2001 CarswellAlta 2058
Alberta Energy and Utilities Board

Genco & Disco 2000 Pool Price Deferral Accounts Proceeding, Re

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A.J. Berg Member, N.W. MacDonald Presiding Member, R.G. Lock Member

Judgment: December 12, 2001
Docket: 2001-92

Counsel: None given

Subject: Public

Related Abridgment Classifications

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Public law --- Public utilities — Operation of utility — Miscellaneous

Table of Authorities

Cases considered:

ATCO Electric Inc., Re (2000), 2000 CarswellAlta 1823 (Alta. E.U.B.) — referred to

ATCO Electric Ltd., Re (May 10, 1999), Doc. U99046 (Alta. E.U.B.) — referred to

ATCO Electric Ltd., Re (October 31, 2000), Doc. 2000-65 (Alta. E.U.B.) — referred to

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ATCO Electric Ltd., Re (2001), 2001 CarswellAlta 2094 (Alta. E.U.B.) — referred to

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ATCO Electric Ltd., Re (June 22, 2001), Doc. 2001-55 (Alta. E.U.B.) — referred to

ATCO Electric Ltd., Re (2001), 2001 CarswellAlta 2055 (Alta. E.U.B.) — referred to

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ATCO Gas - North, Re (2001), 2001 CarswellAlta 2127 (Alta. E.U.B.) — considered

EPCOR Generation Inc., Re (February 1, 2000), Doc. 2000-5 (Alta. E.U.B.) — referred to

EPCOR Transmission Inc., Re (2001), 2001 CarswellAlta 2091 (Alta. E.U.B.) — referred to

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TransAlta Utilities Corp., Re (2001), 2001 CarswellAlta 2046 (Alta. E.U.B.) — referred to

UtiliCorp Networks Canada (Alberta) Ltd., Re (May 30, 2001), Doc. 2001-47 (Alta. E.U.B.) — considered

Utilicorp Networks Canada (Alberta) Ltd., Re (2001), 2001 CarswellAlta 2126 (Alta. E.U.B.) — referred to

Year 2000 Outstanding Matters Deferral Accounts (Other than Pool Price), Re (2001), 2001 CarswellAlta 2043, 2001 CarswellAlta 2050 (Alta. E.U.B.) — referred to

Year 2000 Outstanding Matters Deferral Accounts (Other that Pool Price) Part B, Re (November 8, 2001), Doc. 2001-83 (Alta. E.U.B.) — referred to

1996 Electric Tariff Applications, Re (1997), 1997 CarswellAlta 1294 (Alta. E.U.B.) — referred to

1999/2000 Electric Tariff Applications, Re (1999), 1999 CarswellAlta 1705 (Alta. E.U.B.) — considered

2000 Pool Price Deferral Accounts Proceeding, Re (December 4, 2001), Doc. 2001-89 (Alta. E.U.B.) — referred to

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2000 Pool Price Deferral Accounts Proceeding, Re (December 4, 2001), Doc. 2001-88 (Alta. E.U.B.) — referred to

2000 Pool Price Deferral Accounts Proceeding, Re (December 22, 2001), Doc. 2001-93 (Alta. E.U.B.) — referred to

Statutes considered:

Alberta Energy and Utilities Board Act, S.A. 1994, c. A-19.5
s. 10(3)(f) — considered

Electric Utilities Act, S.A. 1995, c. E-5.5

Generally — referred to

s. 18 — referred to

s. 51(3) — considered

s. 52 — referred to

s. 52(1)(b) — referred to

s. 56 — considered

s. 58(3) — referred to

s. 78 — referred to

Electric Utilities Amendment Act, S.A. 1998, c. 13
Generally — referred to

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Municipal Government Act, S.A. 1994, c. M-26.1
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s. 243 — referred to

s. 244 — referred to

s. 251 — referred to

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s. 87 — referred to

s. 106.1 [en. 1995, c. E-5.5, s. 84] — referred to

Regulations considered:

Electric Utilities Act, S.A. 1995, c. E-5.5
Deferral Accounts Deficiency Correction Amendment Regulation, Alta. Reg. 6/2001

Generally — referred to

Deferral Accounts Deficiency Correction Regulation, Alta. Reg. 240/2000

Generally — referred to

s. 1(a) "deferral account" [rep.& sub. Alta. Reg. 6/2001] — considered

s. 1(a) "deferral account" (i) — considered

s. 1(a) "deferral account" (iii) [en. Alta. Reg. 6/2001] — considered

s. 1(b.1) "municipal owner of an electric distribution system" [en. Alta. Reg. 6/2001] — considered

s. 2 — considered

s. 3 — considered

s. 3(1) — considered

s. 4 — considered

s. 4(1) — considered

s. 4(2) — considered

s. 4(4) — referred to

s. 4(6) — referred to

s. 5 — referred to

s. 5(1) — considered

s. 5(2) "regulatory authority" (a) — referred to

s. 5(2) "regulatory authority" (c) — referred to

Distribution Tariff Regulation, Alta. Reg. 84/2000

Generally — referred to

Decision of the Board:

1 Introduction

1 In March 2001, the Board received the following Applications in the omnibus 2000 pool price deferral accounts proceeding:

Table 1: List of Application Number for Each Application

Application Number	DISCO/GENCO
2001058	UtiliCorp Networks Canada (Alberta) Ltd. *(UNCA)*
2001059	TransAlta Utilities Corporation *(TransAlta)*
2001060	ATCO Electric Ltd. (DISCO) *(AE DISCO)*
2001061	ATCO Electric Ltd. (GENCO) *(AE GENCO)*
2001062	EPCOR Distribution Inc. (DISCO) *(EDI)*
2001063	EPCOR Generation (GENCO) *(EGI)*
2001064	ENMAX Power Corporation (DISCO) *(ENMAX)*
2001065	The City of Lethbridge (DISCO) *(Lethbridge)*
2001066	The City of Red Deer (DISCO) *(Red Deer)*

2 The GENCO deferral accounts were established in accordance with section 3(a)(4) of Decision U99099 [*1999/2000 Electric Tariff Applications, Re* (1999), 1999 CarswellAlta 1705 (Alta. E.U.B.)] for TransAlta Utilities Corporation (TransAlta) and

EPCOR Generation Inc. (EGI) [1] and by the terms of the 1999/2000 Negotiated Settlement (1999/2000 Settlement) approved by the Board in Decision U99046 [*ATCO Electric Ltd., Re* (May 10, 1999), Doc. U99046 (Alta. E.U.B.)] for ATCO Electric Ltd. (AE). TransAlta, EGI and AE were the three GENCO applicants.

3 The DISCO deferral accounts for the investor-owned utilities were established in section 3(c) of Decision U99099 for TransAlta's distribution business (now owned by UtiliCorp Networks Canada (Alberta) Ltd. [UNCA]) and in AE's 1999/2000 Settlement approved by the Board in Decision U99046.

4 The definition of the DISCO deferral accounts was extended by sections 1(a)(iii) and 1(b.1) of the *Deferral Accounts Deficiency Correction Regulation* [2] to include four of the municipal owners of electric distribution systems, namely EPCOR Distribution Inc. (EDI), ENMAX and the Cities of Red Deer and Lethbridge (Cities, unless otherwise distinguished).

5 This Decision will determine an appropriate 2001 carrying cost rate applicable to the 2000 pool price deferral account operations for each of the following Generation entities (GENCOs):

• TransAlta Utilities Corporation (TransAlta GENCO)

• ATCO Electric Ltd. (AE GENCO)

• EPCOR Generation Inc. (EGI)

6 This Decision will also determine an appropriate 2001 carrying cost rate applicable to the 2000 pool price deferral account operations for each of the following Distribution entities (DISCOs):

• UtiliCorp Networks Canada (Alberta) Ltd. (UNCA)

• ATCO Electric Ltd. (AE DISCO)

• EPCOR Distribution Inc. (EDI)

• ENMAX Power Corporation (ENMAX)

• The City of Lethbridge

• The City of Red Deer

7 The 2001 carrying cost rate that is determined for each of the GENCOs and DISCOs will be applied to the Board approved 2000 year-end balances in each GENCO's and DISCO's deferral account for the purposes of determining Board approved 2001 carrying costs.

8 Pursuant to section 4(6) of the *Deferral Accounts Regulation*, the Balancing Pool is required to pay the Board approved 2001 carrying costs for the DISCOs.

9 In addition, as stated in Decisions 2001-82 [*Year 2000 Outstanding Matters Deferral Accounts (Other than Pool Price), Re* (2001), 2001 CarswellAlta 2050 (Alta. E.U.B.)] and 2001-83 [*Year 2000 Outstanding Matters Deferral Accounts (Other that Pool Price) Part B, Re* (November 8, 2001), Doc. 2001-83 (Alta. E.U.B.)], issued on November 9, 2001, in relation to the Outstanding Matters (not pool price related) deferral accounts of the GENCOs and investor-owned DISCOs, the Board will apply the carrying cost rates determined in this Decision to the balances determined in the Outstanding Matters decisions.

10 This Decision is one of a series relating to this omnibus proceeding. The complete list of interim and final decisions is set out below in an Appendix of this Decision.

1.1 Process Applied to the Pool Price Deferral Accounts Applications

11 In a letter dated March 7, 2001, and in accordance with sections 3 and 4 of the *Deferral Accounts Regulation*, the Board established a process for the final determination of all of the 2000 GENCO and DISCO pool price deferral accounts, including the filing of applications dated March 30, 2001 from the nine applicants.

12 The Board established the following process to review the 2000 GENCO and DISCO pool price deferral accounts. With the exception of the scheduled hearings, the Board established a parallel process for both the GENCOs and the DISCOs:

Table 2: Schedule — 2000 Pool Price Deferral Accounts Proceeding

First Round Information Requests to GENCOs and DISCOs	March 16, 2001
GENCO and DISCO Deferral Account applications	March 30, 2001
GENCO and DISCO Applicants' Issues List	March 30, 2001
First Round Information Responses from GENCOs and DISCOs	March 30, 2001
Second Round Information Requests to GENCOs and DISCOs	April 9, 2001
Issues List provided by Interveners	April 9, 2001
Second Round Information Responses from GENCOs and DISCOs	April 23, 2001
Intervener Evidence	May 4, 2001
Information Requests to Interveners	May 11, 2001
Information Responses from Interveners	May 23, 2001
Rebuttal Evidence	May 30, 2001
Independent Financial Expert (IFE) Evidence	June 4, 2001
Information Requests to IFE	June 11, 2001
Information Responses from IFE	June 18, 2001
GENCO and DISCO Deferral Accounts Hearing	June 4-July 30, 2001
Board Ruling — Securitization to be investigated	July 30, 2001
Due Date for Filing of Written Argument	September 4, 2001
Due Date for Filing of Written Reply	September 24, 2001

13 During the proceeding, securitization was identified as an option to finance the deferral account carrying costs on a going forward basis. The Board ruled on July 30, 2001 that an investigation into securitization commence as soon as possible and would include the utilities, customer representation and a Board staff observer. The Board expects to receive a final feasibility review from the securitization assessment group and will accordingly assess and incorporate their recommendations.

14 At the end of the oral phase of the omnibus 2000 deferral accounts hearing, the Board established due dates of September 4, 2001 and September 24, 2001 for the simultaneous filing of written Argument and Reply, respectively. However, one party was late and filed its Argument on September 5, 2001.

15 As a result of this late filing, the Board received a letter dated September 13, 2001, on behalf of ATCO Electric Ltd. (AE) expressing concern about some parties filing their Arguments after the Board-established deadline for doing so.

16 In a letter to all parties on September 14, 2001, the Board expressed its own concern about parties filing material beyond the deadlines established by the Board for this proceeding. Parties were reminded that deadlines established by the Board are intended both to assist the Board and parties and to ensure fairness to all applicants and interveners. In the Board's view, these deadlines become even more important when the Board process calls for simultaneous filing of Argument and Reply by parties. Despite the heavy regulatory agenda facing all participants in Board proceedings, the Board emphasized its expectation that parties will comply with Board-established filing deadlines unless the Board has indicated otherwise. The Board reminded parties that any who fail to meet these deadlines take the risk that their submissions may not be included in the record of the proceeding and may not be considered by the Board.

17 In the particular circumstances of this proceeding, the Board advised parties that it would follow a somewhat different procedure for filing Reply in light of the concern raised by AE. In this proceeding, the Board directed all parties, including AE,

to file their Replies (or a notification that no Reply would be filed) first with the *Board only*, after which the Board would notify parties and direct them to release their Replies to all other parties.

18 The Board received the last Reply on September 25, 2001 and distributed an e-mail instruction to all parties on September 25, 2001 directing parties to distribute their Replies to all other parties.

19 The Board recognizes that further proceedings might be necessary to consider the "securitization option" presently being investigated by some of the parties to the proceedings. The Securitization Investigation Group, as will be discussed later in this Decision, filed an interim report with the Board on November 29, 2001.

20 By letter dated November 1, 2001 the Alberta Energy and Utilities Board (the Board) recognized that the refilings required on the 2000 Deferral Accounts would likely not be processed before January 1, 2002 when a number of other significant changes to Alberta electric rates will occur (i.e. new levels for RROT energy charges, Distribution Tariff riders [3] expire, etc.). The Board indicated its desire to minimize the frequency of changes in the levels of customer rates regulated by the Board. The Board considered that customers would benefit from stability in rates during this period of transition in the restructuring of Alberta's electric industry without affecting the development of a competitive industry. The Board, in AE Decision 2001-102 [*ATCO Electric Ltd., Re* (2001), 2001 CarswellAlta 2098 (Alta. E.U.B.)] determined that the AE pool price deficiency riders would not take effect until April 1, 2002.

21 However, for the purpose of this Decision, the Board considers November 29, 2001 to be the last day that evidence was submitted for this Decision.

2 Legislative Framework for DISCO 2001 Carrying Costs

22 For all six DISCOs, in addition to reviewing the balances in their 2000 pool price deferral accounts, the Board is also required by the *Deferral Accounts Regulation* to determine the associated final 2001 carrying costs that are to be recovered by the DISCOs from the Balancing Pool.

23 In addition, for the AE and UNCA DISCOs, the Board will approve both the allocation of the remaining deferral accounts balances among customer classes and the timing of the collection of those balances from customers during the period January 1, 2002 to December 31, 2004, as contemplated by section 5 of the *Deferral Accounts Regulation*.

24 However, following the Board's review of the deferral accounts of the four municipally owned DISCOs, their regulators (i.e. municipal councils) will determine if and how any deferral account balances should be collected from customers. Pursuant to the *Deferral Accounts Regulation*, these determinations are not within the purview of the Board.

25 In relation to the six DISCOs, including the four municipally owned DISCOs, the Board's authority to review the 2000 pool price deferral accounts is found in the *Deferral Accounts Regulation*, which was originally enacted on November 28, 2000 and was significantly amended on January 17, 2001. [4]

26 Section 1(a) of the *Deferral Accounts Regulation* defines a deferral account as follows:

> (i) in respect of ATCO Electric Ltd., a deferral account established for 2000 referred to in clauses 28, 29, 30 and 31 of the Alberta Power Limited 1999/2000 Phase I Negotiated Settlement dated April 21, 1999 and approved by the Board in Decision U99046 dated May 10, 1999,
>
> (ii) in respect of UtiliCorp Networks Canada (Alberta) Ltd., a deferral account established for 2000 referred to in the Summary of Board Directions numbered 58, 59 and 60 in Part I - General of Board Decision U99099 dated November 25, 1999, and
>
> (iii) in respect of a municipal owner of an electric distribution system, a reconciliation account for 2000 established for the same purpose that a deferral account referred to in subclause (i) or (ii) is established.

27 As noted above, the *Regulation* defines the "municipal owner of an electric distribution system" to mean ENMAX, EDI and the Cities. As also noted above, the inclusion in the definition of "deferral account" of municipal pool price reconciliation accounts has effectively extended the Board's jurisdiction to include the municipal DISCOs for limited purposes. The extent of the Board's authority is discussed in this section of the Decision.

28 Section 2 of the *Deferral Accounts Regulation* prohibited the owner of an electric distribution system from collecting any amounts from customers in respect of its 2000 deferral accounts as follows:

> **2** In 2001, the owner of an electric distribution system must not collect under its distribution tariff or regulated rate tariff any amount in respect of its deferral accounts.

29 At the same time, section 3(1) of the *Regulation* directed the owner of an electric distribution system to apply to the Board in 2001 for a review by the Board of the owner's deferral accounts.

30 In order to provide support for the year-2000 deferral accounts, section 4 of the *Deferral Accounts Regulation* established a process to determine 2001 carrying costs, on both interim and final bases, as follows:

> 4(1) The Board must determine an amount that is payable in 2001 to the owner of an electric distribution system in respect of the cost of financing the amounts in the owner's deferral accounts in 2001.
>
> (2) In determining an amount under subsection (1), the Board must ensure that an owner is able to recover the prudent cost of financing the amounts in its deferral accounts, which may include debt financing, equity financing or a combination of debt and equity financing.
>
> (3) Before the Board makes a determination under subsection (1) in respect of an owner, the owner may apply to the Board for approval of a monthly payment to the owner in respect of the cost of financing the amounts referred to in subsection (1) that is based on the owner's reasonable estimate of the amounts in its deferral accounts.
>
> (4) The Board must base its approval under subsection (3) on the Bank of Canada bank rate plus 1.5%.
>
> (5) On completing a determination under subsection (1) in respect of an owner, the Board must calculate
>
> > (a) any refund payable by the owner where the monthly payments under subsection (3) for the year exceed the amount determined under subsection (1) for the owner, or
> >
> > (b) any additional amount payable to the owner where the monthly payments under subsection (3) for the year are less than the amount determined under subsection (1) for the owner.
>
> (6) Any amount
>
> > (a) payable to an owner under this section is to be paid by the balancing pool administrator out of the balancing pool, or
> >
> > (b) payable by an owner under this section is to be paid to the balancing pool administrator to be credited to the balancing pool.

31 According to Section 5(1) of the *Deferral Accounts Regulation*, after completion of the Board's review of the year-2000 deferral accounts, a regulatory authority may approve the collection by the owner of an electric distribution system of any amount in respect of its deferral accounts during the period from January 1, 2002 to December 31, 2004. In the case of a municipality, a "regulatory authority" means the council of the municipality. [5]

32 For purposes of this particular Decision respecting deferral account carrying costs, the Board particularly notes its responsibility under section 4(2) of the *Deferral Accounts Regulation*, which requires the Board to approve for a DISCO

"the prudent cost of financing the amounts in its deferral accounts which may include debt financing, equity financing or a combination of debt and equity financing." In the Board's view, the *Regulation* is consistent with the exercise of the Board's traditional regulatory jurisdiction with respect to assessing costs, particularly financing costs, claimed by a regulated utility. In that respect, the Board does not consider the *Deferral Accounts Regulation* to have superadded conditions to the exercise of the Board's discretion.

3 Recovery Period

3.1 Introduction

33 As the Board has noted in Decisions 2001-88 [*2000 Pool Price Deferral Accounts Proceeding, Re* (December 4, 2001), Doc. 2001-88 (Alta. E.U.B.)] through 2001-99 respecting its review of the deferral accounts of the municipally owned DISCOs, the *Deferral Accounts Regulation* prohibited all DISCOs from collecting in 2001 the balances in their 2000 deferral accounts. [6] The *Regulation* also requires the Board to review the balances in those accounts in 2001 and approve 2001 carrying costs for all DISCOs to be paid from the Balancing Pool.

34 For those DISCOs for whom the Board is the regulatory authority, namely AE DISCO and UNCA DISCO, the Board also has the responsibility to determine the period of recovery of the Board-approved deferral account balances.

35 For the municipally owned DISCOs, ENMAX, EDI, Red Deer and Lethbridge, the *Deferral Accounts Regulation* places the responsibility for determining the recovery period on the regulatory authorities for those particular DISCOs, namely their respective municipal councils.

36 In this Decision, therefore, the Board is only concerned with addressing the timing of the recovery for UNCA and AE DISCOs. In that regard, the *Deferral Accounts Regulation* provides that, once the Board has completed its review of the deferral account balances, it may approve the collection of those balances "during the period from January 1, 2002 to December 31, 2004." [7]

37 In its March 31, 2001, Application, UNCA DISCO proposed a three-year recovery period from January 1, 2002 through December 31, 2004.

38 In its March 31, 2001, Application, AE DISCO proposed a one-year recovery period from January 1, 2002 through December 31, 2002.

39 The Board will assess the recovery period and recovery methodology for UNCA and AE DISCOs in the following sections.

3.2 Views of UNCA

40 UNCA proposed to collect the Deferral Account amount over the three-year period from 2002-2004. The total amounts presented in Schedule 9.0 of the Application indicated that the revenue the rider is designed to collect is equal to one third of the total principal amount plus the annual total carrying costs for each of these years. UNCA believed this accomplishes a reasonable matching of costs and revenues, while keeping rates stable. [8]

41 Thus, UNCA proposed to design the Pool Price Deferral Rider based on a three-year collection period. UNCA submitted that the rationale for this was that the resulting rider will, on average, be similar in magnitude to the rider resulting from the U99099 Outstanding Matters Rider, thereby minimizing rate shock over the next 3 years. [9]

42 UNCA discussed rate shock and its approach to the matter in the following exchange:

> Q. How does one measure rate shock based on a world, which incorporates a cents-per-kilowatt-hour rider charge? In the past, in the classic case, you would look at a percentage rider, and you would say if it was 10 percent or greater,

maybe that would constitute rate shock. How would you define "rate shock" in a world where you are looking at a cents-per-kilowatt-hour rider charge?

A. MS. KIRRMAIER: Well, to be clear, we didn't quantify this or set any scientific thresholds that we were targeting for. We just felt the regulation allowed a three-year recovery period. We felt the spirit of the regulation was to minimize the overall effect of collecting this deferral account. So, we proposed to use the three-year period.

Now, one could try to calculate some typical bills making assumptions as to what the other components of a customer's bills are going to be and figure out what the impact of the cents-per-kilowatt-hour rider is on a percentage basis on that to determine what the impact is.

I don't think we have explicitly done that in this application, but it could be done. But again, it would be full of speculation.

So, even if we wanted to set the limit at 10 percent, the other components that a customer is going to be paying are not in our control. So, we would have to guess as to what those would be. [10]

43 UNCA discussed the issue further in the following exchange:

Q. So, if I come back, Ms. Kirrmaier, if I come back to the response in BR.UNCA.DISCO-5. In what context are you using the words "rate shock" as it applies to your application?

A. MS. KIRRMAIER: I think, as I said earlier, it was a qualitative — like I said, we didn't define a threshold, a numerical value for that. We just felt that we had three years to collect this, and we thought that would be the most acceptable thing for consumers. It was, basically, the lowest impact method we could come up with.

