

September 29th, 2014

Ms. Kirsten Walli, Board Secretary
Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

**Re: Board Staff Proposal for New Policy Options for the Funding of Capital Investments
Board File Number EB-2014-0219**

This is a joint application by the following LDCs: Burlington Hydro, Cambridge and North Dumfries Hydro Inc., Festival Hydro Inc., Hydro One Brampton Networks Inc., Orangeville Hydro and Veridian Connections Inc. (collectively, the "Applicants" or "we") in regard to the above-referenced proceeding. The Applicants filed cost of service applications for rates effective May 1, 2014, with the exception of Festival Hydro and Hydro One Brampton Networks Inc. who have applied for January 1, 2015 rates, and were therefore some of the first rebasers under the new RRFE. The Applicants commend Board staff on its initiative in this matter.

Briefly, the Applicants seek an Order of the Board authorizing the establishment of a deferral account that will record the Revenue Requirement impacts of transitioning from the Board authorized Revenue Requirement that relies on 50% of the capital spend of the rebasing year to a Revenue Requirement that relies on 100% in the subsequent IRM year. According to Board staff's proposal dated June 20, 2014, in light of the Board's expectations for long-term planning under the RRFE and provision of more predictable and stable rates while allowing distributors to make necessary capital investments, it plans to consider revised approaches to the funding of capital. Of consideration is whether the current rate regulatory cycle under the Price Cap Incentive Rate-setting option (Price Cap IR) results in distributors planning for more capital expenditures in the year of rebasing (or the prior year) to maximize the rate base at that point in time rather than planning based on good asset management practices. A goal identified by Board staff would be to facilitate the optimization and pacing of expenditures throughout the term of Price Cap IR thus avoiding large increases in capital expenditures at the time of rebasing.

One of the mechanisms proposed by Board staff to support this goal is as follows:

"1. Eliminate the effect of the half year rule on test year capital additions for the intervening years between rebasing applications (i.e. during the subsequent IR plan) by adjusting for the incremental revenue requirement (depreciation expense plus return on capital and associated taxes/PILs) of the test year capital additions. This is proposed to be accomplished through an adjustment (to be referred to as the D₁-factor) to the price cap formula in the first IR application subsequent to the cost of service application that resulted in rebased rates. The half year rule would still apply for the test year."

Additionally, in its July 18, 2014 letter to licensed electricity distributors and transmitters, *RE: Update to Chapters 1 and 2 of the Filing Requirements for Electricity Distribution Rate Applications*, the Board makes reference to the initiative as follows:

“On June 20, 2014, the Board initiated a consultation on New Policy Options for the Funding of Capital Investments (EB-2014-0129). While the policy consultation is still ongoing, distributors can propose an approach within their applications based on the proposed policy options as applicable, for the Board’s consideration.”

Based on the Board staff proposal and the invitation to applicants by the Board, the Applicants hereby apply for accounting orders effective as of the date of this joint application to establish a Half Year Rule Elimination Deferral Account (“HYREDA”). The purpose of the deferral account would be to record the incremental revenue requirement of the test year capital additions associated with the application of the half-year rule to the Applicants’ 2014 (or 2015 in the case of Festival Hydro and Hydro One Brampton Networks Inc.) test year capital additions. The balance of the account would be sought for disposition either through: a) a D₁-factor mechanism applied as an adjustment to the price cap formula in an IR application (or a similar mechanism) as adopted by the Board; or b) through disposition proposed by the Applicants in their next individual cost of service or custom IR applications.

The revenue requirement would be comprised of depreciation expenses plus return on capital and associated taxes/PILs, all derived from the Board Approved amounts in the Applicants’ 2014 cost of service proceeding (or 2015 cost of service proceeding in the case of Festival Hydro and Hydro One Brampton Networks Inc.). Draft accounting entries for recording of the incremental revenue requirement are provided at Attachment “A”.

In reviewing an application for the approval of a deferral account, the Board generally considers the following criteria: reasonableness; materiality; and causation. Each of these criteria is discussed below.

i. Reasonableness:

One goal of Board staff’s D₁-factor proposal is to facilitate the optimization and pacing of expenditures throughout the term of the IRM period. With the effect of the half-year rule in place throughout the IRM period, long-lived assets and increases in replacement costs can mean that sustaining and replacement capital is not funded fully during the IRM period by depreciation expense recovered in rates. This distortion in cash flow can have a negative impact on a distributor’s ability to ensure optimization and pacing of capital expenditures throughout the term of the IRM period.

In addition to the above noted goal, the D₁-factor proposal also serves the purpose of allowing distributors to earn a fair return on their test year capital additions during the intervening years between rebasing applications. The half-year-rule as it is applied now makes sense for the test year, as capital additions are made throughout the test year and was developed historically as a part of cost of service regulation which encompassed annual rebasing. However, because the half-year-rule continues to apply to test year capital additions throughout the subsequent IRM period, the Applicants are unable to earn a fair return on test year capital additions during the subsequent IRM period. Now that rebasings have been extended to five years, the half-year-rule exacerbates the fair return problem during the IRM period.

