "orphaned".

4.1.11 If the Board had considered that issue in the IFRS transition policy, and simply decided not to adjust for it, that would be one thing. It could be argued that the policy balanced many competing issues, and the Board had already struck that balance.

4.1.12 That is not the case here. The Board did not consider the impact of material overheads moved from capital to OM&A and not reflected in the PP&E Deferral Account. The issue was not addressed.

4.1.13 In SEC's view, it would be unfair to the utility to ask them to bear $7.2 million of incremental spending – spending for the benefit of the ratepayers – and never recover that from ratepayers solely because of an accounting change. In the same way we have argued that the ratepayers should be protected for the monthly in-service change, so the utility should be protected from this unexpected CWIP effect.

4.1.14 We do not, however, agree with the calculation of the impact, or the method of recovery. We deal with each of those issues below.

4.2 ***Calculation Issues***

4.2.1 There are two issues relating to the calculating of this recovery.

4.2.2 First, the extra OM&A experienced by the Applicant in 2011 and 2012 as a result of the limitations on capitalizing overheads was all tax deductible. PILs expense in those two years would therefore have been reduced by reason of those additional deductions.

4.2.3 We agree with the calculation of that reduction - $1.9 million – provided by Energy Probe in their submissions. It is only the remaining amount, approximately $5.3 million, that Powerstream is out of pocket. That is the amount that should be recovered from ratepayers.

4.2.4 Second, the use of the weighted average cost of capital as the interest rate on the refund or recovery in the PP&E Deferral Account reflects the fact that rate base going forward is over or under stated until that account has been fully cleared. By using WACC, the total cost of capital on rate base is adjusted correctly during the transition period.

4.2.5 That is not the case with CWIP. The Applicant has a variance in their OM&A expenses during IRM. That variance is being recovered from ratepayers. No part of rate base, whether PP&E, is affected. That is, in fact, precisely the reason for the problem.

4.2.6 In those circumstances, it is submitted that the interest to be included in the recovery of the excess OM&A is the same as any other variance account, and not the WACC.

4.2.7 We do note that the Staff Submissions [p. 22] discuss whether recovery should reflect the fact that the CWIP is being added to rate base during the Test Year, so something like the half-year rule should apply.

4.2.8 With respect, that argument is simply incorrect. The amount for which recovery is sought was expended, and expensed, prior to the Test Year. It is not included in the CWIP, which is entirely why the problem arises. The fact that the CWIP is added to rate base during 2013 is completely irrelevant, since the spending happened much earlier.

4.3 ***Method Proposed***

4.3.1 We do agree with Staff, and others, that the recovery of this excess IRM period OM&A is not part of the PP&E Deferral Account**.** Conceptually, it is something different in any case. Practically, trying to tie CWIP into the PP&E Deferral Account complicates that calculation unnecessarily, and particularly given the issues noted in Section 4.2 above.

4.3.2 Therefore, SEC recommends that the Board order the clearance of the PP&E Deferral Account in the normal manner, without consideration of CWIP. The refund of more than $9 million to ratepayers over four years would include the WACC, and the calculations of the account would be no different than any other LDC.

4.3.3 With respect to the amount to be recovered from excess IRM period OM&A, which is a net of just under $5.3 million after the tax is offset, that amount should be placed in a separate deferral account, to be recovered with interest at the normal rate for deferral accounts, over the same four years by way of a rate rider.

4.3.4 In our submission, this is the more straightforward approach, preserving the original intention of the PP&E Deferral Account, while ensuring that the Applicant is given recovery of the "orphaned" amount, as fairness requires.

5 OTHER MATTERS

5.1 *Costs*

5.1.1 The School Energy Coalition hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this proceeding. It is submitted that the School Energy Coalition has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible.

All of which is respectfully submitted.

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Jay Shepherd
Counsel for the School Energy Coalition