Q. Lowest impact to the customer.

A. MS. KIRRMAIER: Yes. [11]

44 In respect to the history of UNCA's deferral accounts and the issue of rate shock, on November 7, 2000, UNCA originally submitted a $404 million application for an amendment to the existing rate riders for the deferral accounts (i.e., a revision to the rate riders in place for TAU based on the determination in Decision 2000-60 [*TransAlta Utilities Corp., Re* (August 31, 2000), Doc. 2000-60 (Alta. E.U.B.)]). In that application, which was terminated as a result of the introduction of the *Deferral Accounts Regulation* later in November 2000, UNCA requested a one-year recovery. UNCA provided the reason for the requested one-year recovery period in the following response:

But we had proposed it within the understanding of the deferral account set out in Decision U99099 and the norm up until that time — now we all agree that nothing is normal about any of this anymore — but was that you would try to collect any outstanding amounts from a previous year in the following year. So, I think that was a — it wasn't an unusual assumption to make, that we would attempt to collect the full amount in one year. [12]

...Rate shock is not the only rate design criterion we look at. So, just because those numbers were above 10 percent on average did not give us an indication we definitely wouldn't be able to collect it within a year. I don't think that is a fair assumption at all to make. [13]

45 With regard to relative impact of the deferral accounts on the DISCOs, UNCA provided the following simple comparison of the pool price deferral account amounts on a per MWh basis for all six DISCOs:

Table 3: UNCA Provided Comparison of Per Unit Pool Price Deferral Account

DISCO	Gross DISCO Pool Price Deferral Amount ($ Millions)	Pool Price Deferral Energy Purchases (GWh)	Per Unit Pool Price Deferral Account ($/MWh)
UNCA	473.3	24,218.5	**19.5**
ATCO	92.3	9,805.0	**9.4**
ENMAX	175.7	7,601.3	**23.1**
EPCOR	100.8	6,574.1	**15.3**
Lethbridge	14.5	618.8	**23.4**
Red Deer	12.5	552.8	**22.6**

46 The above values are the pool price / entitlement deferral amounts and energy volumes as filed in the respective DISCO applications of March 30, 2000 before any adjustments, riders or impacts of GENCO deferral amounts, hedging, financing costs, etc.

47 The effect of reduced entitlements as a result of the Wabamun 4 interim TSR is included for all DISCOs. [14]

48 UNCA noted that on a per MWh basis, UNCA's per MWh deferral account amount falls near the middle range of all other DISCOs. UNCA noted that while its unadjusted pool price deferral account was calculated as prescribed by UNCA's Board approved 2000 deferral account formula and using approved forecast costs and revenues, the other DISCO deferral accounts were calculated relative to different forecasts and budgets and in some cases, approved by different regulators. Consequently, UNCA expected that there would be differences between the DISCOs deferral accounts on a per MWh basis.

49 UNCA confirmed that, from its perspective, it was relatively indifferent as to what the collection period is. [15] However, UNCA indicated that its view of the recovery period was based on the assumption that the Board would accept its requested carrying cost rate.

50 UNCA submitted that if the Board were to determine a carrying cost rate other than, or less than, the requested WACC rate, then it would need to revise its thinking about the recovery period. UNCA confirmed that it viewed the collection period and the financing costs as a package in the following exchange:

> Q. But if [it] come[s] as a package, I guess the question is, If the Board determined a carrying cost rate other than WACC, say, for example, Bank of Canada rate plus 1.5 percent, would that influence UNCA's —
>
> A. MS. KIRRMAIER: Well, I think —
>
> Q. — view as to what the appropriate recovery period is?
>
> A. MS. KIRRMAIER: Well, I think we would prefer to recover it as quickly as possible then, because that would not cover our financing costs. So, yes, I think the response is that we would prefer, then, to collect it quicker.

51 UNCA proposed to monitor rider revenue collected and stop the rider when the right amount has been collected for each of the rate categories effectively providing a "true up" for each class ensuring there is neither an under-recovery or an over-recovery.

3.3 Views of AE DISCO

52 AE DISCO proposed to collect the deferral account balance of $97.9 million via a rider on its Distribution Tariff during the 1-year period from January 1, 2002 to December 31, 2002. AE DISCO submitted in its application that a 1-year rider could collect the entire deferral amount being applied for without impacting the forecast total cost of wires and energy supply to any rate class by more than 10%. AE DISCO also submitted that collecting the deferral account over a one-year period would also minimize the carrying costs of the deferral account. [16]

53 AE DISCO submitted the revenue impact of a one year rider based on a revised $98.3 million deferral account balance. Implementing a one-year rider would result in rider increases of greater than 10% (of the forecast total cost of wires and energy supply) for two rate classes, based on an assumption of $100/MWh for the average 2002 pool price.[17] AE DISCO noted that even assuming that the average pool price is $75/MWh for 2002, implementing a one-year rider would result in rider increases of less than 11% (of the forecast total cost of wires and energy supply) for all but two rate classes.[18]

3.4 Views of EDI

54 EDI submitted that it intends to propose to its regulator that the deferral account balance be recovered over the three-year period from 2002 to 2004.[19]

3.5 Views of IPCCAA

55 IPCCAA submitted that all pool price deferral account recoveries should be paid within the 2002 calendar year.

3.6 Views of FIRM

56 FIRM submitted that if a securitization option is carried out, the collection period will be set as part of the terms of the issue. FIRM noted that it generally appears that these instruments would collect the balance over a three-year period.

57 FIRM submitted that given the magnitude of the balances and the impact on consumers if the recovery is over a short period, they would generally support spreading the recovery to mitigate the rate shock. FIRM further noted that the *Deferral Accounts Regulation* allows for a three-year recovery period and this would appear to be appropriate in this case.

3.7 Views of ACC

58 ACC noted that there appeared to be no disagreement that the DISCO pool price deferral account balances are essentially comprised of three distinct components: the actual-over-forecast payments to the Pool (Pool Price Purchase Variance), the actual-over-forecast refunds or entitlements from the Pool (Entitlement Variance), and the refund of the GENCO deferral balances. ACC noted that the first component was positive and is owed by customers to the DISCO. In contrast, the second and third were negative and are owed by the DISCO to be refunded to its customers. ACC submitted that although UNCA and AE DISCOs lumped these three components into a single balance, and proposed to amortize their balances uniformly over the recovery period (2002 - 2004 for UNCA and 2002 for AE DISCO), there is no fundamental reason why that is necessary or required, or even that there be one recovery method common to all DISCOs. For example, ACC noted that Mr. Beckett on behalf of AE DISCO agreed that no part of the Negotiated Settlement mandates that the cost deferral balance and the credit deferral balance must necessarily be collected and/or returned to customers over the same time period.[20]

59 Dr. Rosenberg's, ACC's expert witness, recommended to take advantage of the distinctiveness of the deferral account balances and to tailor the recovery period of each one so as to achieve an overall objective. Dr. Rosenberg's objective was, in broad terms, to lower the net amount recovered in 2002 and commensurately raise the amounts recovered in the back end, that is the years 2003 and 2004. The reason for this objective was to mitigate the impact to customers. Dr. Rosenberg reasoned that, because of the cessation of the Balancing Pool refund at the end of 2001, the customers would see a rise in prices in 2002 compared to 2001, all other things being equal. Consequently, Dr. Rosenberg was seeking to dampen the effect of the deferral account recovery in the year 2002. ACC's objective was also based on the assumption that pool prices would decline in the years 2003 and 2004, as a result of new generation being built. To the extent that expectation would be met, the reduced pool prices would offset the larger pool price deferral balance recovery in those years based on ACC's recommended proposal.

60 Dr. Rosenberg recommended recovering AE DISCO's positive Pool Price variance evenly over two years instead of one, and returning 65% of its Entitlement Variance in 2002 with the balance returned in 2003. With regard to UNCA, Dr. Rosenberg recommended recovering the Pool Price variance evenly over the period 2002 — 2004 (as UNCA itself proposed),

but returning the Entitlement Variance 50% in 2002, 25% in 2003, and 25% in 2004. With regard to the refund of the GENCO deferral balance due the DISCO, he further recommended that the refund be passed back to customers in 2001 to mitigate current high pool prices.

61 Dr. Rosenberg acknowledged that his proposal would entail somewhat larger carrying charges relative to the carrying costs based on the DISCO proposals. Notwithstanding that, Dr. Rosenberg calculated that utilizing conservative estimates of an opportunity cost of capital for customers and a carrying charge rate for DISCOs, his recommendation produced a net present value to UNCA customers of $29 million, and to AE DISCO customers of approximately $9 million, compared to the proposals of the DISCOs.

62 ACC submitted the following exchange with Dr. Rosenberg discussing his net present value calculation:

> Q. Could you maybe elaborate a little bit more on, then why you are suggesting that you ought to use the 15 percent discount rate instead of saying using the same discount rate as you used for the carrying cost of 7.5 percent.
>
> A. DR. ROSENBERG: I would be happy to. Let's take one thing at a time. Let's take the carrying cost for the utility.
>
> Q. Sure.
>
> A. DR. ROSENBERG: There the question is, What is the least cost method of financing these charges? And I believe I was here earlier this morning when there was some discussion — well, maybe not. In any case, what is the least cost method of financing these charges and, of course, the position that the financial expert took and the position that I espoused was that it should be financed by debt, whether it is off balance sheet debt, through securitization. And so, I estimated, you know, what would be a conservative cost of carrying that debt.

And I thought 7.5 percent was a reasonable estimate. It could be a little bit higher. It could be a little bit lower.

So, when you look at the carrying charges, the consideration is what are the actual cost to the utility of financing these — this regulatory asset? Once the utilities get an award and you say to utility, you say to ATCO or to UNC, You are entitled to X million dollars that, in essence, becomes a regulatory asset that they are entitled to recover over a certain period of time. What is the cost of financing that regulatory asset?

On the other side, when I am looking at the net-present value, I am looking at that through the eyes of the consumer. And so, the question is. What is the appropriate opportunity cost for the consumer? And I believe I indicated in my response that, for example, if a residential consumer is carrying balance on its credit card, the opportunity cost is the interest rate that it is paying on that credit card. I am, of course, implicitly assuming that by paying a lower amount to the utility, the consumer is going to take the difference, and then use it to write off — to pay down his master charge bill or his Visa bill. He may not do that, but that is the assumption here.

For industrial firm, I am looking at what industrial firm considers its opportunity cost of money, and most industrial firms that I have dealt with typically use 25 or 30 percent as a hurdle rate.

And so, you know, based on those considerations, I thought that 15 percent was a reasonable way to view the opportunity cost through the eyes of the consumer. [21]

63 Thus Dr. Rosenberg assumed in his analysis that the opportunity rate (opportunity cost) of customers exceeds the carrying cost to the utilities.

64 ACC concluded that, from both the perspective of mitigating ratepayer impact as well as from a net present value perspective, customers would be better off, and the DISCOs no worse off, if Dr. Rosenberg's timetables were to be adopted.

65 Finally the ACC noted that AE's conclusions regarding the rate rider impact in its Argument were not necessarily meaningful and were based on an assumed average pool price of $100 per MWh for 2002. [22]

3.8 Views of SPPA

66 SPPA submitted that the full amount of the regulated DISCOs pool price deferral accounts should be collected in 2002. SPPA noted that the development of the electric energy markets, especially the retail markets, would be well served by having the DISCO deferral account balances disposed of as soon as possible. It was further noted that customers have experienced price increases in 2001 well in excess of the "rate shock" limit of 10% per year. Also, the market price for electricity has varied considerably, and to an extent far greater than an amount to be collected for the DISCO deferral accounts. SPPA submitted that to the extent that the full collection of the DISCO deferral accounts in 2002 results in greater price increases, the need for price certainty to promote the development of retail markets is greater.

67 SPPA was concerned that the difference in collection timing between rate classes could cause an arbitrage for those customers that can switch between rates.[23] For this reason, and that noted above with respect to ongoing certainty for electric energy markets, SPPA recommended that the timing of the collection period be set at one year for all rate classes.

68 SPPA noted that if the Board is of the view that smaller consumers would be better served by a longer recovery period then SPPA would alternatively recommend that for large commercial and industrial customers the recovery period be restricted to one year. However, SPPA stated that this alternative, which results in delays, will negatively affect the development of all markets, and will be detrimental to all customers.

69 SPPA recommended that the recovery period for both AE DISCO and UNCA be set at one year. The amount to be collected on a ¢/kWh basis should be based on the collection of the outstanding deferral account balances during the 12 month period. SPPA confirmed that was not concerned that the ¢/kWh charge for AE DISCO and UNCA may be slightly different, and further suggested that there is no need to try and make them equal, given the significant historical differences in rates and accompanying riders over the years.

70 SPPA noted AE's conclusion that collection of its deferral accounts, as proposed, would result in rate increases around the 10% level. SPPA further noted that in the past the Board has adjusted cost allocations between rate classes in order to keep rate increases to a maximum of 10% per year. However, SPPA submitted that the rate cap should not apply in this instance. Instead, the 2000 deferral accounts should be fully collected in 2002, some two years after the costs were incurred. SPPA submitted that the transition to retail competition, and the energy procurement strategies and resulting prices that customers are exposed to, make any kind of rate increase cap resulting from this proceeding meaningless. Thus, SPPA submitted that there will undoubtedly be consumers with very low increases, and some with rate increases of 100% or more. As a result, the Board should look to the higher objective of removing market uncertainties and direct that all 2000 deferral account balances be cleared in 2002.

3.9 Views of the Board — Recovery Period

71 As already noted, the *Deferral Accounts Regulation* authorizes the Board to determine and approve the period for recovery of the DISCO deferral account balances, commencing in 2002 and completing not later than 2004.

72 In its November 7, 2000 revised interim application, filed prior to the enactment of the *Deferral Accounts Regulation*, UNCA originally proposed a one-year recovery period for its deferral accounts. At that time, UNCA indicated that its objective was to collect any outstanding year 2000-deferral account amounts in the year 2001 and that rate shock was not the only rate design criterion it considered.

73 In its Application, UNCA subsequently proposed a three-year recovery period in these proceedings on the basis of the three-year period set out in the *Deferral Accounts Regulation*. In UNCA's view, the spirit of the *Deferral Accounts Regulation* appears to be to minimize the overall effect of collecting distribution pool price deferral account balances by spreading their recovery from customers over a longer period.

74 The Board notes that FIRM and ACC supported a three-year recovery period. FIRM submitted that it generally supported spreading the recovery in order to mitigate rate shock. The Board also observes ACC's recommendation that less could be recovered in the first year and more in the last two years of the three-year recovery period. However, ACC acknowledged that its proposal would result in larger carrying costs relative to the carrying costs related to the DISCO proposals.

75 In contrast to UNCA, in its Application, AE DISCO requested a one-year recovery period from January 1, 2002 through December 31, 2002. AE DISCO was of the view that, despite its request for a relatively short recovery period, there would be minimal rate shock, if any.

76 The Board notes that SPPA and IPCCAA supported a one-year recovery period for all DISCOs. SPPA submitted that the development of the electric energy markets, especially the retail markets, would be well served by having the DISCO deferral account balances disposed of as soon as possible. In addition, SPPA noted that customers have experienced price increases in 2001 well in excess of the "rate shock" limit of 10% per year.

77 With regard to the relative impact of the pool price deferral accounts on the DISCOs, the Board notes that UNCA provided a table in its rebuttal evidence comparing the pool price deferral amounts on a per MWh basis for all six DISCOs. [24] The Board observes that the DISCO deferral account balances presented in this table are the pool price/entitlement deferral amounts and energy volumes as filed in the respective DISCO applications before any adjustments, riders or impacts of GENCO deferral amounts, hedging, financing costs, etc. Thus, the deferral account balances presented in UNCA's table are gross balances before adjustments.

78 The Board considers that the appropriate pool price deferral account balances to review in any consideration of the impact of the deferral accounts on the DISCOs, and ultimately on customers, are the net deferral account balances. i.e. the gross balances less all relevant adjustments. As a result, the Board has recast UNCA's table presenting the impact of the net deferral account balances on a per MWh basis for all six DISCOs as follows:

Table 4: Board View — UNCA Comparison of Per Unit Pool Price Net Deferral

DISCO	Net DISCO Pool Price Deferral Amount ($ Millions)	Pool Price Deferral Energy Purchases (GWh)	Per Unit Pool Price Net Deferral Account ($/MWh)
UNCA	345.0	24,218.5	**14.2**
AE DISCO	86.0	9,805.0	**8.8**
ENMAX	81.8	7,601.3	**10.8**
EDI	51.8	6,574.1	**7.9**
Lethbridge	3.3	618.8	**5.3**
Red Deer	4.1	552.8	**7.4**
Arithmetic Average			**9.1**

79 From this table, the Board makes the following observations about the net pool price deferral accounts when viewed on a per MWh basis:

• The simple average per unit pool price net deferral account amount is $9.1/MWh

• UNCA is the highest and is significantly higher than the remaining five DISCOs.

• UNCA is roughly 56% higher than the average impact of $9.1/MWh.

• ENMAX is the next highest above the average.

• AE DISCO, EDI and Red Deer could be grouped together in terms of their relative impacts and are in the range of $7-8/MWh.

• Lethbridge is the lowest of the six DISCOs.

80 The Board notes that AE DISCO's per MWh deferral account amount is very close to the average impact for all of the DISCOs. Therefore, assuming that the DISCOs utilize a similar recovery period, such as a one-year recovery period, the impact of the deferral accounts on AE DISCO's customer base would be generally aligned with the impact on the customer bases of the other DISCOs.

81 In addition, AE DISCO has demonstrated in its evidence that there would be minimal rate shock, if any, if AE recovered its deferral account within a one-year period. AE also submitted that a one-year recovery period would reduce its deferral account carrying costs.

82 Accordingly, for all of the above reasons, the Board approves AE DISCO's request for a one-year recovery period of its pool price deferral account balance beginning in the year 2002.

83 In its letter dated November 1, 2001 the Board recognized that the refilings required on the 2000 Deferral Accounts would likely not be processed before January 1, 2002 when a number of other significant changes to Alberta electric rates will occur (i.e. new levels for RROT energy charges, Distribution Tariff riders [25] expire, etc.). The Board indicated its desire to minimize the frequency of changes in the levels of customer rates regulated by the Board. The Board considered that customers would benefit from stability in rates during this period of transition in the restructuring of Alberta's electric industry without affecting the development of a competitive industry.

84 After considering AE's letter of November 7, 2001, the Board indicated (by letter dated November 16, 2002) that its goal of minimizing the frequency of changes in the levels of customer rates regulated by the Board arising in this period of transition in the restructuring of Alberta's electric industry may not be possible. Instead, the Board considered that appropriate and timely price signals were what should be provided to customers in the transition period. The Board considered that an interim rider for both UNCA and AE with forecast rate increases would be more appropriate than a transition rider since, even though an interim rider may require a second change in rates within a few months, it would provide more accurate price signals to customers during the interim period.

85 Accordingly, the Board in AE Decision 2001-102 approved April 1, 2002 as the commencement date for the one-year recovery period of AE's deferral account balance.

86 In the Board's view, given that UNCA's per MWh deferral account amount is significantly higher than the impact amounts for the other five DISCOs, it would be reasonable for UNCA's recovery period to be longer than the average recovery period for the other DISCOs and should be greater than one year. UNCA has requested a three-year recovery period. However, the Board notes that if UNCA were to recover its deferral accounts over a two-year period, the annual impact in each of the two years would be \$14.2/MWh ÷ 2 = \$7.1/MWh, which is within the range of the impact for most of the DISCOs. The impact of a two-year recover period for UNCA is also less than AE DISCO's per MWh deferral account amount of \$8.8/MWh, which will be entirely recovered in one year.

87 In the Board's view, therefore, a two-year recovery period for UNCA would generally align the impact of the deferral accounts on UNCA's customer base with the impact on the customer bases of the other DISCOs, while it would be less than the impact on AE DISCO's customer base. In addition, a two-year recovery will reduce cumulative carrying costs for UNCA relative to its original requested three-year recovery period. In general, the two-year recovery period represents a compromise between the three-year recovery period recommended by FIRM and ACC and the one-year recovery period recommended by SPPA and IPCCAA. For all of these reasons, the Board considers a two-year recovery period for UNCA to be reasonable and in the public interest.

88 Accordingly, the Board directs UNCA to recover its pool price deferral accounts over a two-year period beginning in the year 2002. The Board, in a subsequent Decision, will determine the commencement of the recovery period for UNCA.

89 At the same time, the Board would like to note that should the securitization option proceed in the year 2002, the issue of the recovery period would become a moot point from the perspective of DISCO carrying costs. Under a securitization Scheme, the participating DISCOs would recover their deferral account balances once the securitization process is finalized.

4 Views of the Parties - Disco Carrying Cost Rates

90 *For editorial reasons, the Board has decided not to reproduce the Views of the Parties — DISCO Carrying Cost Rates in the body of this Decision. Instead the interested reader is referred to Appendix 6 of this Decision for a complete, detailed description of the Views of the Parties in relation to DISCO carrying costs as submitted by way of evidence and argument in the course of these proceedings. The Board has considered all of this material in arriving at the following findings in relation to 2001 DISCO carrying costs.*

5 Views of the Board - Generic 2001 and Onward Framework and Carrying Cost Rates

5.1 Introduction

91 In this section of the Decision, the Board will address the generic 2001 and onward framework that is required to determine on-balance sheet carrying cost rates for 2001 and onward. The Board will deal with proposed alternate forms of off-balance sheet financing for the years 2002 and beyond in a subsequent section of the Decision.

92 With respect to the year 2001, the Board will deal with the 2001 carrying cost rates that would be appropriate for both municipally owned DISCOs and investor owned DISCOs.

93 With respect to the years 2002 and beyond, The *Deferral Accounts Regulation* does not expressly address DISCO deferral account carrying costs beyond 2001. In relation to the municipally owned DISCOs, the Board has already concluded that it has no jurisdiction to deal with this question, which must be determined, instead, by the respective municipal councils of those DISCOs. [26]

94 However, with respect to the two investor-owned DISCOS, AE and UNCA, for which the Board is the regulatory authority, the Board considers that it does have jurisdiction to award carrying costs for 2002 and beyond, given that the Board has the primary jurisdiction to determine how and over what period those DISCOs should be allowed to recover their deferral account balances. [27]

95 From the significant amount of argument respecting carrying cost issues in this proceeding, the Board notes the following three major approaches that were proposed with respect to the determination of carrying costs for 2001 and onward:

- All of the DISCOs, with the exception of ENMAX, submitted a conventional Weighted Average Cost of Capital (WACC) carrying cost approach that included the use of debt and equity.
- In contrast, ENMAX submitted a short-term debt carrying cost approach, consistent with the Board's IL 2000-01 Interest Policy Guidelines.
- Off Balance Sheet- Securitization as proposed by the IFE.