For clarity, it is not the case that the recovery of costs related to the unrecognized rate base is simply deferred until the next rebasing; that investment and asset value is permanently lost. The remaining net book value of the test year additions would be recognized in the next cost of service rebasing (2019 for 2014 filers, and 2020 for 2015 filers) but the half-year depreciation expense, associated PILs expense and associated return over the entire IRM period would not be recovered through rates.

The establishment of a deferral account for the unrecovered depreciation expenses, PILs and return and a mechanism for recovery could allow the Applicants to earn the fair return on their test year capital additions during the subsequent IRM period and remove the half-year rule impact on the Applicants' ability to optimize and appropriately pace expenditures during the IRM period.

The Applicants' proposed methodology quantifies the balances to be recorded in an account that will be administered in the same way as are Variance and Deferral Accounts. This approach is proposed because it is well understood by Ontario's electricity distributors and is administratively simple. The entries are those required to transition from 50% recovery in the rebasing year to 100% in subsequent years. The establishment of the requested account provides a mechanism so that by circumstance of their scheduled rebasing alone, those distributors that have already rebased under the RRFE and are currently under 4th Generation IRM are not subject to differences in policy treatment. We submit that the elimination of the effect of the half-year rule on test year capital additions for the intervening years between rebasing applications for those distributors under 4th Generation IR is a change in structure of regulation and should apply to all distributors under that manner of regulation regardless of their timing within an assigned schedule.

ii. Materiality:

The following table sets out the materiality threshold for each of the applicants, as well as the approximate amount that would annually be recorded within the Half Year Rule Elimination Deferral Account.

Applicant	Distribution Revenue Requirement*	Materiality Threshold (0.5% of Distribution Revenue Requirement)	Approximate Annual Amount to be recorded in Deferral Account
Burlington Hydro	\$30,836,546	\$154,183	\$389,600
Cambridge & North Dumfries Hydro	\$28,559,406	\$142,800	\$455,951
Festival Hydro	\$11,192,091	\$55,960	\$145,882
Hydro One Brampton Networks Inc.	\$73,867,577	\$369,338	\$1,438,597
Orangeville Hydro	\$4,758,815	\$50,000	\$50,000
Veridian Connections	\$49,930,177	\$249,650	\$718,753

** Annual distribution revenue requirement as approved for 2015 for Festival Hydro, and for 2014 for Burlington Hydro, Cambridge & North Dumfries Hydro, Orangeville Hydro and Veridian Connections. The revenue requirement presented for Hydro One Brampton Networks Inc is as proposed for 2015.*

iii. Causation:

The Board considers causation in terms of whether the amounts to be recorded in the account are clearly outside of the base upon which base rates were derived and whether the costs to be recorded in the account relate directly to the purpose of the account.

The Applicants submit that the amounts to be recorded in the proposed deferral accounts are outside the base upon which base rates were derived. The Applicants are in the process of considering, preparing or filing 2015 IRM applications, and under the current IRM regime there is no mechanism to account for the diminished opportunity to earn the allowed return on equity associated with the half-year-rule being applied to capital additions made in the rebasing year. The mechanics of the proposed accounting entries are described at Attachment "A" and ensure that the amounts to be recorded relate directly to the purpose of the account.

The Applicants understand that approval of the accounting order to establish the Half Year Rule Elimination Deferral Account does not ensure recovery of the amounts recorded in the account and that recovery at a future date would be in accordance with Board direction.

We thank you for your consideration on this matter.

Regards,

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Attachment A

Proposed Accounting Entries – Half Year Rule Elimination Deferral Account

Dr: 5705 Depreciation Expenses

Cr: 2100 Accumulated Depreciation

To record preliminary recognition of the amount of depreciation related to the half-year rule impact on 2014 (or 2015 in the case of Festival Hydro & Hydro One Brampton Networks Inc.) test year capital additions

Note: This entry is currently being made, is not dependent upon approval of the requested deferral account and is shown here for illustrative purposes as the genesis of the amount for the following entry.

Dr: 1508 Other Regulatory Assets – Sub Account “Half Year Rule Elimination Deferral Account”

Cr: 4310 Regulatory Credits

To record the amount of depreciation expense related to the half-year rule impact on 2014 (or 2015 in the case of Festival Hydro) test year capital additions

Dr: 1508 Other Regulatory Assets – Sub Account “Half Year Rule Elimination Deferral Account”

Cr: 4310 Regulatory Credits

To record the incremental revenue requirement related to return on capital and associated taxes/PILs

Notes:

- 1. An entry would be made for the annual incremental revenue requirement each year until such time as the Board adopts the D_1 -factor or similar mechanism to allow inclusion in base rates through an annual IRM adjustment.*