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November 13, 2012

**VIA MAIL and E-MAIL**

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Dear Ms. Walli:

**Re: Vulnerable Energy Consumers Coalition (VECC)**
**Final Submissions: PowerStream Inc. EB-2012-0161**
**2013 Electricity Distribution Rate Application**

Please find enclosed the submissions of the Vulnerable Energy Consumers Coalition (VECC) in the above noted proceeding.

Yours truly,

Michael Janigan
Counsel for VECC

cc: PowerStream Inc., Colin Macdonald
colin.macdonald@powerstream.ca

**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 section 78 of the *Ontario Energy Board Act* for an Order or Orders approving just and reasonable rates for electricity distribution to be effective January 1, 2013.**

**FINAL SUBMISSIONS**

**On Behalf of The**

**VULNERABLE ENERGY CONSUMERS COALITION (VECC)**

**November 13, 2012**

# Vulnerable Energy Consumers Coalition (VECC)
# PowerStream EB-2012- 0161
# Final Argument

## 1 The Unsettled Issues

1.1 These are the final submissions of VECC with respect to the issues. VECC has reviewed the submissions of Board Staff and Energy Probe. For the sake of brevity VECC has not provided a summary of the evidence as this is comprehensively provided in the submission of Board Staff. The issues addressed in this submission are:

1. Issue 4.2 – Is the proposed level of the depreciation and amortization expense for 2013 appropriate?
2. Issue 6.1 – Are the proposed Test Year cost of capital parameters appropriate?
3. Issue 8.2 – Is the treatment of property, plant and equipment due to the transition to the new accounting standard appropriate?

1.2 VECC has made no specific argument in respect to Issue 2.1 (Rate Base), which is noted as being partially settled in the Settlement Agreement filed in this case, as the matter is subsidiary to the arguments in respect to issue 4.2 and 8.2.

## 2 Issue 4.2 Is the proposed level of the depreciation and amortization expense for 2013 appropriate?

2.1 PowerStream has calculated deprecation for 2010 and 2011 based on an asset's in-service date. It used the half-year approach to set base rates in 2009 and is proposing to use the half-year rule in 2012, but proposes to use a full year's depreciation in 2013 to set rates.[1] On an actual basis PowerStream proposes to continue to use the in-service method of depreciation for 2013 and beyond.

2.2 PowerStream's proposal seeks to recover $1.9 million more in depreciation than the actual depreciation expense[2]. When grossed up for taxes this has a $2.5 million impact on the revenue requirement[3] .

2.3 PowerStream proposed this methodology in order to address what it considers a funding deficiency in the IRM rate setting methodology.

2.4 VECC submits that the Board should reject this proposal. PowerStream's proposal "cherry picks" the issue by focusing on costs and ignoring offsetting revenues. This was clearly shown in cross-examination by SEC[4]. Specifically the proposal ignores:

- the fact that replacement assets may be of higher nominal costs but may be of lower real costs;
- that a portion of fully depreciated assets after the test year remain in service;
- that no associated adjustment is made to CCA or other tax matters in using a full year's depreciation in the test year; and,
- the revenue side of the equation is not considered at all.

[1] Transcript Vol. 1, October 29, 2012 pgs. 23, 40.
[2] Transcript Vol. 1, October 29, 2012, pg. 40
[3] Transcript Vol. 1, October 29, 2012, pg. 28
[4] Transcript Vol. 1, October 29, 2012 pgs. 46-52.

2.5 VECC notes that the incremental distribution revenues from customers added in 2012 would increase the forecast of 2014 revenues by $1.2 million[5] , largely eliminating any purported funding shortfall. PowerStream has ignored this fact.

2.6 The second reason for denying the proposal is that the Applicant may, under new Board rate setting policies, avail itself to alternative methods of rate setting. The alternative methods, including multi-year cost of service take a comprehensive approach to the issues arising in multi-year rate making. These are, in VECC's submission, superior alternatives to the one-sided approach proposed by PowerStream.