96 As already noted, with respect to 2001 carrying costs, the Board is governed by sections 4(1) and 4(2) of the *Deferral Accounts Regulation*, which state that:

> 4(1) The Board must determine an amount that is payable in 2001 to the owner of an electric distribution system in respect of the cost of financing the amounts in the owner's deferral accounts in 2001.

(2) In determining an amount under subsection (1), the Board must ensure that an owner is able to recover the prudent cost of financing the amounts in its deferral accounts, which may include debt financing, equity financing or a combination of debt and equity financing.

97 For 2001 and onward, in order to determine the prudent cost of financing the 2000 DISCO deferral accounts for the year 2000, the Board will address the following twelve issues and questions:

1. *Application of the Stand-Alone Principle*

• Is it appropriate to apply the stand-alone principle in the determination of the 2001 and onward carrying cost rate for the DISCO 2000 pool price deferral accounts?

2. *"No-Harm Test" for UNCA*

• Should the Board employ the "no-harm" test in the determination of UNCA's carrying costs?

3. *Relevant Time Period for the "No-Harm" Test*

• For what period of time should the "no-harm" test apply?

4. *Prudent Cost of Financing*

• Is the Prudent Cost of Financing necessarily equivalent to the Least Cost of Financing?

5. *Appropriate Methodology to Determine the Carrying Cost Rate*

• What is the appropriate methodology to determine the carrying cost rate(s) for 2001 and onward?

6. *Business Risk of the DISCO 2000 Pool Price Deferral Accounts*

• What is the business risk of the DISCO 2000 pool price deferral accounts compared to the business risks other major business functions of the integrated utility?

7. *Appropriate Capital Structure Based on Business Risk*

• What capital structure appropriately reflects the business risk of the DISCO 2000 pool price deferral accounts?

8. *Appropriate Capital Structure Based on Financial Risk*

• What is the appropriate capital structure for deferral account operations considering the financial risk imposed on integrated utility operations?

9. *Prudent Capital Structure - DISCO 2000 Pool Price Deferral Accounts*

• What capital structure appropriately reflects the business and financial risks of the DISCO 2000 pool price deferral accounts?

10. *Appropriate Cost of Debt*

• What is the appropriate cost of debt to use in the determination of the 2001 and onward carrying cost rate?

11. *Appropriate Cost of Equity*

• What is the appropriate cost of equity to use in the determination of the 2001 and onward carrying cost rate?

98 In order to assist the reader, the Board has noted some of the key views of the parties with respect to each of these issues and associated questions prior to the Board's determination of the issue.

5.2 Application of the Stand-Alone Principle

99 Is it appropriate to apply the stand-alone principle in the determination of the 2001 and onward carrying cost rate for the DISCO 2000 pool price deferral accounts?

5.2.1 Views of UNCA and EDI

100 The Board notes UNCA's explanation of the stand-alone principle in its argument:

> Under the stand-alone principle, a utility is regulated as if the provision of the regulated service were the only activity in which the company is engaged. Thus, the cost of providing utility service — and hence rates for service — reflect only the expenses, capital costs, risks and required returns associated with the provision of the regulated service. [28]

101 UNCA submitted that the stand-alone principle represents a fundamental tenet of regulation and that there are several reasons to adhere to the principle. In this regard, the Board notes Dr. Evan's summary of the reasons to utilize the stand-alone concept:

> The Board should adhere to the stand-alone principle for three reasons — fairness to customers and investors, regulatory consistency/avoidance of risk and administrative simplicity.
>
> First, utility customers and shareholders should be treated fairly. Fairness requires that customers pay rates for service that reflect the costs associated with providing the regulated service. Rates should not be subsidized by the operations of a parent or "sister" company. Neither should the utility customer subsidize the operations of a related company through the payment of rates that reflect more than the expenses, capital costs and required returns associated with the provision of the regulated service.
>
> Second, consistency on matters of regulatory principle is essential if regulatory risks and utility financing costs are to be minimized. ... The perception by potential investors of a "heads you lose — tails I win" form of regulation would unnecessarily increase the regulatory risks facing all utilities under the Board's jurisdiction and would unavoidably lead to an increase in the costs of debt and equity capital. Investor concerns would arise not only because "stand-alone" is a long-standing principle in Alberta but also because it is well accepted elsewhere in Canada.
>
> Third, the administrative complexity of departing from the stand-alone principle is significant. [29]

102 UNCA replied to the IFE submission as follows:

> The stand-alone principle is just that — a principle. The particular "beneficiary" of its application in a specific context does not vitiate its correctness or the need to apply it as a proper regulatory principle. The suggestion that the stand-alone principle *should* be applied in those circumstances where customers benefit and *should not* be applied in those circumstances where shareholders benefit (i.e., the "sword and shield" argument) is both self-serving and contradictory and should be rejected by the Board. [30]

103 EDI responded to the IFE's evidence [31] submitting that:

> But the evidence of Messrs. McCormick and Demcoe does not deal with the core issue — namely, "What are the stand-alone financing possibilities?" [32] Instead, the evidence of Messrs. McCormick and Demcoe focuses on "stretching the balance sheet" of EPCOR, the parent of EDI — an obvious departure from the stand-alone financing question respecting EDI. [33]

104 UNCA and EDI concluded that the Board should continue to be guided by the stand-alone principle for reasons of fairness, regulatory consistency, risk and capital cost minimization and administrative simplicity.

5.2.2 Views of AE DISCO

105 The Board notes that AE also presented its perspective on the stand-alone principle in its reply argument as follows:

> The stand-alone principle is premised on the more basic principle of finance that the cost of capital applied to the operations should reflect the risk of the operations and the opportunity cost of the investment. A symmetric application of that principle to the DISCO operations and the deferral accounts ensures that neither customers nor shareholders have the opportunity to earn a windfall, but rather that utility customers incur, and shareholders receive, a return that incorporates neither positive nor negative subsidies. [34]

106 AE stated the following in reply argument:

> As well, while paying lip service to the "stand alone principle", the Financial Witnesses clearly are encouraging the cross-subsidization of the financing of the deferral accounts by the DISCO and the overall corporate entity. This is clearly inconsistent with the Board's policy of respecting the stand-alone principle and resisting cross-subsidization, although it is usually alleged to occur in the other direction. [35]

107 AE DISCO concluded that proper use of the stand-alone principle ensures that neither customers nor shareholders are given an opportunity to earn a windfall or extraordinary gain, at the expense of the other party. In the case of the 2000 deferral accounts, the stand-alone concept will help to minimize the potential for cross-subsidization of the financing of the deferral accounts by the DISCO, the overall corporate entity, and "sister" companies or related entities.

5.2.3 Views of TransAlta

108 The Board notes that TransAlta also provided its views about the stand-alone concept as it relates to the original decision that created pool price deferral accounts, that is Decision U99099:

> The stand-alone perspective was adopted by the Board for rates purposes for 1999 and 2000, and separate capital structures were established for each of TransAlta GENCO, TRANSCO and DISCO in Decision U99099. The (sic There) should be no real question of now abandoning the stand-alone approach, which was in effect in 2000 and which is wholly consistent with the restructuring and re-regulation of the industry. [36]

109 TransAlta submitted that the stand-alone concept was used extensively in Decision U99099. Based on Decision U97065[*1996 Electric Tariff Applications, Re* (1997), 1997 CarswellAlta 1294 (Alta. E.U.B.)], the Board ordered utilities to file evidence regarding the business risk facing the individual functional components of the integrated utilities at the time of their next GRA application.

110 TransAlta submitted that, in Decision U99099, the Board then examined the business risks of the GENCO, TRANSCO and the DISCO function in relation to the integrated utility business risk. Once the business risks of the separate business functions were established, TransAlta submitted that the Board was in a position to determine the appropriate common equity ratio differentials relative to the common equity ratio of the integrated utility.

111 Through this U99099 process, TransAlta submitted that the Board was able to determine the capital structure of the separate business functions, incorporating the unique business risks of the individual functions. Thus, as a result of utilizing the stand-alone principle, TransAlta submitted that the Board approved separate capital structures for TransAlta GENCO, EPGI (now EGI), TransAlta TRANSCO, EPTI and TransAlta DISCO in Decision U99099.

5.2.4 Views of Red Deer and Lethbridge

112 Red Deer and Lethbridge submitted the following argument in response to IFE argument about the stand-alone concept:

> The stand-alone principle as applied to a greater or lesser extent is a notional concept and not an actual state of affairs for one or more of the DISCOs and it is this notional concept that the Board has utilized to determine the appropriate level of cost necessary to provide utility service to customers without cross-subsidization. [37]

5.2.5 Views of the IFE

113 The Board notes the IFE's argument regarding the actions of the DISCOs in relation to the stand-alone principle:

> Some, though not all, [38] DISCOs suggested that funds should not be tracked, and that the appropriate rate to be utilized for the notional financing of deferral account balances should be the WACC, either of the DISCO or of a notional "deferral account business" subset of the DISCO. DISCOs also argued that the stand-alone principle requires that the Board consider the WACC of the DISCO (or the deferral account operations of the DISCO) rather than the WACC of the entity that actually finances the deferral account balances. [39]

114 IFE further stated in argument that "while the DISCOs seek to have the Board apply the stand-alone principle, their evidence includes a number of examples of facts which do not support the image of vigorously independent stand-alone operations." [40]

5.2.6 Views of the Board — Stand-Alone Principle

115 The Board considers that the stand-alone principle is a fundamental principle of utility regulation.

116 However, for the purpose of determining the relevance of the stand-alone principle as it relates to the 2000 pool price deferral accounts, it is important to distinguish between the following two applications of the stand-alone principle:

> 1) The application of the stand-alone principle to allocate total utility costs to regulated activities and non-regulated activities.
>
> 2) The application of the stand-alone principle to allocate the costs of integrated regulated utility activities into business functions.

117 This first application of the stand-alone principle is designed to remove the effects of diversification by utilities into non-regulated activities. Using the stand-alone principle in this case, a utility is regulated as if the provision of the regulated service were the only activity in which the company is engaged. This application of the principle ensures that the revenue requirement of regulated utility operations is not influenced up or down by the operations of a parent or "sister" company. Thus, the cost (or revenue requirement) of providing utility service reflects only the expenses, capital costs, risks and required returns associated with the provision of the regulated service.

118 For example in the 1999/2000 proceedings leading up to Decision U99099, the Board had to ensure that unregulated costs incurred by TransAlta Corporation were not rolled into the regulated costs of TransAlta Utilities Corporation. In that regard, the Board said the following in Decision U99099:

> Thus, based on the Board's assessment of business risk of the integrated company for 1999 and 2000, the Board has determined that an acceptable range of common equity ratios for TransAlta is in the range of 40-42%. This target range provides a mid-point of 41%, reflecting the slight increase in risk from 1996. This Board Decision in effect allows TransAlta to realize a higher common equity ratio in comparison to the utility's 40% ratio that was deemed by the Board in 1996. In addition, the Board notes that based on an allowed common equity ratio of 40-42% and an equity rate of return of 9.00-9.50% (determined in the Return on Equity section), TransAlta's before tax interest coverage will be 3.29-3.39 times for 1999 and 3.47-3.58 times for the year 2000. The Board observes that this coverage ratio is comfortably above the

minimum interest coverage ratio of 3.0 times that is necessary to maintain a AA rating (DBRS) or a A+ rating (CBRS) in general. In addition, the Board notes COCI's argument that TransAlta's interest coverage ratio should improve over time as the utility refinances its debt at lower interest rates relative to the embedded cost of its debt. On an after-tax basis, TransAlta's interest coverage will be 2.11-2.16 times for 1999 and 2.15-2.20 times for the year 2000....

Accordingly, the Board considers that its determinations will allow TransAlta to maintain its current credit rating. In addition, the Board's determinations will allow TransAlta to attract capital for new construction and refinancing purposes on favourable terms.

Taking into consideration all of the above, the Board considers that the following integrated capital structure (i.e. investor supplied funds; excluding no-cost capital and contributions) for TransAlta will reflect the business and financial risks that are faced by the utility during the 1999-2000 period...

Accordingly, the Board considers that an integrated common equity ratio of 40-42% is appropriate for TransAlta for the test years 1999 and 2000. [41]

119 The second application of the stand-alone principle is designed to fix rates that are just and reasonable for the services provided by each business function within a regulated, integrated utility. An example of this second application of the principle is provided in the following excerpt from Decision U99099:

In Decision U97065, the Board ordered the utilities to file evidence regarding the business risk facing the individual functional components of the integrated utilities at the time of their next general rate application. The Board is of the view that there is now sufficient evidence to arrive at a fair assessment of business risk for each of the functional elements of the utilities. The Board will reflect its findings respecting business risk and return by function in fixing prices and tariffs by business function. [42]

120 It is important to recognize that the second application of the stand-alone principle is restricted to a notional "stand-alone" entity within the context of the "stand-alone" regulated, integrated utility. The Board, in Decision U99099, did not and should have not separately viewed the financing requirements, credit ratings, and other related factors of each of the business functions, making the assumption that each function needed to access "the market" on a "stand-alone" basis. Such an approach would likely have led to a windfall for the integrated utility since the sum of the three parts (i.e. the three functions) would likely have exceeded the requirements for the regulated whole.

121 Therefore, the primary purpose of determining the business risk and return by function was to "fix prices and tariffs by business function". [43] However, the Board also recognized that there were additional benefits to determining business risk and return by function in order to set the stage for the electricity industry restructuring that would occur on January 1, 2001.

122 The Board summarized its approach to determining business risk by function as follows in Decision U99099:

In the Business Risk and Capital Structure section, the Board will first determine the business risk associated with the integrated utility. Having determined the business risk of the integrated utility, the Board will be in a position to assess any changes that have occurred in terms of overall business risk since the 1996 GTA, the time of the last Phase 1 Proceeding. Accordingly, to the extent that the Board determines that integrated utility risk has changed, the Board will be able to establish an appropriate common equity ratio and capital structure for the integrated utility, which may differ from the capital structure approved in 1996. In essence, the new capital structure will reflect the overall change in business risk since 1996 combined with an assessment of financial risk for the integrated utility.

The Board will then examine the business risks of the GENCO, TRANSCO and DISCO functions in relation to the integrated utility business risk. Once the business risks of the separate business functions have been established, the Board can then determine appropriate common equity ratio differentials relative to the common equity ratio of the integrated utility. The differentials will reflect the difference in business risks between the risk of the specific function and the risk of the integrated utility. Through this process, the Board can then determine the capital structure of the separate business functions, incorporating the unique business risks of the individual functions. In support of the Board process to determine the capital structures for the business functions, the common equity ratios of the individual business functions, weighted by the corresponding rate base of the functions, when aggregated will be in balance with the overall common equity ratio of the integrated utility. [44]

123 The Board notes that in Decision U99099, it was careful to ensure that the rate base weighted business risk and return by function "when aggregated will be in balance with the overall common equity ratio of the integrated utility."

124 However, the Board notes that a further question was raised in these proceedings as to whether administration of the DISCO deferral accounts (or their "operations") should be viewed as "stand-alone" operations within the DISCO function or, alternatively, as "stand-alone" within the integrated utility.

125 This question becomes relevant when determining the amount of equity that might be required to finance the 2000-deferral account operations. For example, the amount of equity that would be required to underpin DISCO deferral account operations, in relation to a stand-alone DISCO corporate entity, is clearly different than the amount of equity required to underpin DISCO deferral account operations in relation to an integrated corporate entity.

126 In this regard, the Board considers the following excerpt from Decision U99099 to be relevant to this question:

It should be noted that the impact of a deferral account on the business risk of an integrated utility is less than the impact of deferral accounts on the risk of a GENCO or a TRANSCO on a stand-alone basis. The reduced effect is related to the fact that there are diversification benefits characteristic to an integrated utility, which tend to reduce the risk of the separate functions within the utility. Specifically, there are natural risk mitigants between the GENCO and the DISCO functions. For example, high pool prices represent a risk to the DISCO in terms of higher costs but they represent an offsetting benefit to the GENCO in terms of higher revenues. Thus, a deferral account would have less of an effect on the reduction in risk for an integrated utility, in comparison to the impact of a similar deferral account on the risk of a GENCO or a DISCO. [45]

127 In the Board's view, these findings in Decision U99099 recognize that the GENCO and DISCO 2000 deferral account operations would have less of an impact on the reduction in risk for integrated utility operations than the impact of a similar deferral account on the respective individual GENCO and DISCO business functions.

128 As will be discussed later in this Decision, the Board has determined that it will employ the same carrying cost rate for the 2000 GENCO deferral accounts, as it will for the 2000 DISCO deferral accounts. This equivalency of rates will commence in the year 2001 and will be in effect from the year 2001 until the deferral account balances are retired.

129 Having regard to these considerations, the Board concludes that, for the purpose of determining the appropriate 2001 carrying cost rates for the DISCO and GENCO 2000 pool price deferral accounts, it should be consistent in its approach by acknowledging that deferral account operations are a separate stand-alone business unit within the totality of the integrated electric utility as it existed in the year 2000. Furthermore, the Board considers that this determination shall apply until the 2000-deferral account balances are retired for each Utility. The Board considers this approach to be similar to the Board's approach in its determination in Decision U99099 for the three business functions (GENCO, TRANSCO and DISCO) for the years 1999 and 2000.

130 At the beginning of this section of this Decision, the Board outlined that for the purpose of determining the relevance of the stand-alone principle as it relates to the 2000 pool price deferral accounts, it was important to distinguish between the following two applications of the stand-alone principle:

1) The application of the stand-alone principle to allocate total utility costs to regulated activities and non-regulated activities.

2) The application of the stand-alone principle to allocate the costs of integrated regulated utility activities into business functions.

131 Accordingly, the Board considers that the second of the 2 applications of the stand-alone principle is the appropriate approach for this Decision. Accordingly, the Board, in determining the appropriate carrying costs for Deferral Account operations, will utilize the stand-alone principle in the following manner:

• Determine the carrying costs of the regulated integrated utility, as it existed in the year 2000.

• Apply the stand-alone principle to allocate the above determined costs to the following functions:

1. GENCO business function operations
2. TRANSCO business function operations
3. DISCO business function operations
4. Deferral Account business function operations

132 In summary, the Board will view deferral account operations as "stand-alone" operations within the integrated utility and not "stand-alone" within the DISCO function or "stand-alone" within the GENCO function.

5.3 "No-Harm" Test for UNCA

133 Should the Board employ the "no-harm" test in the determination of UNCA's carrying costs?

5.3.1 Views of the Board - "No-Harm" Test for UNCA

134 Given the Board's decision to determine the business risk and carrying costs of deferral account operations as though they were a separate stand-alone function within the integrated utility, the question of potential "harm" is raised with respect to the determination of UNCA's carrying costs. The Board's approval of the sale of the DISCO by TransAlta to UNCA in Decision 2000-41 [*TransAlta Utilities Corp., Re* (2000), 2000 CarswellAlta 1816 (Alta. E.U.B.)] addressed this issue.[46] In that Decision, the Board concluded that, subject to certain conditions, customers would not be exposed to any immediate harm as a result of the sale, either in terms of rates or service.

135 The DISCO having been transferred to UNCA, it is possible that UNCA may require a higher cost of financing for its deferral account balances than would TransAlta had the sale not occurred. The question is whether the possibility of higher carrying costs for UNCA may represent a potential "harm" to customers that must be mitigated in order to preserve the Board's approval of the sale of the DISCO.

136 The Board agrees with the following submission of Dr. Evans in this proceeding:

> Equity financing is required to backstop debt. Banks, financial institutions and private investors will not supply debt financing without an equity underpinning. Securitizations cannot be constructed without equity support through credit enhancements. Thus, the *actual* cost of financing is a blended cost of debt and equity."[47]

137 The Board also notes and agrees with Mr. Marcus that UNCA required "some amount" of equity to finance its deferral account balances and that shareholders should be compensated for the equity that they commit, assuming "that the choice to put up equity was a reasonable and prudent choice".[48] However, the Board considers that the amount of equity underpinning that is required is dependent on whether the stand-alone deferral account is financed as a business unit within the DISCO operations or within the integrated utility operations.

138 The Board notes that it has not finalized the DISCO 2000 pool price deferral account balances for UNCA and AE DISCO and the GENCO 2000 pool price deferral account balances at the time of this Decision. Accordingly, for the purpose of this Decision, the Board has used the amounts applied for by the GENCOs and DISCOs in their respective applications.

139 The relative difference in the two approaches is highlighted in the following table, which presents the financial impact of the DISCO 2000 pool price deferral accounts in relation to the rate bases for the DISCOs and their related, integrated operations:

Table 5: Financial Impact of the DISCO 2000 Pool Price Deferral Accounts

Business Entity	DISCO Deferral Collect from (Payable to) Customers ($ Millions)	DISCO Rate Base ($ Millions)	Percent of DISCO Rate Base %	Integrated Utility Rate Base ($ Millions)	Deferral Account to Integrated Utility Rate Base %
UNCA/TransAlta					
UNCA DISCO	364.5 [49]	473 [50]	77%	2,839 [51]	13%
TransAlta GENCO	(65.7) [52]				
UNCA/TransAlta Integrated	298.8		63%	2,839	11%
AE					
AE DISCO	97.9 [53]	470 [54]	21%	1,857 [55]	5%
AE GENCO	24.4 [56]				
AE Integrated	122.3		26%	1,857	7%

140 Clearly, the DISCO deferral account operations are much more significant in relation to DISCO operations (i.e. 21% in the case of AE and 77% in the case of UNCA) than they are in comparison to integrated operations (i.e. 5% in the case of AE and 13% in the case of UNCA).

141 The Board notes the following position of UNCA during the proceedings that dealt with the sale of TransAlta DISCO to UNCA:

> UtiliCorp requested that TransAlta's Application be approved as quickly as possible and in a manner that recognizes the public interest while being sufficiently flexible to allow for future developments and deregulation and to permit the Board to carry out its role in an appropriate manner in the future. UtiliCorp stated that, while it expects to bring benefits to all stakeholders, the test of public interest should be the assurance that the public is no worse off than it would have been had TransAlta carried on with the distribution business. UtiliCorp suggested that this was essentially the same as the no harm test. UtiliCorp added that rate payers and other stakeholders of the regulated business have a right to expect that they will not be injured by the transaction, but they have no right to expect a level of regulatory certainty that they would [not] have had otherwise. [57]

142 UNCA submitted in this proceeding that, in order for the Board to apply the "no-harm" test, the Board would have to:

1) Abandon the stand-alone principle;

2) Abandon the ability to finance principle;

3) Abandon the actual cost principle;

4) Conclude, contrary to the evidence, that TransAlta on a *consolidated basis* could have financed the deferral accounts at a materially lesser cost than UNCA; and

> 5) Conclude that it would be appropriate public policy to penalize UNCA under the "no harm" test, notwithstanding the Board's prior conclusion that the purchase and sale transaction constituted "no harm" to customers. [58]

143 The Board has not abandoned the stand-alone principle. As found earlier, the Board will view the deferral account operation as a separate stand-alone business unit within the totality of the integrated regulated electric utility as it existed in the year 2000. In applying this principle, the Board will examine the "ability to finance principle", the "actual cost principle" and the extent to which TransAlta, on a consolidated basis, could have financed the deferral accounts at a "lesser cost than UNCA".

144 With respect to UNCA's fifth concern, the Board agrees with UNCA's previous submission, in the TransAlta DISCO sale proceeding, that rate payers and other stakeholders of the regulated business have a right to expect that they will not be injured by the transaction, but they have no right to expect a level of regulatory certainty that they would not have had otherwise.

145 TransAlta also considered that the Board had defined the financial aspects of 'no-harm' issues as part of the sale proceeding. Those issues, as presented in Decision 2000-41, were as follows:

• Treatment of the pension surplus

• The level of available undepreciated capital cost (UCC) for regulatory purposes, and

• The potential recovery in future rates of the premium paid by UNCA.

146 TransAlta noted that in response to each issue, the Board in Decision 2000-41 made a direction, or other observation that it saw as appropriate, to deal with the matter. TransAlta argued that, by following this approach, the Board had satisfied itself with regard to the no-harm issues and subsequently approved the sale transaction, placing conditions as it saw appropriate to protect customers from harm.

147 TransAlta also referred to the following quote from Decision 2001-65:

> The no-harm test determines whether a proposed sale can proceed in a fashion, which ensures customers are left at least no worse off. Some form of mitigation may be necessary to ensure this occurs. The allocation principles are applied to allocate the proceeds of a sale between customers and shareholders, whether or not some potential harm to customers must be mitigated. In Decision 2000-41, the Board was able to attach appropriate conditions to its approval of the transaction to satisfy itself that any potential harm to customers was adequately mitigated. It was unnecessary in that case for the Board to apportion to customers any of the gain on sale. In dealing separately with the allocation question, in the circumstances of that case, the Board concluded that the gain on sale properly belonged to shareholders rather than customers. [59]

[*ATCO Gas - North, Re* (2001), 2001 CarswellAlta 2127 (Alta. E.U.B.)]

148 The Board does not agree with either UNCA or TransAlta that the Board's conclusion in Decision 2000-41 that the three, specific, identified harms could be mitigated with appropriate conditions was a general conclusion with respect to all potential harms to which customers might be exposed as a result of the sale. In the pre-hearing conference in the DISCO sale proceedings, parties raised a number of areas of potential harm, all of which the Board considered could be dealt with in future proceedings given the Board's ongoing regulatory role in relation to UNCA. For that reason, and that reason alone, those issues were not considered in the Board's assessment of the "no-harm" test. The Board considered that it could continue to protect customers on an ongoing, future basis given its regulatory responsibilities. [60]

149 The Board remains of the view that it has a responsibility, in the public interest, to ensure that UNCA's customers are saved harmless from potential effects that arise after the sale was approved and closed. The Board considers that the relative difference between the financing costs of TransAlta and UNCA as they relate to the DISCO deferral accounts are just such an issue. If the Board ignored this issue in this context, it would be ignoring its ongoing responsibility to ensure that UNCA's customers are not harmed by the sale.

150 As noted earlier, the amount of equity underpinning that is required for deferral account operations is dependent on whether the stand-alone deferral account is financed as a business unit within the a regulated DISCO operations balance sheet or within the regulated integrated operations balance sheet.

151 Accordingly, the Board considers that if the Board had not approved the sale of the TransAlta DISCO operations to UNCA in Decision 2000-41, TransAlta Utilities could have financed UNCA's DISCO deferral account operations on an integrated basis with less equity than was necessary for UNCA DISCO.

152 If the Board finds the additional equity underpinning required for UNCA DISCO to be material, the sale of TransAlta DISCO operations to UNCA would result in injury and harm to customers unless the Board prescribes a remedy in this proceeding. For the reasons outlined earlier, the Board considers that it retains the discretion to do so notwithstanding its approval of the sale in Decision 2000-41.

153 Accordingly, the Board is persuaded that it must have regard to the "no-harm" test in the determination of UNCA's carrying costs. However, the Board does agree with UNCA's submission in the DISCO sale proceeding that customers "have no right to expect a level of regulatory certainty that they would [not] have had otherwise." [61]

154 This leads the Board to consider the time period over which the "no-harm" test should apply, which will be discussed in the following section.

5.4 Relevant Time Period for the "No-Harm" Test

155 For what period of time should the "no-harm" test apply?

5.4.1 Views of TransAlta

156 TransAlta submitted that it is not reasonable to go back at this time, in hindsight, and say "perhaps the financing of deferral accounts for years after 2000 should now be considered as a term of the sale approval". TransAlta submitted that such a perspective would turn a vendor in a transaction long-since closed into a guarantor of unspecified amounts in respect of unforeseen and unlimited events.

157 TransAlta also noted that the cause of the carrying costs issue is a combination of the increase in pool prices and the government decision (not expected at the time of the sale, and not foreseen until the government acted in late 2000) to pass regulations terminating the existing year 2000 collection and postponing collection of the account right out of 2001. Moreover, the regulations so passed prescribed the parameters for financing of the outstanding deferral account balances in recognition that collection was being postponed by government actions.

158 TransAlta submitted that it had sought, and the Board had approved in 2000, the early interim commencement of collection of the deferral account, and no interest was being calculated on or paid by customers as part of that collection.

159 TransAlta also submitted that the interim order would have continued in its terms into 2001 had it not been overridden by the new regulations, and would have proceeded to collect amounts needed — still without carrying cost charges.

160 TransAlta submitted that its approach would have obviated or mitigated the need for carrying costs to be charged to TransAlta/UNCA DISCO customers, until it was overridden by the new regulations.

161 TransAlta concluded that it would not be a reasonable application of the 'no harm' concept to deny or diminish the carrying costs otherwise applicable to the UNCA DISCO deferral account.

5.4.2 Views of the Board — Relevant Time Period — No Harm Test

162 In the Board's view, it must recognize that the Government did take action in relation to DISCO deferral accounts and specifically charged the Board with the responsibility of determining prudent financing costs having regard to all relevant factors.

163 Absent specific legislative direction to the contrary, the Board considers that it is required to determine prudent financing costs in the context of the regulatory framework the Board has established for TransAlta DISCO and UNCA DISCO, including application of the "no-harm" test. For the reasons set out in the preceding section, the "no-harm" test is a relevant consideration in relation to UNCA's cost of financing its deferral accounts.

164 At a minimum, the Board is of the view that the no-harm test should apply with respect to the year 2000 since this was the year that the sale of TransAlta's DISCO to UNCA took effect. However, for 2000, the Board has based its award of carrying costs on the Board's Interest Policy in IL 2000-01. On that basis, UNCA is not being awarded greater carrying costs than TransAlta would have been awarded had the sale not occurred. Therefore, in relation to 2000, the no-harm test is satisfied in the Board's view.

165 The crux of the issue faced by the Board is whether the "no-harm" test should also apply to UNCA during the "no recovery period" of 2001 and the Board determined recovery period. The Board considers that the issue needs to be addressed for the entire life of the 2000-year deferral accounts including the year 2001, even though the Balancing Pool is paying the carrying costs in 2001. Any funds that the Balancing Pool pays out results in less funds being available to the customers for other payouts for the benefit of customers. Therefore, the Board considers that for purposes of this Decision that the Balancing Pool payouts of 2001 carrying costs are the equivalent of customer funds. Accordingly, the year 2001 is equally subject to the "no-harm test".

166 Although the 2000 deferral accounts arise from circumstances that occurred in the year 2000, their impact extends beyond 2000 until they are fully collected.

167 For these reasons, the Board is persuaded that the no-harm test should apply to UNCA over the entire life of its deferral account operations, that is until the deferral account is fully recovered. Accordingly, in a subsequent section dealing with the appropriate specific carrying cost rate for UNCA, the Board will apply the no-harm test over the entire life of UNCA's 2000 deferral account. As already noted, however, the Board is satisfied that the test is met for the year 2000.

5.5 The Prudent Cost of Financing

168 Is the Prudent Cost of Financing necessarily equivalent to the Least Cost of Financing?

5.5.1 Introduction

169 A fundamental question that arose in these proceedings is, to the extent that the Board has a mandate to determine the prudent cost of financing for the deferral accounts, is the prudent cost of financing necessarily equivalent to the least cost of financing?

5.5.2 Views of ACC

170 The Board notes that ACC submitted in argument that all non-utility expert witnesses, including the Independent Financial Experts, strongly advocated the use of short to intermediate term debt as the best vehicle for financing these deferral balances. ACC submitted that a major reason to utilize debt is that debt financing is far less expensive than equity financing. Thus, some parties, including ACC, suggested that the standard by which the Board should fix the carrying cost rate is the lowest cost method of financing the deferral accounts.

171 The Board notes, however, that ACC's expert witness agreed in cross-examination that "...cheap isn't enough of a justification; it has got to be just and reasonable and fair in all the circumstances." [62]

5.5.3 Views of AE

172 The Board notes AE's comments about the issue of prudent costs versus least costs:

> I guess, as I look at what is in front of the Board, and their responsibility is to determine what the prudent cost of financing are, and I took an opportunity to look up the definition of "prudence," and it doesn't talk about the lowest cost. "Prudence" isn't necessarily lowest cost. "Prudence" is using skill and good judgment in the use of the resources, and prudent costs is what the evidence in front of you is, the prudent costs of financing. [63]

5.5.4 Views of UNCA and EDI

173 The Board also notes the UNCA and EDI review of historical proceedings in which the Board and the National Energy Board (NEB) rejected the "least cost" standard or approach. For example, in Decision U96001 [*Nova Gas Transmission Ltd., Re* (1996), 1996 CarswellAlta 1197 (Alta. E.U.B.)], parties requested that the Board adopt a capital structure for Nova Gas Transmission that was, in their view, the "least cost" financing option.

174 The Board did not accept the "least cost" approach, and responded:

> The Board is not persuaded that an equity component in the range of 25%-27% as recommended by CAPP would not affect NGTL's ability to access financial markets at reasonable terms and conditions. The Board does not accept the arguments advanced in support of this position, nor the suggestion that NGTL's common equity ratio should be leveraged in order to identify the minimum acceptable level. In the Board's view, this would be unfair to NGTL's shareholders and to its ratepayers. [64]

175 The Board notes that the NEB rejected a similar request to apply the "least cost" standard in the context of its multi-pipeline rate of return hearing. In its decision, the NEB stated that:

> Contrary to what some parties advocated during the hearing, the Board is of the view that it is not appropriate to over-leverage a pipeline in order to identify the minimum acceptable deemed common equity ratio acceptable. [65]

5.5.5 Views of Red Deer and Lethbridge

176 The Board notes Red Deer and Lethbridge's comments about the issue of prudent costs versus least costs:

> Firstly, the owner's prudent cost of financing is not the lowest cost that can be achieved for this particular deferral account. Any assessment of the prudence of the cost must have regard not just to the circumstances of the deferral account but the overall operation of the utility. Certainly one can finance this deferral account entirely with short-term debt (subject to some restraints on municipalities contained in the Municipal Government Act). Ability to do so does not make it a prudent decision. [66]

5.5.6 Views of the Board — The Prudent Cost of Financing

177 The concept of "prudent costs" is another fundamental principle of utility regulation and is expressly reflected in the EU Act. [67] In the specific context of determining 2001 deferral account carrying costs, section 4(2) of the *Deferral Accounts Regulation* obliges the Board to ensure that an owner is able to recover the "prudent cost of financing" its deferral account balances in 2001. However, the Board acknowledges that, historically, the "least cost" approach has not necessarily been accepted when assessing the prudence of utility costs.

178 Accordingly, the Board considers that in its determination of the prudent cost of financing, the relevant objective is to determine if the utilities are acting with careful deliberation and exercising sound judgement with regard to the matter of carrying costs. In the words of AE, "prudence is using skill and good judgement in the use of resources..." [68] In the Board's view, the prudent cost of financing is not necessarily equivalent to the least cost of financing.

179 Nevertheless, financing costs that are unnecessary and inflated or, alternatively, result in windfall profits to the utility cannot be considered prudent. The Board notes that the DISCOs appeared to have also embraced this principle in these proceedings. The DISCOs submitted that the short-term deferral account operations require prudent financing costs in order to compensate them for carrying the deferral accounts for the period during which they are outstanding. However, the DISCOs acknowledged that they did not view the deferral accounts as an investment opportunity and regarded the deferral accounts as a relatively short-term, temporary operation.

5.6 Appropriate Methodology to Determine the Carrying Cost Rate

180 What is the appropriate methodology to determine the carrying cost rate(s) for 2001 and onward?

181 In Decision U99099,[69] the Board indicated it would consider the matter of interest on over-collections or under-collections at the time of the re-filings when the magnitudes of adjustments were known. The Board further indicated any determinations would be made in accordance with its guidelines on interest. The Board published the final version of this guideline as Informational Letter IL 2000-1 "General Policy for Payment of Interest" on February 16, 2000, subsequent to the release of Decision U99099 and Decision 2000-5 [*EPCOR Generation Inc.*, *Re* (February 1, 2000), Doc. 2000-5 (Alta. E.U.B.)]. The Board, in this Decision, may refer to this document interchangeably as IL 2000-1 or the Board's Interest Policy.

5.6.1 Introduction

182 Two methodologies or approaches were presented to the Board with respect to the treatment of carrying costs for the 2000-deferral accounts for on balance sheet financing.

1. All of the DISCOs, with the exception of ENMAX, submitted a conventional WACC carrying cost approach that included the use of debt and equity.

2. In contrast, ENMAX submitted a short-term debt carrying cost approach, which was in line with the Board's Interest Policy.

183 The IFE also presented an off balance sheet financing alternative as will be discussed later in this Decision.

184 In the Board's view, these approaches are consistent with the terms of the *Deferral Accounts Regulation*.

185 With regard to the WACC carrying cost approach, the Board notes that all of the DISCOs originally applied for an after-tax WACC that was in the range of 8-9%. UNCA and EDI applied for a 2001 WACC of 8.47%, while Red Deer and Lethbridge applied for a WACC of 8.31% and 8.44%, respectively. AE applied for an 8.43% WACC in its original application. However, AE later filed new evidence based on its 2001/2002 Distribution Tariff Application. As a result of the new evidence, AE revised its applied for WACC to 9.81%.

5.6.2 Views of ENMAX

186 With regard to the short-term debt carrying cost approach, the Board notes that ENMAX has applied to recover carrying costs for 2001 in respect of its 2000 Pool Price Reconciliation Account at a rate calculated as the Bank of Canada Bank Rate plus 1.5%.

187 ENMAX stated that it had selected this rate because this rate closely reflects ENMAX's cost of short-term debt for the relevant period. ENMAX believed that in the circumstances, debt financing is appropriate, represents the least cost to customers, and promotes regulatory efficiency.

5.6.3 Views of the IFE

188 The Board notes that the IFE concluded that the DISCOs, with the exception of UNCA, could wholly finance the deferral account balances with short-term, on balance sheet debt. [70] The Board further notes that, after responding to information requests, reviewing rebuttal evidence from the DISCOs, and considering the evidence given by DISCO witnesses under cross-examination, the IFE continued to believe that the deferral account balances in most cases could be financed with short-term debt at rates more competitive than the applied for WACC rates. [71]

189 However, the Board observes that the IFE also submitted that debt financing of the deferral accounts might require a small amount of equity infusion. In that regard, the IFE stated that:

> We believe that it is instructive to look at the financing of similar accounts on an off balance sheet and therefore stand-alone basis to understand the upper limit of any equity component required to finance those assets within a DISCO. [72]

190 In a further discussion of the issue of debt versus equity financing, the IFE stated:

> It can also be inferred from the application of ENMAX DISCO that a high or 100 percent debt structure for the financing of the deferral account balances is both practical and financially prudent. We suggested in our evidence that a capital structure that would include significantly more debt with credit enhancements (such as equity or other enhancements such as a Balancing Pool collateralization of a securitization) would be practical. Our securitization model is based on a 10 percent over-collateralization. [73]

5.6.4 Views of IPCCAA

191 With respect to carrying costs, the Board observes IPCCAA's endorsement of the IFE's recommendations with the exception that IPCCAA had a strong preference that the Balancing Pool not be used as a vehicle for an "off balance sheet financing". [74]

5.6.5 Views of ACC

192 The Board also notes that ACC advocated the use of short to intermediate term debt as the best vehicle for financing these deferral balances. ACC explained that financing should be synchronized to the longevity of the asset that is being financed. Thus, if short to intermediate debt financing is utilized, the debt can be systematically repaid from customer amortization payments over the amortization period. At the end of the amortization period, the debt should be completely paid off.

5.6.6 Views of UNCA

193 UNCA submitted that the Board should use the actual cost of financing the deferral accounts as the carrying cost rate, unless there are compelling reasons to reject the actual cost. However, in its assessment of the "actual cost", the Board should not ignore the fact that equity is required to underpin any debt financing of the deferral accounts. [75]

194 The Board notes that Dr. Evans, UNCA's expert witness, discussed the rationale for using the WACC carrying cost approach in the following manner:

> I agree with the principle that the utilities should be reimbursed their *actual* cost of financing. But the *actual* cost of financing is not simply the out-of-pocket interest payments on debt. Equity financing is required to backstop debt. Banks, financial institutions and private investors will not supply debt financing without an equity underpinning. Securitizations cannot be constructed without equity support through credit enhancements. Thus, the *actual* cost of financing is a blended cost of debt and equity. [76]

195 The Board notes UNCA's observation that the IFE repeatedly refused to take the position that UNCA could finance its obligations with 100% debt. [77]

5.6.7 Views of EDI

196 The Board observes that Dr. Evans, EDI's expert witness, submitted that:

> EDI could not on its own go out and raise 100 percent debt to finance the deferral account balances. It can't be done. They needed equity behind that. That equity can come from many places and in many forms. But it simply isn't possible to raise 100 cents on the dollar. That is not the actual cost. The actual cost is a blend of debt and equity, both the debt and the equity that was necessary in order to underpin it. And in this case, I think the best estimate of the actual cost of financing is how you would finance the deferral accounts on a stand-alone basis. That is the actual cost of financing. [78]

5.6.8 Views of AE

197 The Board notes that AE also advocated the use of WACC in the determination of 2001 carrying costs for the year-2000 deferral accounts. AE submitted the following comments with regard to the evidence that has been presented in respect to a determination of WACC in these proceedings:

> I have some difficulty with that because I don't think you are litigating the — you may be litigating the weighted average cost of capital if the Board agrees with us that the financing costs, the prudent financing costs, should be the weighted average cost of capital. Then you would be making a determination of that.
>
> The only evidence you have in front of you for weighted average cost of capital are Ms. McShane and Dr. Evans.
>
> What you have from other interested parties is a rendition of what current short-term rates are and some suggestions as to alternative financing. [79]

5.6.9 Views of Red Deer and Lethbridge

198 In terms of the issue of stretching the balance sheet, the Board notes Red Deer and Lethbridge's argument that the IFE have taken a constrained view of the issue of prudence, submitting that:

> In particular, the independent expert is of the view that the deferral accounts "*can be prudently financed with short term debt to the breaking point if you like"* and only then is some equity layer "*desirable*" (Transcript, page 6670)... Instead the utilities are to stretch their equity to finance on a short-term basis and essentially provide their equity for free. This is particularly inappropriate when it is in effect a forced investment. In that regard, the Cities share the views expressed by ATCO at page 4281 of the transcript:
>
> > We don't see this as an investment, as an opportunity to earn; we just feel it is important that we get fair compensation for those monies we have put forward. [80]

199 The Board observes that Red Deer and Lethbridge further commented that they had "considerable difficulty is understanding how stretching one's balance sheet to the breaking point, or undertaking risk without return could from any perspective whatsoever be deemed to be cautious or careful on the part of a utility." [81] Thus, Red Deer and Lethbridge submitted that this perspective is in conflict with the true meaning of the concept of prudence.

5.6.10 Views of the Board - Appropriate Methodology — Carrying Cost Rate

200 Having considered the two major approaches with regard to the treatment of carrying costs in terms of conventional balance sheet financing for the 2000 deferral accounts, the Board is of the view that:

> • The best estimate of the actual cost of financing is a determination of how the deferral accounts should be financed on a stand-alone basis within the umbrella of the integrated utility;

• While the deferral accounts should not represent an investment opportunity, the utilities do require fair compensation;

• The actual cost of financing is not simply the out-of-pocket interest payments on debt;

• Banks, financial institutions and private investors might not supply debt financing without some measure of an equity underpinning;

• Equity financing is required to backstop debt;

• The equity underpinning should reflect the operation of the deferral accounts within an integrated utility; and

• Equity can come from many places and in many forms, with consequent cost impacts.

201 Therefore, in the Board's view, the prudent cost of financing must be a blended cost of debt and equity.

202 For the above reasons, the Board considers that the WACC carrying cost approach is the appropriate methodology to use to determine the prudent 2001 and onward carrying cost rate for the DISCO 2000 pool price deferral accounts, subject to the Board's views on securitization as discussed later in this Decision.

203 As previously mentioned, financing arrangements that result in carrying costs that are unnecessary and inflated or that result in windfall profits to the utilities can not be considered prudent.

204 Having reached the determination that it is appropriate to use a WAAC approach to determine 2001 and onward carrying costs, the Board will need to consider the business risk of the 2000 pool price deferral accounts relative to the business risk of the other functions that form part of the integrated utility business. Following the determination of business risk, the Board will also have to ensure that the parameters chosen for the WAAC rate compensate the utility for the relevant level of financial risk. The Board used this same methodology in Decision U99099:

> In terms of defining business risk and investment risk, the following excerpt from the Board Findings for Capital Structure in Decision U97065 summarizes the Board's perspective on risk in the current proceeding:
>
> An appropriate capital structure keeps the utility's total investment risk (which is a function of business and financial risks) at a level that will allow the utility to raise equity, debt and preferred financing at a fair overall average cost to customers. Generally, investment risk is the risk of a market security as appraised by investors. Business risks are all of the physical, economic, political, competitive and regulatory risks to which the utility is exposed. Financial risks are the risks relating purely to the capital structure used to finance the assets of the utility. The greater the proportion of debt and preferred (i.e., fixed-charge financing) to total capital, the greater the financial risk. [82]
>
> In general, business and financial risks tend to be inversely related to each other. As a result, businesses such as utilities that have characteristically lower business risk are able to assume a greater degree of financial risk by incorporating higher amounts of debt in their capital structure. Once the business risk of a utility has been determined, it is important to address the appropriate capital structure for the utility, acknowledging the overall financial risks. [83]

205 After the determination of the relative business risk of the 2000 deferral accounts, the Board will then, as it did in Decision U99099, "address the appropriate capital structure for the utility, acknowledging the overall financial risks".