2.7 VECC also supports the submissions of Board Staff in that the issue of underfunding under the current rate policy, if exists at all, is best dealt with on a generic basis.

2.8 Parties were also unable to resolve the issue of whether PowerStream should be required to adjust the 2013 depreciation expense for the difference between the actual depreciation methodology it employs (in-service dates) and the method used to calculate rates (half-year rule).

2.9 VECC has no specific submissions on this issue, but makes the following observation. The use of half-year depreciation rule is a well-established part of cost of service test year rate calculations. It is used to avoid the need for an applicant to create inordinately complex (and spuriously accurate) forecasts of actual in-service depreciation. In the long-run there should be no difference between the use of in-service date depreciation on an actual basis and half-year rule for rate making purposes. This is because the half-year rule purports to approximate in-service depreciation. If it is found that there are long-run differences between in-service depreciation and half-year depreciation methodology then the half year methodology is a biased estimator. If such a conclusion is reached then the logical extension is the half-year rule must be replaced for all utilities by a more accurate and less biased methodology.

[5] Exhibit J1.2

## 3 Issue 6.1 – Are the proposed Test Year cost of capital parameters appropriate?

3.1 A parties did not resolve the matter of the appropriate rate for the promissory notes held by PowerStream's three shareholders. The promissory notes in question are:

- Promissory Note to the City of Vaughn in the amount of $78,236,285 (the "Vaughn Note");
- Promissory Note to the City of Markham in the amount of $67,866,202 (the "Markham Note");
- Promissory note to the City of Barrie in the amount of $20,000,000 (the "Barrie Note");
- Collectively known herein as "the City Notes".

3.2 PowerStream proposes to calculate the interest cost for The City Notes at a rate of 5.58%. In VECC's submission the appropriate rate for this calculation is 4.41%, or the default rate assigned by the Board for fully callable affiliated debt. Should the Board decide to apply the default long-term debt rate of 4.41% there would be a savings to ratepayers of $2 million[6] .

3.3 When originally issued in 2004 the Vaughn and Markham Notes carried an interest rate of 5.58%. The Barrie Note was originally issued at 6.5%, but this rate was subsequently renegotiated in 2010 to 5.58%.[7]

3.4 PowerStream testified that they treat this debt "as if it were not callable due to the conditions of callability specified in the promissory note".[8]

3.5 Each note contains a postponement clause and subordination clauses which requires that all other debentures be paid prior to payment of the City Notes. The City Notes also share the following characteristics:

[6] Transcript Vol. 1, October 29, 2012, pg. 22
[7] Transcript Vol. 1, October 29, 2012, pg. 18
[8] Transcript Vol. 1, October 29, 2012, pg. 19

- the notes are not described as Demand Promissory Notes and have no explicit prepayment provision;
- the notes contain an “acceleration” provision which allows the Cities to redeem the debt upon demand and subject to subordination provisions and credit rate rating;
- all the notes contain a provision which states that the interest rate may be adjusted from time to time as agreeable between the Cities and PowerStream in order to “*reflect current market conditions* ***and the deemed interest rate as prescribed by the Ontario Energy Board***” (emphasis added).

3.6 The subordination and postponement agreements provide the ability for the change of interest rates upon the consent of the senior debt holder[9].

3.7 At the time of the refinancing in the summer of 2012 PowerStream had the opportunity to replace its subordinated affiliate debt with lower cost debt at 3.99%[10]. In the alternative PowerStream had the opportunity to leverage its positions with the lending affiliates since refinancing made the issue of subordination momentarily moot. During this time it was known that the cost of affiliated debt approved by the Board was 4.41%. In the event, PowerStream neither replaced the affiliated debt nor renegotiated a lower interest rate on the City Notes.

3.8 With respect, VECC disagrees with the submissions of Board Staff on this issue. Staff accurately recalls the facts but, in our view, miss the point. The regulator establishes rules around affiliated debt in order to circumvent self-dealing. Staff’s submission and PowerStream’s proposal rely on the technicality of what is or is not a “callable debenture”. This is a spacious argument.