206 As part of its consideration of an appropriate capital structure, the Board will also determine the appropriate 2001 and onward cost of debt and cost of equity for the 2000-deferral accounts.

5.7 Business Risk of the DISCO 2000 Pool Price Deferral Accounts

207 What is the business risk of the 2000 pool price deferral accounts compared to the business risks of the other major functions of the integrated utility?

5.7.1 Introduction

208 In Decision U99099, the Board determined the business risk of TransAlta Utilities on an integrated utility basis and on a business function basis for the years 1999 and 2000. The following table sets out the range of common equity percentages and the mid-point of equity percentages as determined by the Board for TransAlta in Decision U99099. The common equity percentages reflect the appropriate business risk for TransAlta as an integrated utility as well as the individual business risk of the three separate functions within TransAlta:

Table 6: Board Determined (U99099) TransAlta 2000 Common Equity Ratios [84]

Function	Common Equity % Range	Common Equity % Mid-Point
Integrated Utility	40-42	41.0
DISCO	53.5-55.5	54.5
GENCO	39-41	40.0
TRANSCO	34-36	35.0

5.7.2 Views of AE

209 The Board notes that AE's submission is based on an assumption that the deferral accounts represent an integral component of the DISCO operations. Consequently, AE stated that there is no separate deferral account business. As a result, in its determination of the carrying cost rate, AE assumed that the business risk of the deferral accounts would therefore be the business risk of the distribution operations.

210 However, Ms. McShane acknowledged that the business risk for deferral account operations could be different from DISCO operations:

> I said that they are part of the DISCO operations. That doesn't mean that they are of the same risk as the DISCO operations. Just as if you tried to pull apart every other asset from the total that is within the DISCO operations that you could identify some with greater or lesser risk depending on, you know, what type of asset they are. [85]

211 AE further noted that the evidence of business risk for the Distribution function has been provided in Tab 18, Rate of Return/Capital Structure of ATCO Electric's 2001-2002 Distribution Tariff Application. This evidence contemplated the existence of deferral accounts in the Distribution Function. [86]

5.7.3 Views of IFE

212 The Board notes that the IFE also provided its assessment of the business risk of the DISCO 2000 deferral accounts in its evidence. As a summary, the IFE submitted that:

> We are also of the view that the deferral accounts have materially less risk than the operating assets of the DISCOs. [87]

213 The IFE provided further evidence regarding its views that the business risk of the deferral accounts was relatively low in comparison to the risk of the DISCO business:

> Well, sir, what we believe is true is that these assets have a lower risk. It is very difficult for me to understand the argument that something that is going to be recovered in three years with a true-up provision is similar in risk to the longer-term asset, if you like, the wires asset. [88]

214 The Board observes that IFE provided the following evidence about the unique characteristics of the year-2000 deferral accounts:

> Our conclusions regarding the appropriate carrying cost reflect our view that the deferral accounts in question are a special short-term situation. With this in mind, we do not believe it is part of the core ongoing business of the utilities and therefore would not be part of a rate base return. It is because of this special and expected non-recurring situation that we believe it should be segmented. [89]

5.7.4 Views of UNCA and EDI

215 The Board observes that evidence regarding the business risk of the deferral accounts was provided Dr. Evans in his Deferral Accounts Carrying Cost Rate Evidence for UNCA [90] and EDI [91] . The Board notes that Dr. Evan's evidence was limited to the comparison of the business risk of the DISCO deferral account to the business risk of the total DISCO function.

216 As noted earlier in this Decision, the Board considers it more appropriate to compare the GENCO, DISCO and Deferral Account operations to the total integrated function. [92] However, the Board considers that Dr. Evan's evidence is nonetheless helpful in assessing the stand-alone business risks of the deferral account operations.

217 The Board notes that in his direct evidence for UNCA, Dr. Evans presented the following five principal differences between the business risks of the deferral account operations and those of the distribution access wires business:

- Recovery Period
- Actual sales insufficient to recover forecast revenues
- Locked in Carrying Cost Rates
- Short-term vs. long-term debt costs
- Embedded vs. Current Cost of Debt

5.7.5 Views of the Board - Business Risk of the DISCO Deferral Accounts

218 The Board notes that the principal differences identified by Dr. Evans are also applicable to the differences between the business risks of the deferral account operations and those of the TRANSCO wires only operation.

219 Based on this consideration, the Board will now present its views on the business risk elements identified by Dr. Evans, as well as other business risk elements that may apply to deferral account operations.

5.7.5.1 Recovery Period

220 First, Dr. Evans submitted that the period for recovery of the deferral account balances is considerably shorter than the period for recovery of distribution wires assets.

221 Based on this risk, Dr. Evans concluded that the capital recovery risks associated with the deferral account operations are less than those associated with the distribution wires business. [93] The capital recovery risk was the major reason why the deferral account operations are exposed to lesser business risks than those of the distribution access business.

222 The Board notes that the DISCO 2000 pool price deferral accounts will continue to exist for a period approximately in the range of 2-4 years. By comparison, the Board notes that the average life span of transmission or distribution wires assets typically is in the range of 30 to 40 years. Transmission and distribution wires assets are exposed to risks including bypass,

self-generation, and technological advances over the 30 to 40 year period. As a result, the Board considers that capital recovery risks are significantly reduced in the case of the DISCO deferral accounts based on the relatively short period of their tenure.

223 The Board notes that the purpose of a deferral account is to eliminate the risk associated with the recovery of costs that cannot be reasonably forecast. Therefore the Board considers that the capital recovery risks associated with deferral account amounts are, by their very nature, very low.

224 Accordingly, the Board considers that the capital recovery risks associated with the deferral account operations are much less than those associated with the transmission and/or distribution wires business.

5.7.5.2 Actual Sales Insufficient to Recover Forecast Revenues

225 A second principle difference between the business risks of the deferral account operations and those of the distribution access business that Dr. Evans identified is the risk that actual sales will differ from forecast and that sales will be insufficient to recover forecast revenues. Dr. Evans submitted that there is no such material risk respect of the deferral accounts. Sales forecast risk is not material for deferral account operations, since UNCA is applying to continue its rate rider based on 2001 billing determinants until such time as the dollar amounts in the deferral accounts are collected. Thus, Dr. Evans concluded that the sales forecast risks for deferral account operations are less than those of the distribution access business. [94]

226 The Board also notes that this risk can even be further mitigated by a "true-up" provision for the deferral accounts. In that respect, later in this Decision, the Board has directed that AE DISCO and UNCA are to provide for a true-up that would allow for adjustments to ensure that unanticipated changes would not jeopardize the collection of adequate funds from customers to retire the deferral account balances and their cost of financing. The Board considers that these provisions would resolve any default risk. This approach is consistent with that taken in Decision 2001-83 [*Year 2000 Outstanding Matters Deferral Accounts (Other that Pool Price) Part B, Re* (November 8, 2001), Doc. 2001-83 (Alta. E.U.B.)], where the Board directed a true-up mechanism in respect of the DISCO Outstanding Matters deferral accounts.

227 The Board considers that these true-up mechanisms provide greater certainty for the recovery of revenues relative to the recovery of forecast revenues of the other three business functions (GENCO, TRANSCO or DISCO). In light of these mechanisms, the general certainty of recovery suggests that the business forecast/actual sales risk would require a very low equity percentage.

5.7.5.3 Locked in Carrying Cost Rates

228 Dr. Evans submitted that the carrying cost rates in respect of the deferral account costs are "locked in" for periods of up to three years, while the costs are deferred for periods of up to four years. In contrast, the rate of return on distribution wires assets can be varied on an annual basis. In this respect, Dr. Evans concluded that the UNCA deferral account operations are exposed to greater risks than the distribution access business. [95]

229 In the Board's view, the risk identified by Dr. Evans only arises if the test year period for utility operations is shorter than the recovery period for deferral account operations. However, in the Appropriate Cost of Debt section of this decision, the Board has mitigated this risk by directing that the debt cost component of the carrying cost rate be determined for 2001, and then updated commencing in 2002. By making this type of determination, the debt cost component, which is a significant part of the carrying cost rates, would be "locked in" for a maximum period of approximately two years consistent with the typical test year period for utility regulation. Successful implementation of Securitization, as outlined in the November 29, 2001 interim report of the Securitization Implementation group could result in payout of the deferral account balances around April 1, 2002.

230 In addition, in the Appropriate Cost of Equity section of this decision, the Board has also allowed the equity component to change based on a change in the long-term risk free debt rate, with the result that the cost of equity would only be locked in for a maximum approximate period of two years if Securitization does not proceed.

231 With these adjustments to both components of the WACC, the Board considers that the business risk associated with locked in carrying cost rates would require a relatively low equity percentage.

5.7.5.4 Short-Term vs. Long-Term Debt Costs

232 Another principle difference that Dr. Evans identified is the maturity of debt. For UNCA, the debt cost rate for the deferral account operations assumes a maturity of approximately two years. For EDI, the debt cost rate for the deferral account operations assumes a maturity of 1-3 years.

233 By comparison, the debt cost rate for distribution access operations assumes a long-term maturity. Dr. Evans stated that the shorter-term debt costs are subject to greater variability and, therefore, greater forecast risk than longer-term rates. For this reason, Dr. Evans concluded that deferral account operation is exposed to greater risks than the distribution access business. [96] In light of the Board's determination that the debt cost component of the carrying cost rate be determined on the basis of a 1-3 year bond for 2001 and then updated on January 1, 2002 with the updated cost applying for the first quarter of 2002, the Board is of the view that debt maturity does not lead to a significant risk for deferral account operations. The Board considers that the debt being carried by the Utilities for the 2000-deferral accounts is likely of a short-term nature, given that securitization is being actively pursued with a potential short-term payout of approximately April 1, 2002.

234 If securitization proceeds, the issue is moot. If securitization does not proceed, the Board will implement the appropriate rate of debt so the risk faced by the integrated utility requires a relatively low equity ratio.

5.7.5.5 Embedded vs. Current Cost of Debt

235 Finally, Dr. Evans noted that the UNCA deferral account debt and the EDI deferral account debt do not have an embedded cost rate. At the same time, Dr. Evans noted that, since UNCA is a new company, there is no embedded debt cost for its distribution access operations. However, UNCA is proposing to use its actual embedded debt cost to determine the distribution access revenue requirement, once that cost rate is known with certainty.

236 In the case of the deferral account operations, UNCA is proposing to use the forecast debt cost, irrespective of the actual cost, for the entirety of the debt portion of its capital structure. Dr. Evans concluded that this difference is in the direction of greater relative risk to UNCA's and EDI's deferral account operations relative to their respective distribution access operations. [97]

237 The Board recognizes that the embedded cost of debt based on known, actual debt instruments would tend to be more certain than forecast costs for current debt. However, the Board has mitigated this risk by directing that the debt cost component of the carrying cost rate be determined for 2001 and then updated on January 1, 2002 with the updated cost applying for the first quarter of 2002. In the preceding section, the Board also addressed the potential if securitization does not proceed.

238 By making this type of determination, the debt cost component, which is a significant part of the carrying cost rates, would be similar to the business risks associated with embedded cost rates.

239 Accordingly, the Board considers this business risk to be minimal and requires only a low equity ratio.

5.7.5.6 O & M Costs

240 In its assessment of the business risk of the deferral accounts, the Board has also reviewed the detailed risk analysis carried out by the Board in Decision U97065. In particular, the Board notes the summary of risk by business function presented in Appendix 9 of Decision U97065. [98] The Board considers it is particularly relevant to review the O&M business risk that was identified for integrated operations and for each of the three business functions in Decision U97065.

241 The Board notes that the risk of forecast error for O&M costs that exists for both TRANSCO and DISCO operations does not arise in deferral account operations. The absence of this significant business risk also suggests a low equity percentage.

5.7.6 Views of the Board — Summary of Business Risk

242 Having examined each of the business risk elements raised by Dr. Evans and the additional O&M business risk element identified by the Board, the Board concludes that, based on the business risks associated with the recovery of debt costs, and to a lesser extent the capital recovery risk, the 2000 deferral accounts require some minimal level of equity support.

243 Based on this determination, the Board will now consider and determine the appropriate capital structure for the 2000 deferral accounts, including the specific percentage of equity required to manage the business risks associated with the 2000 pool price deferral accounts.

5.8 The Appropriate Capital Structure based on Business Risk

244 What capital structure appropriately reflects the business risk of the DISCO 2000 pool price deferral accounts?

5.8.1 Views of UNCA and EDI

245 Dr. Evans submitted that the capital cost parameters or capital structure associated with the DISCO's distribution access tariff are a logical point of departure for analyzing the appropriate carrying cost rate for deferral account operations. Dr Evans provided three reasons for using this logic:

> First, the amounts in the deferral accounts arose from DISCO operations. Second, the amounts in the deferral accounts will be recovered through UNC(A)'s distribution access tariff. Third, I have already provided detailed rate of return evidence to the Board respecting UNC(A)'s distribution access tariff. Use of the distribution access tariff parameters as a point of departure therefore avoids the need for further detailed rate of return studies and a *de novo* appraisal of that evidence by the Board. [99]

246 The Board notes that in his direct evidence for the UNCA and EDI deferral accounts carrying cost rate, Dr. Evans submitted that the appropriate capital structure for UNCA's distribution access business should contain 55-60% debt and 40-45% common equity. [100]

247 Based on this evidence, Dr. Evans submitted the following capital structure for UNCA's deferral account:

> In light of its somewhat lesser business risk [relative to DISCO operations], I recommend that the carrying cost rate for deferral account operations be established by reference to a capital structure containing 60% debt and 40% common equity. [101]

248 Also, Dr. Evans submitted the following capital structure for EDI's deferral account:

> In light of its lesser business risk [relative to DISCO operations], I recommend that the carrying cost rate for EDI's deferral account operations be established by reference to a capital structure containing 62.5% debt and 37.5% common equity. [102]

249 The Board notes Dr. Evans' comments with respect to the IFE's submission that credit enhancements in the world of securitization can be used as a logical point of departure for analyzing the appropriate equity ratio for deferral account operations:

> If one went to off balance sheet financing and if it were possible with a number of other companies to securitize the deferral accounts, then although in the world of securitization, one doesn't normally speak of "equity." One does speak of "credit enhancements."

> And so, from that perspective, there would have to be what we are calling in this world "some equity" in order to backstop the asset pool. [103]

250 In his role as the expert witness for UNCA, Dr. Evans further stated that:

> ...In the world of securitizations, one talks about credit enhancements, and they can be provided in a number of different ways that we have discussed before.
>
> But outside that world, one typically speaks of equity. So, they are not dissimilar concepts, if I can put it that way, although they — they are not precisely the same, as I am sure you appreciate. [104]

251 The Board notes that Dr. Evans disagreed with IFE that the evidence related to credit enhancements in off-balance sheet financing, such as securitization schemes, could be used as evidence for determining the appropriate equity ratio in balance sheet financing. In response to the IFE's argument that off-balance sheet evidence related to credit enhancements could be used to determine the appropriate equity ratio within WACC, the Board observes that Dr. Evans submitted the following cautionary statement:

> They [credit enhancements] are effectively the equity backstopping. Although, I would not want you to think — I am sure you wouldn't — that one could simply transport the percentage of credit enhancements that would be required in the securitization of an asset pool and transfer that over and say that would be the appropriate equity ratio that would be required if you were financing operating assets...
>
> You can't do that because they are two different financial structures. In one case, you have got a trust that has got certain obligations and certain backstops of these assets. You probably have a specific legislation in place in order to make that happen.
>
> In the other case, you are collecting amounts through an operating company, which has all the normal business risks. So, they — they really are two different financial structures. [105]

252 The Board further notes that, in comparison to the IFE's evidence, Dr. Evans submitted that credit enhancements for securitization are in the neighbourhood of 12 to 16 percent:

> Each securitization has its own credit enhancement features. DBRS provides broad indicators of credit enhancements and distinguishes between bank-sponsored credit card securitizations and retailer-sponsored credit card securitizations. For bank-sponsored programs, credit enhancements are on the order of 12-16% with third-party enhancements of 5.0-5.5%. [106] Due to their somewhat higher loss rates, retailer-sponsored programs have credit enhancements "near 20%" with third-party enhancements of 7-10%. [107] The senior debt issued against these asset pools is typically rated AAA. [108]

5.8.2 Views of AE

253 The Board notes that AE's recommended capital structure for its DISCO 2000 deferral is based on the evidence filed by Ms. McShane in the 2001/2002 General Rate Application for AE's DISCO operations. AE submitted that Ms. McShane's evidence should be used to determine the components of WACC for ATCO Electric pursuant to clause 29 of the 2001/2002 TFO Negotiated Settlement. [109] The Board notes that in her evidence, Ms. McShane proposed a capital structure for AE DISCO consisting of 47.5% debt, 7.5% preferred shares and 45.0% common equity. [110]

254 The Board also observes that AE submitted alternative evidence regarding WACC that could be used *if* the Board chose to ignore its Negotiated Settlement Agreement. AE's expert witness, Ms. McShane, filed an additional report on the derivation of a WACC proposing that, were the settlement to be overturned, a reasonable WACC for the DISCO deferral accounts would

comprise 45% common equity and 55% short-term debt.[111] The Board notes that AE's alternative submission proposes a common equity component of 45% that is consistent with its base case recommendation.

5.8.3 Views of Red Deer

255 The Board notes that Red Deer proposed to finance its 2000 deferral accounts according to a deemed debt/equity structure of 52.5% debt and 47.5% equity. Red Deer submitted that its proposed financing structure is consistent with Red Deer city policy and the method used in its transmission cost filings with the Alberta Department of Resource Development (DRD).[112]

5.8.4 Views of Lethbridge

256 The Board notes that Lethbridge applied for financing in accordance with the deemed debt to equity structure of 47.5% debt and 52.5% equity established for its electric utility. Lethbridge submitted that this financing structure was approved by Lethbridge City Council financial policy[113] and represented the same structure for determining annual transmission cost filings made with DRD.[114]

5.8.5 Views of IFE

257 The Board notes that, in its evidence, IFE referred to various historical precedents in order to determine a prudent equity ratio:

> If you think of the historical evidence that we have addressed, the TOPGAS, the A&S type of financing where people were able to expand their balance sheets or stretch their balance sheets, those essentially had zero incremental equity attached to financing very large amount, in some cases up over $1 billion.
>
> If you look at the securitization precedents and you say that a 12 to 16 percent layer would be an appropriate equity support level for a securitization of accounts similar in nature to the ones that we are speaking of, that would argue for a much lower level than a 40 percent equity layer in respect of these assets if you will agree they are comparable assets.[115]

258 The IFE summarized its position with regard to the required equity ratio for the WACC equity component in the following statement:

> Generally, yes. I say "generally," because if it was the Board's decision that the 10 percent number would be prudent, although it is open to you to choose 10 or 40 or zero or any number within that maximum range, over a three-year period, there might be dramatic changes in the interest rate environment which would cause equity investors to have a different view about what they might perceive to be the appropriate equity risk premium.
>
> And we haven't done any study on that, but if I could say to you that throughout zero to three-year time period, we are constant in our view that zero to 10 percent is an appropriate equity layer — the zero coming from that group of precedents, the 10 from the securitization — you correctly understand our evidence.[116]

5.8.6 Views of the Board - Appropriate Capital Structure - Business Risk

259 While the IFE recommended an equity ratio of 0-10%, they also noted that the equity ratio for securitization precedents is in the range of 12-16%. Dr. Evans also submitted that credit enhancements for securitization are in the neighbourhood of 12-16%, based on evidence provided by the Dominion Bond Rating Service (DBRS).

260 The Board notes Dr. Evans' view that the IFE evidence was not entirely appropriate since it utilized off-balance sheet evidence related to credit enhancements in order to make a determination about the appropriate equity ratio within WACC. The Board also acknowledges Dr. Evans' submission that off-balance sheet financing represents a financing structure that is, to a certain extent, unique and different from the structure of balance sheet financing.

261 However, the Board notes that in these proceedings the concept of equity has been used interchangeably in discussions and evidence regarding both on-balance sheet and off-balance sheet financing. The Board agrees with Dr. Evans that it is more appropriate to refer to equity in the context of normal, balance sheet financing and to credit enhancements in the context of off-balance sheet financing.

262 The Board notes Dr. Evans' evidence that the capital cost parameters or capital structure associated with the DISCO's distribution access tariff represent a logical point of reference or departure for analyzing the appropriate carrying cost rate for deferral account operations. However, previously in this Decision, the Board concluded that it should be consistent in its approach by acknowledging that, for the purpose of determining the appropriate 2001 and onward carrying cost rates for the DISCO and GENCO 2000 pool price deferral accounts, the deferral account operations are a separate stand-alone business unit within the whole integrated electric utility. Therefore the Board does not consider that the capital structure associated with the DISCO wires-only operation is the logical point of reference or departure in the determination of the appropriate capital structure for deferral account operations. The Board has earlier noted that the litigated TRANSCO wires-only operation at an equity ratio of 35% potentially represents an equally valid point of reference or departure in the determination of the appropriate capital structure.

263 In that respect, the Board considers that capital recovery risk, sales volume risk, revenue risk and O&M risk are relatively low or absent in the 2000 deferral accounts, whereas each of these risks are present and by comparison, are significantly higher in a TRANSCO wires-only operation.

264 As a result, for the purposes of establishing an appropriate capital structure for DISCO 2000 pool price deferral account operations, the Board concludes that the business risk of the deferral accounts is significantly lower than the business risk of any of the three business functions of the integrated utility and, in particular, is significantly lower than the risk of the TRANSCO wires-only operation. Regardless of whether the TRANSCO or DISCO wires-only operation is used as a point of reference or departure, the Board considers that the business risks of the 2000-deferral accounts are much less.

265 Accordingly, the Board concludes that minimal levels of equity are required for the 2000 pool price deferral account operations. As noted earlier, the risks associated with debt and equity costs would suggest marginal equity support. However, the Board considers that, with the debt and equity cost risk mitigants put in place by the Board, the equity ratio required for deferral account operations would be in the order of 15% equity. The Board notes that this is in the order of magnitude with the upper limit of the credit enhancements suggested by Dr. Evans for an off-balance sheet approach and higher than the equity ratio recommended by the IFE.