3.9 It is, in our submission the regulators has a duty to view the facts in light of what PowerStream could have reasonably been expected to do had they not been related to the debt holders. It is clear from the renegotiation of Barrie Note that there is are opportunities to renegotiate lending rates downward. It is also clear

[9] Exhibit J1.5
[10] Transcript Vol. 1, October 29, 2012, pg. 79

that there is no prohibition in the subordination and postponement agreements to lowering the interest rate on junior debt. In fact, lowering the interest rates of subordinated debt reduces the risk to the senior debt holder by reducing the Utility's overall debt servicing costs.

3.10 The facts are that in 2012 the Utility had the opportunity to lower the cost to ratepayers of its long-term debt. The facts are there is no evidence it sought to do this[11]. Similar points are made by Energy Probe and we are in agreement with their submissions[12].

3.11 In VECC's submission the appropriate interest rate for the affiliated debt should be 4.41%. To allow PowerStream a higher cost of debt is to allow the shareholder to enrich themselves to the determinant of ratepayers.

# 4 Issue 8.2 – The appropriate treatment of property, plant and equipment due to the transition to modified IFRS

4.1 PowerStream is seeking to put into the deferral account an amount of $2,386,855 related to the inclusion of 2012 CWIP.[13]

4.2 In the transition to IFRS a number of utilities, like PowerStream have made changes to the burden or overheads that are capitalized. All other things being equal this results in an increase in OM&A and a reduction in capital costs. The other major change in moving to IFRS are changes to depreciation rates. Generally, and in the case of PowerStream, depreciation rates have been extended. PowerStream has calculated the net impact of these changes to be a $2.387 million credit to customers. This amount is proposed to be paid equally

[11] Transcript Vol. 1, October 29, 2012, pgs. 82-85.
[12] Energy Probe Submission, November 13,2012 pgs 13-17.
[13] Transcript Vol. 1, October 29, 2012, pg. 91.

over four years.[14]

4.3 PowerStream has deviated from the Board's filing guidelines and the common practice of cost of service applicants by including 2012 CWIP. Had PowerStream calculated the PP&E deferral account without this adjustment there would be a credit to customer of $9.571 million.[15]

4.4 It is PowerStream's position if 2012 CWIP is not considered as an IFRS transition cost then it would be forced to write off the difference of $7.184 million in 2012.

4.5 In VECC's submission the question is not, as suggested by Board Staff, whether PowerStream has filed in accordance with the rules of the Board. Nor is it particularly material to the resolution of this issue that PowerStream failed to raise the matter of CWIP at an earlier point in time. The evidence suggests that PowerStream has a clear, if perhaps different, understanding of the role of CWIP in the transition from CGAAP to MIFRS. There is no evidence that PowerStream purposely misled the Board or avoided addressing the issue in a timely manner.

4.6 VECC also supports the arguments of Energy Probe which conclude that the proposal does not amount to retroactive rate making but rather is captured as an element of the transition to IFRS and therefore recoverable[16].

4.7 In VECC's submission PowerStream has provided reasonable and sound arguments for the inclusion of the material impact of 2012 CWIP as an IFRS adjustment.

4.8 VECC supports the proposal of Energy Probe to establish a separate account for the recovery of the 7.184 million of non-capitalized 2012 OM&A net of income taxes (PILS). Energy Probe has calculated this amount as being $5.28 million[17]. In VECC's submission this a reasonable estimate of net amount to be recovered.

[14] Transcript Vol. 1, October 29, 2012, pg. 29
[15] Exhibit JT1.4
[16] Energy Probe Submission pgs. 17-18
[17] Energy Probe Submission pgs. 20-21

As also noted by Energy Probe, should the Board accept these submissions a corresponding adjustment should be made to the net book value of the PP&E to recognize the $9.571million increase in rate base.

## 5 Recovery of Reasonably Incurred Costs

5.1 VECC submits that its participation in this proceeding has been focused and responsible. Accordingly, VECC requests an award of costs in the amount of 100% of its reasonably-incurred fees and disbursements.

All of which is respectfully submitted this 13th day of November 2012.