266 As mentioned earlier in this Decision respecting the interrelationship between business and financial risk, the Board stated:

> In general, business and financial risks tend to be inversely related to each other. As a result, businesses such as utilities that have characteristically lower business risk are able to assume a greater degree of financial risk by incorporating higher amounts of debt in their capital structure. Once the business risk of a utility has been determined, it is important to address the appropriate capital structure for the utility, acknowledging the overall financial risks. [117]

267 Given the very low business risk of the 2000 deferral account operations, and the Board's determination of the need for a 15% equity ratio to manage business risk, the Board will now assess the financial risk imposed on integrated operations by the deferral accounts in order to arrive at a final conclusion respecting a prudent capital structure.

5.9 Appropriate Capital Structure Based on Financial Risk

268 What is the appropriate capital structure for deferral account operations considering the financial risk imposed on integrated utility operations?

5.9.1 Views of the Board - Appropriate Capital Structure - Financial Risk

269 While the business risk analysis demonstrates that the required equity ratio is very low, the Board must also consider the impact of a very low equity ratio on the financial risk of the DISCOs. In Decision U97065, the Board summarized financial risk as follows:

> Financial risks are the risks relating purely to the capital structure used to finance the assets of the utility. The greater the proportion of debt and preferred (i.e., fixed-charge financing) to total capital, the greater the financial risk. [118]

270 For example, the Board notes UNCA's evidence demonstrating that it breached its financial covenants following its emergency, interim inter-company financing. In addition, UNCA confirmed the potential impact of financing its deferral account using only debt financing and no new equity:

> Financing the deferral account completely with new debt, rather than with the $105 million portion actually financed through equity, would have produced a ratio of "Total Debt to EBITDA" of 5.5 times. That level would have exceeded the 3.75 times maximum allowed under section 9.2 of UNCA's Credit Agreement with the Bank of Montreal and the Toronto Dominion Bank, dated August 30, 2000. The banks have the right to call the loan when the 3.75 maximum is exceeded. It would have been imprudent to issue debt to a level much above 3.25 times, as that would not leave sufficient room for other unexpected unfavourable variations in cash flow from operations or in total debt, exposing the company and its customers to the risks of insolvency. [119]

271 UNCA also confirmed the necessity of issuing equity of $105 million in June 2001:

> If UtiliCorp had not injected the $105 million equity at the end of May, 2001, UNCA would be materially in breach of its covenants at the end of the second quarter and the banks would again be in a position to call the loan. [120]

272 The Board notes that UNCA's evidence was submitted in the context of the deferral account operations being financed within UNCA DISCO rather than on an integrated utility basis. Nevertheless, the evidence suggests that financial risk to the integrated utility is an important factor that the Board must consider in its assessment of the appropriate capital structure for financing the 2000 deferral accounts.

273 The IFE submitted that there is "an ability that exists from time to time to *stretch*, if you like, to expand the debt borrowing capacity, particularly where you are dealing with an increase in a particular type of asset which is, in our mind, one that requires a lower level of equity to support the financing thereof." [121] In light of this evidence, the Board considers it important to determine whether it would be possible to stretch the balance sheet of the integrated utility for the relatively short duration of the deferral accounts without causing financial harm to the integrated operations. The Board considers that this approach should be investigated particularly in the light of statements of both AE and UNCA that they do not regard the deferral account operations as "investment opportunities"

274 However, the Board considers that if it were to allow any stretch, the stretch should not cause financial harm by way of significant reductions to interest coverage ratios or violations of covenants (e.g. increases to "total debt to EBITDA" ratios above 3.75) for integrated utility operations.

275 The Board will carry out a test for UNCA for each of the years 2001, 2002 and 2003, based on the Board's approved approximate two-year (i.e. approximately 2002-2003) recovery period. By comparison, the Board's test for AE needs only to be carried out for the years 2001 and 2002, given the Board's approved approximate one-year recovery period for AE (i.e. 2002).

276 The Board notes that its financial risk test, at this stage of the Decision, has a scope that encompasses the entire approved recovery period of the respective utilities. Using this approach, the Board will ensure that potential on-balance sheet financial risks are examined over the entire recovery period notwithstanding the fact that the Board may only approve an on-balance sheet WACC for a portion of the recovery period.

277 The Board will examine the impact of the deferral account operations on the following financial indicators:

• Before Tax Interest coverage ratios

• Total Debt to EBITDA ratios.

278 The Board notes that the above financial indicators are affected by the following parameters:

• the remaining amount in the deferral accounts at the beginning of each year

• the forecast income tax rates for each year

• the Board approved WACC parameters for each year.

279 Accordingly, in Appendix 1, the Board has tested the on-balance sheet financial impact of deferral account operations respecting UNCA (TransAlta) and AE integrated utility operations (UNCA Integrated and AE Integrated, respectively) considering the above parameters.

280 The Board has conservatively used the remaining amount of deferral account balances at the beginning of the year, rather than adhering to the normal mid-year convention. To ensure a complete and fair test, the Board has also included in its calculations the deferral accounts related to the 2000 GENCO pool price and GENCO and DISCO Outstanding Matters. In the Board's view, including these other related accounts will ensure that the financial impact of all 2000 deferral accounts, both pool price and non-pool price, have been incorporated in its assessment of the financial effect on the integrated utility.

281 The Board emphasizes that it is performing these financial tests to determine whether the Board's preliminary finding of a 15% equity ratio for business risk would be sufficient to manage the financial risks of the integrated utility.

282 The following table summarizes the results of the financial risk tests for UNCA Integrated. The table provides an approximate indication of the impact of the total deferral account operations on the balance sheet of TransAlta Utilities (representing a proxy for UNCA Integrated) using the results of the Board's year 2000 litigation, assuming a Board determined equity ratio of 15% for the 2000 pool price deferral accounts:

Table 7: Financial Risk Tests for UNCA Integrated (TransAlta Utilities)

UNCA Integrated (TransAlta Utilities) Based on a 15% Equity Ratio for the Deferral Accounts		
Impact of Deferral Accounts by Year	**Before Tax Interest Coverage Ratio**	**Total Debt to EBITDA Ratio**
Starting Ratios Without Deferral Accounts	3.43	2.32
2001	3.05	2.81
2002	3.09	3.45
2003	3.10	3.30

283 Based on this financial risk test, the Board is satisfied that a stretch of the UNCA Integrated balance sheet using a 15% equity underpinning for deferral account operations would not cause a significant change to before tax interest coverage ratios. Further, the Board notes that, for the most part, total debt to EBITDA covenant ratios would be maintained close to or below the "prudent" ratio of 3.25. [122] The Board recognizes that the 3.75 limit referred to by UNCA DISCO may not specifically apply to UNCA Integrated operations. However, the Board considers the fact that the deferral account with 15% equity underpinning produces a ratio significantly below the 3.75 limit to be evidence that the integrated utility would not suffer financial harm using the 3.75 limit as a reasonable standard.

284 In addition, the Board observes that UNCA Integrated at a maximum debt percentage with all deferral accounts is less than 55%, which is comfortably below the prudent debt to total capital ratio of 65% discussed in BR.UNCA DISCO-32. [123]

285 The Board notes that AE was granted approval to transfer AE's Generation Assets to Alberta Power (2000) Ltd. (APL 2000) in Decisions 2000-77 [*ATCO Electric Inc., Re* (2000), 2000 CarswellAlta 1823 (Alta. E.U.B.)] (conditional approval) and 2001-72 [*ATCO Electric Ltd., Re* (2001), 2001 CarswellAlta 2055 (Alta. E.U.B.)] (final approval).

286 In both of these Decisions, the Board was, once again, concerned to ensure that the transfer of AE's generation assets to an unregulated affiliate would not harm AE's remaining regulated customers (of its transmission and distribution functions). As it did in relation to UNCA, the Board considers that it should continue to ensure that AE's regulated customers are not harmed, directly or indirectly, by the transfer of its generation assets.

287 Consistent with its approach to UNCA, therefore, the Board is of the view that it is reasonable, for deferral account carrying cost purposes, to consider AE on an integrated basis.

288 Accordingly, for the purpose of determining deferral account carrying costs, the Board will consider AE's generation assets to form part of AE Integrated operations. In this way, the Board can manage any negative impact on AE's risk exposure as a result of the transfer and any consequent, negative carrying cost impacts for customers.

289 The following table summarizes the results of the same financial risk tests for AE Integrated. The Board notes that its test was based on actual results for AE Integrated for the year 2000. The Board recognizes that the effect of the year 2000 actual deferral account operations would already be reflected in the actual year 2000 results financed at whatever capital structure ratios deemed appropriate by AE. However, the table does provide some indication of what the impact of the total deferral account operations would be on the balance sheet of AE Integrated using the results of the Board's year 2000 litigation and assuming a Board determined equity ratio of 15% for the 2000 pool price deferral accounts:

Table 8: Financial Risk Tests for AE Integrated

	AE Integrated Using a 15% Equity Ratio for the Deferral Accounts	
Impact of Deferral Accounts by Year	**Before Tax Interest Coverage Ratio**	**Total Debt to EBITDA Ratio**
Starting Ratios Without Deferral Accounts	2.69	2.68
2001	2.64	2.91
2002	2.61	2.87

290 The Board notes that the above results for AE Integrated are consistent with the following testimony of Mr. Edmondson on behalf of AE:

> Q. Have you considered the impact of any additional borrowing as a result of the deferral accounts by ATCO Electric DISCO on the financial risk of the parent?
>
> A. MR. EDMONDSON: The additional — any additional borrowing that would result from ATCO DISCO would impact the parent to some degree. It would increase the risk, yes.
>
> Q. How much would it impact the financial risk of the parent?
>
> A. MR. EDMONDSON: I think on the parent of CU Inc., I think if you look at the further evidence, rebuttal evidence, we try and categorize some of the risk factors that the Board's consultants had prepared in that table that exists there, and can you see that the impact on CU Inc., as a consolidated entity, is relatively small as opposed to the impact that you would see on ATCO Electric DISCO on the stand-alone basis. [124]

291 While the above exchange is in reference to the impact of deferral account operations on CU Inc., the Board's test demonstrates that the impact of deferral account operations on AE Integrated with 15% equity is also very small.

292 Based on its financial risk test, the Board observes that a stretch of the AE integrated utility balance sheet using a 15% equity underpinning for deferral account operations would place a maximum downward pressure of 0.08 times on the before tax interest coverage ratios.

293 The Board notes, from its test, that actual year 2000 AE integrated operations produce a before tax interest coverage ratio which is at or below the reasonable target interest coverage of 2.75-3.25 times for an AA rating as suggested by Ms. McShane using the Canadian gas pipeline industry as a proxy.

294 The Board notes that it did not litigate the capital structure ratio for AE for the years 1999 - 2002. Accordingly, the Board has no knowledge of what interest coverage factors, and implicit ratings were accepted by AE in the negotiated settlements.

295 While the Board is not necessarily suggesting that the above interest coverage factors are an appropriate standard for AE Integrated, the Board is satisfied that a maximum downward shift of only 0.08 times would not cause financial harm to AE Integrated.

296 Further, as with UNCA Integrated, the Board notes that total debt to EBITDA covenant ratios would be maintained below the "prudent" 3.25 ratio that was identified for UNCA. The Board recognizes that the 3.75 limit referred to by UNCA may not specifically apply to AE Integrated operations. However, the Board considers the fact that the deferral account with 15% equity underpinning produces a ratio significantly below the 3.75 limit to be evidence that the integrated utility would not suffer financial harm using the 3.75 limit as a reasonable standard.

297 The Board notes that according to the trust indenture of CU Inc., consolidated indebtedness should not exceed 75% of total consolidated capitalization. [125] The Board also notes that AE Integrated is part of the CU Inc. family. As well, the Board observes that based on its financial risk analysis of AE Integrated that the maximum debt percentage even with all deferral accounts is less than 55%. Therefore, AE's integrated balance sheet with less than 55% debt is comfortably below the CU Inc. trust indenture restriction. Accordingly, AE Integrated on a stand-alone basis within CU Inc. is not contributing to any violation of the CU Inc. trust indenture.

298 Based on the financial risk test, the Board is satisfied that a stretch of the UNCA Integrated balance sheet and the AE integrated utility balance sheet using a 15% equity underpinning for deferral account operations would not cause a significant change to before tax interest coverage ratios. The Board also tested the 15% equity underpinning for UNCA Integrated and AE Integrated by addressing other considerations related to financial integrity.

5.10 Prudent GENERIC Capital Structure - DISCO 2000 Pool Price Deferral Accounts

299 What generic capital structure appropriately reflects the business and financial risks of the DISCO 2000 pool price deferral accounts?

5.10.1 Views of the Board - Prudent Generic Capital Structure

300 In summary, the Board has determined the following with regard to the appropriate prudent capital structure for the DISCO 2000 pool price deferral accounts:

- the DISCO 2000 pool price deferral account operation is exposed to very low business risk in comparison to the business risk for any of the three business functions;

- the appropriate common equity ratio for the 2000 deferral accounts to prudently manage business risk is in the order of 15%;

- the 15% common equity ratio required to manage business risk is sufficient to prudently manage the integrated utility's financial risk.

301 For all of the above reasons, the Board concludes that a deemed capital structure of 15% common equity and 85% debt is prudent for the 2000 pool price deferral account operations as shown in the following table:

Table 9: Board Determined (U99099) Common Equity Ratios for the Year 2000 [126]

(Including 2000 Pool Price Deferral Account Operations)

Function	**Common Equity % Range**	**Common Equity % Mid-Point**
Integrated Utility	40 - 42	41.0
DISCO (wires and retail)	53.5 - 55.5	54.5
DISCO (wires only)	Not litigated	Not litigated
GENCO	39 - 41	40.0
TRANSCO	34 - 36	35.0
2000 Pool Price Deferral Accounts	**Range not determined**	**15.0**

5.11 Appropriate Cost of Debt

302 What is the appropriate cost of debt to use in the determination of the 2001 and onward carrying cost rate?

5.11.1 Views of the Board — Appropriate Cost of Debt

Year 2001 - Appropriate Cost of Debt

303 Under normal circumstances in a GTA, the Board would determine the cost of debt by reviewing the embedded cost of prudently incurred existing debt plus the forecast cost of new debt issues. However, such a review would not be relevant to determining appropriate carrying costs for the DISCO 2000 pool price deferral accounts since the DISCO 2000 deferral accounts are incremental to integrated operations and need to be financed with new debt.

304 Earlier in this Decision, the Board concluded that the stand-alone principle is relevant for the purpose of determining the appropriate 2001 carrying cost rate for the 2000 pool price deferral accounts. Therefore, the Board considers it appropriate to determine a cost of debt based on the cost of new debt required to finance the debt component of deferral account operations on a stand-alone basis within integrated operations.

305 The DISCO 2000 pool price deferral accounts are a short to intermediate term regulatory asset/liability. As stated earlier, the Board notes that the DISCO 2000 pool price deferral accounts will be in existence for a period approximating two to four years. Based on the Board determinations in the recovery period section of this decision, UNCA's deferral account will have a life of less than four years for the significant balances (late 2000-2003) while AE DISCO's deferral account will have a life of less than three years for the significant balances (late 2000-2002). The municipally owned DISCOs did not provide evidence about the life of their deferral accounts, although at the maximum the deferral accounts could be in existence until the end of 2004, representing less than five years.

306 The Board notes the views of Dr. Rosenberg, ACC's expert witness, regarding the use of debt financing for the DISCO 2000 deferral accounts:

> Dr. Rosenberg explained that financing should be synchronized to the longevity of the asset that is being financed. These balances will be completely amortized by year-end 2004, under any proposal. If short to intermediate debt financing is utilized, the debt can be repaid from customer amortization payments systematically over the amortization period. At the end of the amortization period, the debt should be completely paid off. [127]

307 The Board also notes ACC's response to BR.ACC-8(a) with regard to financing the 2000 deferral accounts and the definitions of short- and intermediate-term debt:

> According to finance theory, short-term debt is technically classified as notes having maturity of one year or less, and intermediate term connotes maturities of between 1 year and 8 years. However textbooks will also point out that the line between short-term debt and intermediate term debt is fuzzy, and that the important points are i) what is the purpose of the note? And ii) how will the note be repaid? [128]

308 Within the context of this statement, the Board observes that, in their original applications, all of the DISCOs other than AE have included short- to intermediate term debt in the calculation of WACC. For those DISCOs that advocated the use of short- to intermediate-term debt, the cost of debt is in the range of 6-7%. Furthermore, the Board notes that ENMAX has utilized the Bank of Canada Bank Rate plus 1.5% for the calculation of its 2001 carrying costs.

309 The Board observes that AE included long-term debt in the calculation of WACC in its original application. The 2001 cost of long-term debt was calculated to be 9.32%. [129] AE stated the reason for using long-term debt in BR.ATCODISCO-PP-17 (b & c) (Revised):

> Under the terms of the 2001-2002 Negotiated Settlement, carrying costs are to be applied to all variances from forecast. The carrying cost rate is specified to include ATCO Electric's actual embedded cost of debt and preferred stock when calculating the weighted average cost of capital. The forecast capital structure and cost rates for long term debt and preferred stock, as presented in the Distribution 2001 forecast, was used in order to comply with the terms of the Board approved Negotiated Settlement. [130]

310 However, the Board notes that AE revised its application regarding the method of calculating the AE carrying cost rate. AE used the evidence filed on behalf of AE by Ms. McShane in the 2001/2002 General Rate Application for the DISCO operations. The Board further observes that in these proceedings, Ms. McShane, acting as the expert witness for AE, filed another report [131] on the derivation of a WACC that could be used for AE if its Negotiated Settlement Agreement were to be ignored by the Board. [132] Based on this evidence, the Board notes the testimony of Ms. McShane with regard to the appropriate use of debt in the derivation of AE's carrying cost rate:

> Given the Board's letter of April 24, 2001, I recommend that the Board adopt ATCO Electric's filed-for DISCO common equity ratio for 2001 of 45%, with the remainder of the capital structure deemed to be short-term debt. The deeming of short-term debt is a departure from the typical approach to financing utility assets, in which dollars of financing are not traceable to specific assets. In these unique circumstances, however, the deeming of short-term debt to the deferral accounts ensures that customers benefit from ATCO Electric DISCO's short-term debt financing in 2001. [133]

311 Thus, the Board notes that Ms. McShane, in her response to the Board's inquiries, was of the view that short-term debt should be included in her alternative calculation of the AE WACC. The Board observes that Ms. McShane utilized a forecast cost of short-term debt of 5.75% in conjunction with the common equity return. [134]

312 Accordingly, based on all of the evidence, the Board concludes that short- to intermediate-term debt is the appropriate debt instrument to consider in the determination of the 2001 cost of debt.

313 Having made this determination, the Board has considered potential different methods of incorporating short- to intermediate-term debt in the calculation of the cost of debt. Based on this exercise, the Board has concluded that the approach advocated by Dr. Evans in his direct evidence for UNCA and EDI is the most appropriate method. [135]

314 In estimating the 2001 cost of debt for UNCA and EDI, Dr. Evans started with the cost of long-term debt for UNCA's distribution access business and the cost of long-term debt for EDI. Dr. Evans's long-term debt calculation is comprised of the following:

- The yield on long-term Government of Canada bonds

• A credit risk premium

• A financing cost allowance.

315 From this estimate, Dr. Evans then deducted the spread between yields on long-term Government of Canada bonds and 1-3 year Government of Canada bonds. Based on this calculation, Dr. Evans arrived at an estimate of a corporate bond debt instrument with a maturity of 1 to 3 years.

316 For the 2001 and first quarter of 2002 period, the Board finds Dr. Evans' formula appealing for several reasons:

• The term of the debt obligation should roughly correspond to or match the term or life of the DISCO 2000 deferral accounts. The life of the DISCO 2000 deferral accounts will be in existence for a period approximating from two to less four years for the significant amounts. This roughly corresponds with a corporate bond debt instrument with a maturity of 1 to 3 years.

• Dr. Evans' methodology acknowledges corporate risk and the related credit risk premium in its calculation, which is relevant for the DISCOs. For example, based on the evidence provided by Dr. Evans, UNCA has a provisional long-term debt rating of A (Low). [136]

• Third, Dr. Evans' method is a mathematical approach to calculating the cost of debt. As a result, this approach is flexible and is able to incorporate changes in the interest rate environment. For example, Dr. Evans's method could potentially be used to calculate the cost of debt on an annual basis for each year, starting with the year 2001 and ending with the final year of recovery for each of the DISCOs.

317 The Board also notes that Ms. McShane used a comparable sample of US gas distribution utilities with a S&P rating of A- or higher in her equity rate of return analysis. [137] Finally, Dr. Evans considers that EDI has a BBB rating based on inference from the provisional rating given to UNCA. [138]

318 For the purposes of this decision, the Board will utilize Dr. Evans' credit risk premiums to determine the spreads for a high-grade investor-owned utility and a municipal utility. In order to determine the spread for a high-grade investor-owned utility, the Board will use Dr. Evans' evidence regarding the required credit risk premium for an A rated utility. Similarly, in order to determine the spread for a municipal utility, the Board will use Dr. Evans' evidence regarding the required credit risk premium for a BBB rated utility.

319 For the purpose of calculating the 2001 carrying cost rate, the Board accepts Dr. Evans' formula and assumptions as reasonable to calculate the cost of debt. The Board notes the following:

• During the proceeding, the yield for long-term Government of Canada bonds was estimated to be 6.0%. The Board notes that Ms. McShane arrived at the same 6.0% yield in her forecast of long-term Government of Canada bonds. [139]

• A credit risk premium was estimated to range from 105 basis points for a high-grade investor-owned utility and 125 basis points for a municipal utility.

• A financing cost allowance was estimated to be 5 basis points.

• A spread of 65 basis points was estimated between yields on long-term Government of Canada bonds and yields on 1-3 year Government of Canada bonds. [140]

320 Accordingly, for the purpose of calculating the 2001 carrying cost rate, the Board approves a prudent cost of debt for a high-grade investor-owned utility would be 6.45% (i.e., 6.00% +1.05%+0.05%-0.65%) and for a municipal utility would be 6.65% (i.e., 6.00% +1.25%+0.05%-0.65%).

First Quarter of 2002 - Appropriate Cost of Debt

321 The Board notes that long-term bond yields have significantly declined during the year 2001. For example, the Board notes that at the current time in the last quarter of 2001, the yield for long-term Government of Canada bonds is hovering around 5.5%. This represents a decline of 50 basis points relative to the evidence of 6.0% provided in these proceedings with regard to the long-term bond yield.

322 Similarly, the Board also observes that short-term interest rates, including the Bank of Canada bank rate, prime rates and commercial paper rates, have declined considerably during the year 2001. For example, the Bank of Canada bank rate, which was used in the DISCO interim financing decisions, has declined from 6% down to a rate of 2.5% at the current time in the last quarter of 2001, representing a decrease of approximately 3%. The Board notes that this 300 basis point decline in the Bank of Canada bank rate is much greater than the decrease of 50 basis points in the yield for long-term Government of Canada bonds.

323 Therefore, the Board believes that Dr. Evans's original assumptions regarding the cost of debt, which is based on longer-term bond yields, do not completely incorporate the current widening spreads between short-term and long-term interest rates. As a result, the Board does not consider Dr. Evans's formula to be sufficiently robust to fully capture the general decline in shorter-term interest rates, which is of relevance to the financing of the deferral accounts during the period 2002-2003.

324 The Board observes that if it were to use Dr. Evans's formula for the first quarter of 2002, based on a decline of 50 basis points in the yield for long-term Government of Canada bonds, the cost of debt for a high-grade investor-owned utility would decline to 5.95%, down from 6.45% in 2001.

325 At the same time, the Board observes that short-term interest rates appear to be in the range of 3-4%. For example, the Canadian prime rate is 4.0%. Thus, based on a conservative estimate, short-term rates are currently averaging around 4%. Weighing the results of the updated formula of Dr. Evans with the mid-point of the current range of short-term interest rates, the Board considers that an estimate of 5% for the current cost of debt would be reasonable for the first quarter of 2002.

326 Accordingly, the Board considers prudent and the Board approves a deemed cost of debt equal to 5.0% for the purpose of calculating the carrying cost rate for a high-grade investor-owned utility for the first quarter of 2002.

Second Quarter of 2002 and Onward - Appropriate Cost of Debt

327 Please see the Securitization section for the Board's determination of the carrying cost rate for the second quarter of 2002 and onward.

5.12 Appropriate Cost of Equity

328 What is the appropriate cost of equity to use in the determination of the 2001 and onward carrying cost rate?

5.12.1 Views of the Board - Appropriate Cost of Equity

Year 2001 - Appropriate Cost of Equity

329 The Board observes that, of those that applied for WACC, the DISCOs requested an after-tax return on equity that is in the range of 9-11%.

330 AE requested a return on equity of 9.25% in its original application, based on the Board approved 2000 common equity return for TransAlta in Decision U99099. [141] However, AE later revised its requested return to 11.0-11.25%, based on the evidence provided by Ms. McShane in the 2001/2002 General Rate Application for the DISCO operations. [142] Ms. McShane recommended the same rate of return for the AE deferral accounts as the rate of return that was applicable to AE DISCO, based on the assumption that the deferral accounts were an integral part of the DISCO business. [143]

331 Both Red Deer and Lethbridge requested an equity rate of return of 9.75%. Both DISCOs submitted that this was the same return that the Board had used in its test of return in the Transmission Facilities Owner (TFO) decisions — in Decision 2000-65 [*ATCO Electric Ltd., Re* (October 31, 2000), Doc. 2000-65 (Alta. E.U.B.)] for AE, in Decision 2001-04 [*TransAlta Utilities Corp., Re* (2001), 2001 CarswellAlta 2046 (Alta. E.U.B.)] for TransAlta and in Decision 2001-05 [*EPCOR Transmission Inc., Re* (2001), 2001 CarswellAlta 2091 (Alta. E.U.B.)] for EPCOR Transmission Inc. (TFO Decisions). [144]

332 UNCA and EDI submitted an equity rate of return of 11.50%, based on the direct evidence provided by Dr. Evans for each of these DISCOs. [145] The Board notes that, in arriving at his assessment of the appropriate rate of return on common equity for deferral account operations, Dr. Evans made the following comments:

> The somewhat lesser business risks of these operations *vis-à-vis* distribution access are already reflected in the somewhat "thinner" common equity ratio for deferral account operations. I therefore recommend that the Board apply the same common equity rate of return to the deferral account and distribution access businesses. The updated common equity rate of return for distribution access operations is 11.5%. Thus, the cost of equity for carrying charge purposes is also 11.5%. [146]

333 The Board considers that Dr. Evan's statement accords with the following view of the Board in Decision U99099:

> Given the particular business risks of a corporation, the Board considers it appropriate to make any necessary changes to the common equity ratio, rather than the equity rate of return, to achieve the desired investment risk. Using this approach, the allowed fair return to shareholders on a utility=s common equity is the return commensurate with rates of return earned by common equity exposed to similar generic investment risk. [147]

334 The Board has approved a common equity ratio for the 2000 pool price deferral account operations that is lower than the common equity ratio for the integrated utility operations, reflecting the lower business risk of the deferral account operations. Based on this adjustment for investment risk, the Board will apply the same common equity rate of return to the deferral accounts as is applicable to the integrated utility operations, but the return is applied to the lower Board approved common equity ratio for the 2000-deferral accounts.

335 Based on the Board's recent litigation of fair return for the 1999 and 2000 test years in Decision U99099, the Board does not consider that any of the recommendations of UNCA, EDI, AE, Lethbridge or Red Deer for equity rate of return would necessarily result in just and reasonable 2001 carrying cost rates. In the Board's view, the DISCOs' recommendations are significantly different from the 1999/2000 litigated equity rate of return of 9.25% approved in Decision U99099.

336 However, the Board observes that in its original application, AE requested a return on equity of 9.25%, based on the Board approved 2000 common equity return for TransAlta in Decision U99099. In addition, Red Deer and Lethbridge both based their recommendations on the 2001-2002 TFO Decisions. In the TFO Decisions, the Board used the litigated equity rate of return in Decision U99099 as the reference point to carry out its test of the reasonableness of the negotiated settlements approved in those Decisions.

337 With respect to the appropriate 2001 equity rate of return, the Board notes that Dr. Evans and Ms. McShane both estimated the forecast risk free rate to be 6.00%.

338 The Board considers that a forecast risk free of 6.00% is reasonable and the Board approves a risk free rate of 6.0% for the purpose of determining the 2001 equity rate of return. The Board notes that this forecast risk free rate is approximately 25 basis points higher than the litigated 2000 risk free rate of 5.75%.

339 The Board notes that both Dr. Evans and Ms. McShane provided evidence regarding the equity risk premium in these proceedings. However, following a review of the evidence, the Board considers that there is insufficient reason to change its original findings regarding the equity risk premium determined in Decision U99099. Accordingly, the Board will continue to

use the 3.50% equity risk premium that was determined in Decision U99099 as the appropriate equity risk premium to arrive at a 2001 equity rate of return for the 2000-deferral accounts.

340 As a result, the Board approves a rate of 9.50% as the appropriate equity rate of return for the purpose of determining the 2001 carrying cost rate, comprising of a risk free rate of 6.00% and an equity risk premium of 3.50%.

First Quarter of 2002 - Appropriate Cost of Equity

341 The Board has already noted that interest rates in general have significantly declined during the year 2001. As well, the yield for long-term Government of Canada bonds has declined during the course of 2001. The Board notes that at the current time in the last quarter of 2001, the yield for long-term Government of Canada bonds is hovering around 5.5%. This represents a decline of 50 basis points relative to the evidence provided in these proceedings with regard to the long-term bond yield.

342 The Board considers that the current yield of 5.5% for long-term Government of Canada bonds is more representative of future risk-free bond yields for the purpose of determining the equity rate of return for the first quarter of 2002, in comparison to the original forecasts of Dr. Evans and Ms. McShane of a long-term bond yield of 6.0% in these proceedings. Due to the shorter-term nature of the 2000-deferral accounts, the Board is of the view that the yield on long-term Government of Canada bonds should be used to determine the first quarter of 2002 cost of equity.

343 Accordingly, based on the long-term Government of Canada bond yield in late November 2001, the Board has determined that the appropriate long-term debt benchmark for the year 2002 should be 5.5% and the Board approves that rate for the purpose of determining the equity rate of return for the first quarter of 2002.

344 The Board notes that this forecast risk-free rate is approximately 25 basis points lower than the litigated 2000 risk free rate of 5.75%

345 For the reasons given above in relation to year 2001 carrying costs, the Board will use the 3.50% equity risk premium that was determined in Decision U99099 as the appropriate equity risk premium to arrive at an equity rate of return for the first quarter of 2002.

346 As a result, the Board approves 9.0% as the appropriate equity rate of return for the first quarter of 2002, comprising a risk free rate of 5.50% and an equity risk premium of 3.50%.

Second Quarter of 2002 and Onward - Appropriate Cost of Equity

347 Please see the Securitization section for the Board's determination of the carrying cost rate for the second quarter of 2002 and onward.

6 UNCA Disco Deferral Account Debt / Equity Rates and Capital Structure

6.1 Background

348 The Board notes that UNCA's 2000 pool price deferral accounts are large relative to its DISCO rate base. The total size of the UNCA deferral account is $365 million. [148] UNCA has confirmed that its 2001 mid-year rate base was forecast to be $473 million. [149] Based on UNCA's evidence, therefore, UNCA's 2000 deferral account balance represents roughly 77% of its DISCO rate base.

349 Earlier sections of this Decision and the Views of the Parties in Appendix 6 provide further background on UNCA's views. The interested reader is referred to Appendix 6 of this Decision for the complete Views of the parties. The Board has utilized all of this material in arriving at the following findings respecting the carrying cost matters.

350 The Board notes IFE's comments about the relative size of UNCA's deferral accounts:

Messrs. McCormick and Demcoe acknowledge that the deferral accounts are "significant relative to the rate base of the utility" and "...the size of the deferral account balances is an important factor in considering the financing options available to UNCA". [150]

351 The Board in an earlier section discussed the relationship of UNCA's DISCO to that of UNCA's (TransAlta's) integrated rate base including for purposes of the no harm assessment. In terms of the original acquisition of the DISCO operations, UNCA purchased the distribution and retail assets of TransAlta Utilities on August 31, 2000. The Board notes that Mr. Van Yzerloo provided comments about the debt portion of the financing:

At that time, UNCA's acquisition financing consisted of a short-term bridge loan for the debt portion of rate base. This short-term loan was to be repaid with the proceeds from a long- term debt financing planned for 2001. [151]

352 UNCA submitted in its application that the appropriate capital structure for its distribution operations is 56% debt and 44% equity, as evidenced in UNCA's DT Application. [152]

353 The Board notes UNCA's submission that it required emergency interim debt financing to finance the deferral accounts:

On an emergency interim basis, financing of the deferral accounts was obtained from UtiliCorp Canada Corp., the parent of UtiliCorp Networks Canada Ltd, at an interest rate of 7.5%. This interim financing arrangement has temporarily increased the debt component of UNCA's capital structure substantially above the 56% appropriate for the utility operations. UNCA will refinance this emergency loan using an appropriate mix of debt and equity capital. [153]

354 However, the Board also notes UNCA's argument that the emergency debt financing of the deferral account balance ultimately put it in violation of its banking covenants:

Incremental debt materially in excess of the 56% debt financing for distribution operations would put UNCA in violation of the covenants of its current credit facility agreement. One such covenant is a requirement to maintain a minimum 3.75 ratio of EBITDA (earnings before interest, income taxes, depreciation and amortization) to debt, which would be impossible with the addition of $278 million debt. [154]

355 With regard to UNCA's financial situation, the Board observes Mr. Van Yzerloo's comments about the matter:

Unfortunately, the fact that the deferral accounts were financed with 100% debt under the emergency loan caused UNCA to be in breach of its key financial covenant under its existing credit agreements with the banks. In particular, the requirement for UNCA to maintain a total debt to EBITDA ratio of no more than 3.75 to 1 was breached with the inclusion of the UtiliCorp United loan in the calculation of total debt, as is required by the terms of the credit agreement with the banks. The banks therefore had the right to call the bridge loan as at March 31, 2001. [155]

356 Thus, Mr. Van Yzerloo further submitted that it was imperative for UNCA to issue new equity in order to resolve its financial concerns:

After much negotiation, it was determined that injection of common equity by UtiliCorp into UNCA was the only solution that would satisfy the banks and allow UNCA's covenants to be met. As evidenced by BR.UNCA DISCO-32, the covenant breach was substantial as at February 28, 2001 and is slightly in breach as forecast to June 30, 2001. With the equity injection and an overall plan to re-finance the existing debt, including UtiliCorp's debt, the banks waived the covenant requirement for March 31, 2001 and did not call their loans. It should be noted that final negotiations to receive the waiver from the banks concluded on March 30.

If UtiliCorp had not injected the $105 million equity at the end of May, 2001, UNCA would be materially in breach of its covenants at the end of the second quarter and the banks would again be in a position to call the loan. [156]

357 The Board notes that other parties agreed that UNCA required some equity to finance the deferral account balances:

> Mr. Marcus agreed that UtiliCorp required "some amount" of equity to finance its deferral account balances and that shareholders should be compensated for the equity that they commit, assuming "that the choice to put up equity was a reasonable and prudent choice". [157]

> Dr. Rosenberg, in the context of on-balance sheet financing, agreed with Mr. Wallace that: "When you have $400 million worth of capital that is required, you need some equity to underpin that". [158] Dr. Rosenberg also agreed that, subject to a finding of imprudence, shareholders should be compensated for the equity that they have invested. [159]

358 The Board approved the issuance of common equity by for up to $120 million in Decision 2001-47 [*UtiliCorp Networks Canada (Alberta) Ltd., Re* (May 30, 2001), Doc. 2001-47 (Alta. E.U.B.)]. In the Board Findings of the Decision, the Board concluded that:

> Having considered the Application, and the representations of UNCA and the FIRM Group, the Board will approve the issuance of common equity, up to a maximum amount of $120 million, to finance the deferral account. Adjustments to the allowed equity component may occur following the decision of the Board on the 2000 Distribution Deferral Accounts. [160]

359 The Board notes that in BR.UNCA DISCO-32, UNCA presented its status with respect to a critical Debt to EBITDA covenant and a Debt to Total Capitalization covenant, under several circumstances, including the emergency interim inter-company financing, following the equity financing and debt refinancing, and debt-only financing. In its response, UNCA confirmed the implications of financing the deferral account completely with new debt, as opposed to issuing $105 million in equity:

> Financing the deferral account completely with new debt, rather than with the $105 million portion actually financed through equity, would have produced a ratio of "Total Debt to EBITDA" of 5.5 times. That level would have exceeded the 3.75 times maximum allowed under section 9.2 of UNCA's Credit Agreement with the Bank of Montreal and the Toronto Dominion Bank, dated August 30, 2000. The banks have the right to call the loan when the 3.75 maximum is exceeded. It would have been imprudent to issue debt to a level much above 3.25 times, as that would not leave sufficient room for other unexpected unfavourable variations in cash flow from operations or in total debt, exposing the company and its customers to the risks of insolvency. [161]

360 The Board notes that in its application letter to the Board regarding the issuance of common equity UNCA summarized the impact of the equity issue and discussed UNCA's intention to redeem the equity issue during the collection period of the deferral accounts:

> The net proceeds received by UNCA from the equity issue will be used to refinance a portion of this emergency loan. The proposed equity issue will result in a capital structure of the deferral account of 40% equity, 60% debt. The equity will be redeemed with cash flows from the recovery of the deferral account balances during the period 2001 to 2004. [162]

361 Thus, the Board notes that the purpose of UNCA's equity issue is to help finance its deferral account balance. Furthermore, the equity issue will be redeemed using the cash flows from the recovery of UNCA's deferral accounts. In addition to the $105 million equity financing, UNCA stated that it issued commercial paper in July 2001 to replace the remaining part of the 7.5% emergency interim financing from UCC. [163] The commercial paper carries a rate of 5.75% according to BR.UNCA DISCO-32. [164]

362 With regard to the 2001 carrying costs for the deferral accounts, UNCA has applied for a 2001 after-tax 8.47% WACC that is based on the direct evidence of Dr. Evans. The 8.47% WACC is comprised of a capital structure of 60% debt and 40%

common equity that is applicable to deferral account financing, a 6.45% forecast cost of debt and an 11.5% common equity rate return. [165] UNCA has requested a three-year recovery period for the deferral accounts during the period of 2002-2004. [166]

6.2 Views of the Board — UNCA's Deferral Account Capital Structure

363 The Board considers that the deferral accounts of each DISCO may have unique characteristics that would warrant a deviation from the Board's generic finding that a capital structure consisting of 85% debt and 15% equity is prudent for deferral account operations. Accordingly, the Board will now examine the specific circumstances of UNCA DISCO.

364 In terms of determining the appropriate capital structure for UNCA's 2000 deferral account operations, the Board observes that UNCA's deferral account is large in relation to its DISCO rate base. In addition, while UNCA initially secured some emergency debt financing, it ultimately was required to issue some temporary equity in order to achieve a more appropriate mix of capital structure. However, the Board notes that UNCA's equity is intended to be of a temporary nature and that UNCA has expressed its intention to redeem its new equity issue (related to the deferral accounts) as the deferral account would be retired. Finally, the Board observes that UNCA has requested a three-year recovery period for its deferral accounts.

365 If the Board ignored the "no harm" test and viewed UNCA DISCO from only a UNCA DISCO perspective, the Board could have justified a capital structure for UNCA that would have called for an equity ratio greater than the 15% required to manage business risk as earlier determined by the Board. However, as earlier stated by the Board, it cannot ignore the application of the "no harm" test.

366 The Board, in a previous section, determined that financing the deferral account with 15% equity would not cause material financial harm to integrated utility operations. Specifically, the results of the Board's financial risk test determined that it was highly unlikely that, viewed from an integrated utility basis, financial covenants such as the "Total Debt to EBITDA" of 3.75 times would have been in jeopardy during the life of the UNCA deferral account. Thus, on an integrated basis, UNCA's concerns about financial risk would have been minimized if not completely mitigated.

367 The Board notes that, consistent with its generic findings, UNCA's deferral account has very low capital recovery, sales forecast, financing cost and O&M risks.

368 Based on a consideration of UNCA's business risk and financial risks and after application of the no-harm test, the Board has determined that it would be appropriate and prudent to use the generic deemed capital structure of 85% debt and 15% equity for the UNCA DISCO deferral account for the period 2001 through the first quarter of 2002.

369 Accordingly, the Board approves a deemed capital structure of 85% debt and 15% equity for the UNCA DISCO deferral account for the period 2001 to the first quarter of 2002.

6.3 Views of the Board — UNCA's Cost of Debt

370 The Board will ensure that UNCA, as viewed on an integrated basis, is compensated for its debt costs by using a conservative A level credit rating in determining the cost of debt for deferral account operations. Accordingly, the Board's previous generic finding of a 6.45% cost of debt for high-grade investor-owned utilities for the year 2001 would be appropriate and prudent for the UNCA DISCO deferral account. Accordingly, the Board approves a 6.45% cost of debt for the year 2001 for UNCA DISCO's deferral account.

371 Further, the Board considers its generic finding that a 5.0% cost of debt for the first quarter of 2002 would also be appropriate and prudent for the UNCA DISCO deferral account. Accordingly, the Board approves a 5.0% cost of debt for the first quarter of 2002 for UNCA DISCO's deferral account.

372 The Board advises that the Securitization section of this Decision discusses the Board's determination of the carrying cost rate for the second quarter of 2002 and onward.

6.4 Views of the Board — UNCA's Cost of Equity

373 In the Board's view, there are no special circumstances that would warrant a change to the Board's generic finding respecting the cost of equity for the period 2001 to the first quarter of 2002. Accordingly, the Board approves a 2001 cost of equity of 9.50% and a cost of equity of 9.00% for the first quarter of 2002 for the UNCA DISCO deferral account.

374 The Board advises that the Securitization section of this Decision discusses the Board's determination of the carrying cost rate for the second quarter of 2002 and onward.

7 AE Disco Deferral Account Debt / Equity Rates and Capital Structure

7.1 Background

375 AE has suggested that the Board's determination of both of AE's deferral account balances and of AE's carrying costs is circumscribed by the interrelated terms of the 1999/2000 Settlement and the 2001/2002 TFO Settlement. The Board's consideration of the principal balances in AE's DISCO deferral accounts, including the impact of AE's various negotiated settlements on those balances, will be set out in forthcoming Decision 2001-94 in relation to these proceedings. The Board's consideration of the impact, if any, of the Settlements on carrying costs is addressed in this section of this Decision.

376 The Board notes that AE DISCO's 2000 pool price deferral accounts are relatively significant in comparison to its DISCO rate base. The total size of the AE DISCO deferral accounts is $97.9 million. [167] AE has confirmed that its actual 2000 mid-year DISCO rate base was $470 million (gross rate base less customer contributions). [168] Thus, AE DISCO's outstanding 2000 pool price deferral account balance represents roughly 21% of AE DISCO's rate base.

377 In its original application, AE submitted that the WACC rate to be used for 2001 should be determined in accordance with sections 4(1) and 4(2) of the *Deferral Accounts Regulation* and with Clause 32 of ATCO Electric's 2001-2002 Distribution Tariff Negotiated Settlement (2001-2002 DT Settlement). [169]

378 Clause 32 of the 2001-2002 DT Settlement reads as follows:

> With respect to all deferral accounts ***contained in this agreement***, carrying costs will be applied to all variances from forecast. The carrying cost rate for 2001 and 2002 will be determined as follows:
>
> > a) An AEUB approved weighted average cost of capital for UtiliCorp Networks Canada's 2001 Distribution Revenue Requirement, ***adjusted for ATCO Electric's actual embedded cost of debt and preferred stock***.
> >
> > b) In the event that an explicitly AEUB approved weighted average cost of capital for UtiliCorp Networks Canada's 2001 and 2002 Distribution Revenue Requirement is unavailable, then parties agree that they will attempt to negotiate a weighted average cost of capital rate for 2001 and 2002.
> >
> > c) If the attempt at negotiating a weighted average cost of capital rate for 2001 and 2002 fails, then the parties agree that they will request the AEUB to determine that rate for 2001 and 2002. [170]

379 AE initially submitted that the Board must apply the terms of the 2001-2002 DT Settlement to arrive at an appropriate WACC. However, based on the terms of that Settlement, the Board has concluded that it is not applicable to AE's 2000 pool price deferral accounts. The opening words of Clause 32 of the Settlement make it clear that the carrying cost provisions in that Clause apply only to the deferral accounts established in that Settlement. In the Board's view, any determination it or the parties to the Settlement might have made with respect to WACC pursuant to Clause 32 would have been nothing more than evidence to which the Board would have regard in these deferral account proceedings. However, for the reason just given, the Board is not bound by the terms of the 2001-2002 DT Settlement in determining carrying costs for AE pursuant to the *Deferral Accounts Regulation*.

380 In its Argument and Reply, AE took a somewhat different approach and urged the Board to apply the terms of the 1999/2000 Negotiated Settlement (1999/2000 Settlement) approved in Decision U99046 and AE's 2001/2002 TFO Negotiated Settlement approved in Decision 2000-65 (2001/2002 TFO Settlement).

381 Clause 43 of the 1999/2000 Settlement provides as follows:

> 43 (a) With respect to the deferral accounts established by clauses 17, 18, 19, 20, 28, 29, 30, 31, and 38, [AE] will make a one time adjustment, at the end of 1999 and 2000, respectively, in order to pass through the balances in each account to the affected DISCO's. [AE] will provide parties to this Negotiated Settlement an accounting of the final balances in the deferral accounts and their disposition as early as is reasonably possible after the calendar year-end for each of 1999 and 2000. Parties to this settlement agreement will have audit rights. [AE] and the parties to this settlement agreement will negotiate in good faith to reach agreement on the final balances in the deferral accounts and their disposition. If an agreement is reached, they will be filed with the Board for final approval. If agreement cannot be reached, [AE] will file its calculations with the Board for approval. Parties will be free to oppose [AE's] calculations or advance their own calculations as they see fit consistent with the principles agreed upon herein. Parties opposing will file their calculations with the Board.

382 Clause 29 of the 2001/2002 TFO Settlement provides as follows:

> 29. With respect to all deferral accounts contained in this agreement, ***as well as the final settlement of deferral accounts identified in Section 43(a) of the 1999/2000 Negotiated Settlement for the Year 2000***, carrying costs will be applied to all variances from forecast. The carrying cost rate for 2001 and 2002 will be determined as follows:
>
> > (a) An AEUB approved weighted average cost of capital for TransAlta Utilities' 2001 TFO Revenue Requirement, adjusted for ATCO Electric's actual embedded cost of debt and preferred stock.
> >
> > (b) In the event that an explicitly AEUB approved weighted average cost of capital for TransAlta Utilities' 2001 TFO Revenue Requirement is unavailable then parties agree that the AEUB approved weighted average cost of capital for ATCO Electric's 2001 and 2002 Distribution Revenue Requirement will be used.
> >
> > (c) In the event that an explicitly AEUB approved weighted average cost of capital for ATCO Electric's 2001 and 2002 Distribution Revenue Requirement is unavailable, then parties agree that they will attempt to negotiate a weighted average cost of capital rate for 2001 and 2002.
> >
> > (d) If the attempt at negotiating a weighted average cost of capital rate for 2001 and 2002 fails, then the parties agree that they will request the AEUB to determine that rate for 2001 and 2002. [171]

383 Clause 43 of AE's 1999/2000 Settlement clearly refers to the four AE pool price deferral accounts encompassed by the definition of "deferral account" in the *Deferral Accounts Regulation*, namely the accounts established by Clauses 28, 29, 30 and 31 of that Settlement. However, as the Board found in Decision 2001-83 respecting the DISCO Outstanding Matters, AE's 1999/2000 Settlement does not provide for carrying costs for these accounts. [172] Rather, carrying costs for 2001 and 2002 in relation to these accounts are contemplated in the 2001/2002 TFO Settlement. Therefore, the Board considers that its determination of 2001 carrying costs for AE DISCO should take into account the terms of the 2001/2002 TFO Settlement.

384 The record of these proceedings demonstrates the following:

> (a) The Board has not approved a WACC for TransAlta's 2001 TFO revenue requirement since all relevant aspects of TransAlta's 2001 TFO tariff were agreed to in TransAlta's 2001 TFO Negotiated Settlement approved by the Board in Decisions 2001-4. [173] Therefore, Clause 29(a) of AE's 2001/2002 TFO Settlement is not applicable.
>
> (b) The Board has not approved a WACC for AE's 2001 and 2002 Distribution revenue requirements since all relevant aspects of AE's 2001/2002 DT were agreed to in its 2001/2002 DT Settlement approved by the Board in Decision 2001-14

> [*ATCO Electric Ltd., Re* (2001), 2001 CarswellAlta 2111 (Alta. E.U.B.)]. [174] Therefore, Clause 29(b) of AE's 2001/2002 TFO Settlement is not applicable.
>
> (c) The parties to AE's 2001/2002 TFO Settlement have not negotiated a WACC for 2001 and 2002. Therefore, Clause 29(c) of AE's 2001/2002 TFO Settlement is not applicable.

385 For these reasons, the Board concludes that Clause 29(d) of AE's 2001/2002 TFO Settlement applies. However, all that Clause 29(d) requires is that the Board determine a WACC for AE for 2001 and 2002. In the Board's view, there is nothing in Clause 29 or any other provision of the 2001/2002 TFO Settlement that in any way circumscribes the Board's discretion to approve an appropriate and reasonable WACC for AE taking into account all relevant considerations.

386 The Board notes AE's submission that the Board needs only to determine the "missing components" of the WACC for AE. AE presented the following argument in BR.ATCODISCO-PP-17 (d) (Revised):

> The 2001-2002 TFO Negotiated Settlement in clause 29 outlines how carrying costs are to be calculated. The clause specifically allows for the embedded cost of debt and preferred stock, plus an equity component, which due to the Negotiated Settlements of TAU and UNCA will be determined through negotiation. Should negotiations be unsuccessful, the Board will determine the equity component. Consequently, use of the embedded cost rate for long-term debt as a component of carrying costs is consistent with the 2001-2002 TFO Negotiated Settlement. [175]

387 The Board notes, however, that the reference in Clause 29 of the TFO Settlement to AE's "embedded cost of debt and preferred stock" appears only in paragraph (a) in the event that a WACC for AE is to be determined on the basis of TransAlta's 2001 TFO revenue requirement. In all other paragraphs of Clause 29, no reference to embedded cost of debt or preferred stock is found. Either the parties negotiate an appropriate WACC or the Board must approve one.

388 As already noted, the Board has concluded that it must approve a WACC by virtue of the parties having failed to negotiate one. In this context, the Board does not agree with AE's characterization when AE speaks of "missing components" of WACC in the sense that the Board's discretion is limited to determining specific components of AE's WACC for purposes of these proceedings.

389 In the Board's view, based on its interpretation of the relevant Settlements, its discretion to set a WACC for AE is limited, if at all, only by section 4(2) of the *Deferral Accounts Regulation*. As the Board has also already concluded, its determination of a WACC for AE pursuant to Clause 29(d) of the 2001/2002 TFO Settlement is consistent with the Board's discretion under section 4(2) of the *Deferral Accounts Regulation* to determine a prudent cost of financing for AE.

390 In the Board's view, sections 4(1) and 4(2) of the *Deferral Accounts Regulation* are entirely consistent with the Board's role contemplated by the parties to the 2001/2002 TFO Settlement. In particular, the Board notes that the definition of "deferral account" for AE set out in section 1(a)(i) of the *Regulation* is expressed in terms of the accounts established in the 1999/2000 Settlement, carrying costs for which are only provided for in the 2001/2002 TFO Settlement. Therefore, the Board does not consider that the assessment of prudence prescribed by section 4(2) of the *Deferral Accounts Regulation* requires the Board to "disregard" the terms of any of AE's Settlements. For all of these reasons, the Board concludes that it is free to set a WACC for AE according to the criteria of section 4(2) of the *Regulation* while still respecting the terms of all of AE's applicable Settlements.

391 The Board will proceed to determine an appropriate capital structure for AE DISCO's deferral account having regard to these conclusions.

7.2 Views of the Board — AE's Deferral Account Capital Structure

392 As noted in relation to UNCA, the Board considers that the deferral accounts of each DISCO may have unique characteristics that would warrant a deviation from the Board's generic finding that a capital structure consisting of 85% debt and 15% equity is prudent for deferral account operations.

393 For the reasons given in the preceding section, the Board does not agree with AE's argument that the Board is limited to determining the "missing components" of AE's WACC. In the Board's view, the terms of the 2001/2002 TFO Settlement which apply in this context leave all component's of AE's WACC open to Board determination in light of the terms of section 4(2) of the *Deferral Accounts Regulation*.

394 The Board notes that in its original application, AE asked the Board to approve a pre-tax WACC of 12.44% for 2001 (or an after-tax WACC of 8.43%), as outlined in Schedule 10.0 of AE's application.[176]

395 However, the Board notes that AE later submitted new evidence related to WACC. AE adopted the evidence that was filed by Ms. McShane in the 2001/2002 General Rate Application for the DISCO operations.[177] AE submitted that the new evidence should be used to determine the "missing components" (Board emphasis) of the WACC contemplated for AE pursuant to clause 29 of the 2001/2002 TFO Negotiated Settlement.

396 Based on this new evidence, AE requested a 2001 after-tax 9.81% WACC.[178] The 9.81% WACC was comprised of a capital structure of 47.5% debt, 7.5% preferred stock and 45% common equity,[179] a 9.3% forecast embedded cost of debt, a 5.2% forecast embedded cost of preferred stock and an 11.0-11.25% common equity rate of return.[180]

397 AE responded to a Board request that AE provide supplementary responses to some IRs originally posed by the Board. AE summarized as follows the testimony of Ms. McShane that was used to provide further additional evidence regarding the derivation of a WACC for AE:

> Ms. McShane filed a further report on the derivation of a WACC that could be used for ATCO Electric if its Negotiated Settlement Agreement were to be totally ignored by the Board (which ATCO Electric submits should not be the case). Ms. McShane proposed that, were the settlement to be overturned, a reasonable WACC for the DISCO deferral accounts would comprise 45% common equity and 55% short-term debt. The ROE to be applied to the common equity component should be the same as would be applicable to the DISCO operations, as updated to 11.5%.[181]

398 AE's submission is based on an assumption that the deferral accounts represent an integral component of the DISCO operations and cannot be considered as a separate "business". As a result, in its determination of the carrying cost rate, AE assumed that the business risk of the deferral accounts would be the business risk of its distribution operations.[182]

399 For the reasons expressed earlier in this Decision regarding generic capital structure issues, the Board disagrees that the deferral accounts cannot be viewed as separate business within the DISCO operations. The deferral accounts have unique characteristics, are quantifiable and have their own risk parameters.

400 The Board notes that AE has not commented on the impact of the DISCO deferral account balances on its DISCO or its integrated operations. In addition, while AE has submitted that the deferral accounts represent an integral part of the DISCO operations, it has emphasized the fact that its deferral account balance recovery period is considerably shorter than the recovery period of its distribution wires assets. Thus, as previously noted by the Board, the capital recovery risks associated with the deferral account operations are very low in comparison to those associated with the distribution wires business. In AE's case, the Board has approved a very short recovery period of only one year.

401 The Board also observes that AE has not provided any evidence regarding how it would potentially finance its 2000 deferral account balance. By comparison, UNCA has submitted evidence in relation to all aspects of its deferral account financing, including interim debt financing, its commercial paper program and its equity financing.

402 The Board notes that in its original application and in its reference to the 2001/2002 GRA for the DISCO operations, AE has requested a preferred equity component in the capital structure of its 2000 pool price deferral accounts. For the purposes of determining the appropriate capital structure for the deferral accounts, the Board does not consider that preferred equity financing is a relevant component of the deferral account capital structure. Based on the evidence regarding carrying costs and

actual financings related to the deferral accounts, the Board has concluded that the appropriate capital structure is a combination of short to medium term debt and common equity.

403 In a previous section of this Decision, the Board determined that financing the deferral account balances with 15% equity would not cause material financial harm to integrated utility operations.

404 Consistent with its generic findings, the Board considers AE's deferral account to have very low capital recovery, sales forecast, financing cost and O&M risks. In summary, AE's 2000 deferral account operation is exposed to very low business risk in comparison to the business risk for any of the three business functions of AE's integrated operations.

405 For these reasons, based on a consideration of AE's business and financial risks, the Board has determined that it would be appropriate and prudent to use the generic, deemed capital structure of 85% debt and 15% equity for the AE DISCO deferral account for the period 2001 to the first quarter of 2002.

406 Accordingly, the Board approves a deemed capital structure of 85% debt and 15% equity for the AE DISCO deferral account for the period 2001 through to the first quarter of 2002.

7.3 Views of the Board — AE DISCO's Cost of Debt

407 The Board observes that Ms. McShane used a forecast cost of short-term debt of 5.75%, an equity rate of return of 11.5% and derived an after-tax WACC of 8.34% for AE DISCO and its deferral accounts. [183]

408 Notwithstanding this evidence, AE emphasized its position with respect to its embedded cost of debt and short-term debt as follows:

> ATCO Electric is not requesting that there be a component of short-term debt in capital structure. Ms. McShane's filing was solely in response to the Board's request (which ignores the Negotiated Settlement Agreement) and is <u>not</u> ATCO Electric's requested disposition. [184]

409 Nevertheless, in its response to BR.ATCODISCO-PP-17 (a) (Revised), AE supported the use of short-term debt in the derivation of AE DISCO's WACC:

> As per the Board's letter of April 24, 2001, ATCO Electric is adding the following:
>
>> ...The settlement agreement was premised on ATCO Electric's traditional manner of financing its utility assets, i.e., utilization of short-term debt as an interim measure only, until such time as the external financing requirements have reached a level, which are sufficient for an issue of long-term debt. As such, short-term debt has never been included in the capital structure. However for purposes of this application, which reflect the unique circumstances associated with the deferral accounts, short-term debt financing will be part of the financing mix while the deferral accounts are outstanding. Although the company does not trace dollars of financing to specific assets, ATCO Electric is proposing to assign a short-term debt cost to the proportion of the deferral account balances, which are not deemed to be financed with common equity. This proposal will ensure that customers receive the benefit of the short-term debt cost incurred by ATCO Electric. [185]

410 In light of this evidence, the Board considers that AE has acknowledged the benefits of including a short-term debt cost in the calculation of WACC for AE's deferral accounts.

411 The Board will ensure that AE, as viewed on an integrated basis, is compensated for its debt costs by using a conservative A level credit rating in determining the cost of debt for deferral account operations. Accordingly, the Board's previous generic finding of a 6.45% cost of debt for high-grade investor-owned utilities would be appropriate and prudent for the AE DISCO deferral account. Accordingly, the Board approves a 6.45% cost of debt for the year 2001 for AE DISCO's deferral account.

412 Further the Board considers its generic finding that a 5.0% cost of debt for the first quarter of 2002 would also be appropriate and prudent for the AE DISCO deferral account. Accordingly, the Board approves a 5.0% cost of debt for the first quarter of 2002 for AE DISCO's deferral account.

413 The Board advises that the Securitization section of this Decision discusses the Board's determination of the carrying cost rate for the second quarter of 2002 and onward.

7.4 Views of the Board — AE DISCO's Cost of Equity

414 Similar to UNCA, in the Board's view, there are no special circumstances that would warrant a change to the Board's generic finding respecting the cost of equity for the period 2001 through to the first quarter of 2002. Accordingly, the Board approves a 2001 cost of equity of 9.50% and a cost of equity of 9.00% for the first quarter of 2002 for the AE DISCO deferral account.

415 The Board advises that the Securitization section of this Decision discusses the Board's determination of the carrying cost rate for the second quarter of 2002 and onward.

8 EDI Disco Deferral Account Debt / Equity Rates and Capital Structure

8.1 Background

416 The total size of the EDI's deferral accounts is $70 million. [186] EDI submitted as of March 31, 2001 that its total DISCO assets were $360.8 million. [187]

417 The Board has prepared the following table to determine the significance of EDI's deferral account to its DISCO and integrated operations.

Table 10: Significance of EDI's Deferral Account to Integrated Operations

Business Entity	**GENCO/DISCO Deferrals [188]**	**Functional Rate Base**		**Integrated Utility Rate Base**	
	$ Millions	**$ Millions**	**%**	**$ Millions**	**%**
EGI	(70)	1,241 [189]	6%	1,752	(4%)
ETI	N/A	150 [190]			
EDI	70	361	19%	1,752	4%
EPCOR Integrated	**0**	**1,752**	**0%**	**1,752**	**0%**

418 The Board notes that EDI's DISCO 2000 pool price deferral account is relatively significant in comparison to its DISCO assets (i.e. approximately 19%). However, the Board notes that EDI's DISCO 2000 pool price deferral account is relatively insignificant in comparison to its integrated utility assets (i.e. approximately 4%).

419 Further, the Board notes that the EGI GENCO deferral account balance is approximately equal to the EDI deferral account balance, resulting in essentially a nil net balance for the total EPCOR integrated entity up to the time that EGI GENCO pays out the surplus GENCO deferral account. After that time, EPCOR, as an integrated entity, will have an outstanding net deficit balance related to the DISCO deferral account balance.

420 The Board notes that EDI has used a combination of debt and equity to finance its deferral accounts. EDI confirmed that, on an emergency basis, it borrowed money from EPCOR Utilities Inc. (EUI) to finance the deferral account balances. [191] EUI obtains the debt for EPCOR and then mirrors it down to the subsidiaries. EDI submitted that its short-term debts costs

are generally in the range of 5-6%.[192] EDI also confirmed that, under normal circumstances, all of its debt issues are long-term debt.[193]

421 The Board observes that on April 1, 2001, EDI issued $50 million in common equity to EUI. EDI characterized the purpose of the equity issue as follows:

> Well, it provides equity to support all of the operations of EDI including the deferral account operations.[194]

422 EDI acknowledged that part of the equity issue helped to support its 2000 deferral accounts balance, but part of the issue was also required to finance EDI's wires operations.[195] EDI submitted that it doesn't have specific plans for the redemption of its April 2001 equity issue. While EDI will not retain unneeded equity, it will recognize the potential need for additional equity to finance its growing distribution business in its decision to redeem all or any part of its recent equity issue.[196] EDI summarized its views about the issue as follows:

> ... [O]ur redemption of equity would depend on the business situation in which we found ourselves, and a component of that business situation would be the ongoing need to finance capital investments as the deferral account balances dropped.[197]

423 The Board notes that in his assessment of the business risk of EDI's deferral account, Dr. Evans concluded that the deferral account operations are exposed to lesser business risks than those of UNCA's distribution access business.[198] As a result, Dr. Evans recommended that EDI's carrying costs should have a capital structure containing 35-40% equity, which is lower than the 40-45% common equity recommended for UNCA's distribution access business. Thus, Dr. Evans recommended a 37.5% common equity ratio for EDI's deferral account operations, or 2.5% less than the 40% equity ratio Dr. Evans recommended for UNCA.[199]

424 With regard to the 2001 carrying costs for the deferral accounts, EDI has applied for a 2001 after-tax 8.47% WACC that is based on the direct evidence of Dr. Evans. The 8.47% WACC is based on a capital structure of 62.5% debt and 37.5% common equity that is applicable to deferral account financing, a 6.65% forecast cost of debt and an 11.5% common equity rate of return.[200]

8.2 Views of the Board — EDI's Capital Structure

425 The Board considers that the deferral accounts of each DISCO may have unique characteristics that would warrant a deviation from the Board's generic finding that a capital structure consisting of 85% debt and 15% equity is prudent for deferral account operations.

426 While EDI initially secured some emergency debt financing, EDI stated that it ultimately was required to issue some equity in order to achieve a more appropriate mix of capital. The Board also notes that EDI's view that it may redeem part or all of its new equity issue related to the deferral accounts. In addition, the Board observes that EDI has indicated that it will request approval from its regulator for a three-year recovery period for the deferral accounts during the period of 2002-2004.[201]

427 For carrying costs purposes, the Board observes that EDI's deferral accounts are relatively insignificant in relation to its total, integrated assets. Thus, based on the benefits of size and diversification for the integrated utility, the Board's considers that it has assessed EDI's concerns about financial risk in the Board's consideration on an integrated basis.

428 The Board notes that in its argument, EDI has discussed the option of including a preferred equity component in the capital structure of its 2000 pool price deferral accounts. The Board also observes that EDI concluded that preferred shares do not represent an economic alternative in the derivation of carrying costs. For the purposes of determining the appropriate capital structure for the deferral accounts, the Board does not consider that preferred equity financing is a relevant component of the deferral account capital structure. Based on the evidence regarding carrying costs and actual financings related to the

deferral accounts, the Board has concluded that the appropriate capital structure is a combination of short to medium term debt and common equity.

429 Consistent with its generic findings, the Board considers EDI's deferral account to have very low capital recovery, sales forecast, financing cost and O&M risks. Accordingly, EDI's 2000 deferral account operation is exposed to very low business risk in comparison to the business risk for any of the three business functions of EDI's integrated operations.

430 For these reasons, based on a consideration of EDI's business and financial risks, the Board has determined that it would be appropriate and prudent to use the generic deemed capital structure of 85% debt and 15% equity for the EDI DISCO deferral account for the year 2001.

431 Accordingly, the Board approves a deemed capital structure of 85% debt and 15% equity for the EDI deferral account for the year 2001. This structure is inherent to the Board's approved carrying cost rate used in Decision 2001-89 [*2000 Pool Price Deferral Accounts Proceeding, Re* (December 4, 2001), Doc. 2001-89 (Alta. E.U.B.)], issued December 4, 2001.

8.3 Views of the Board — EDI's Cost of Debt

432 The Board notes that EDI is a municipal utility. Therefore, the Board's previous generic finding of a 6.65% cost of debt for municipal utilities would be appropriate and prudent for the EDI deferral account. Accordingly, the Board approves a 6.65% cost of debt for the year 2001 for EDI's deferral account. This rate is inherent in the rate approved in Decision 2001-89, issued December 4, 2001.

433 Since the Board is not EDI's "regulatory authority" for purposes of the *Deferral Accounts Regulation*, the Board need not determine EDI's cost of debt for 2002 and onwards. That is a matter for EDI's regulatory authority, Edmonton City Council.

8.4 Views of the Board — EDI's Cost of Equity

434 In the Board's view, there are no special circumstances that would warrant a change to the Board's generic finding respecting the 2001 cost of equity. Accordingly, the Board approves a 2001 cost of equity of 9.50% for the EDI deferral account. This rate is inherent in the rate approved in Decision 2001-89, issued December 4, 2001.

435 As with EDI's cost of debt for 2002 and beyond, EDI's cost of equity for 2002 and beyond is a matter for EDI's regulator, Edmonton City Council.

9 ENMAX Disco Deferral Account Debt / Equity Rates and Capital Structure

9.1 Views of the Board — ENMAX Carrying Cost Rates and Capital Structure

436 The Board notes that other DISCOs requested a higher 2001 carrying cost rate than ENMAX applied for in its Application. During the hearing, the Board explored this difference with ENMAX. ENMAX explained that, while it was comfortable with the carrying cost rate requested in its Application, it acknowledged the jurisdiction and discretion of the Board to determine an appropriate carrying cost rate that would differ from that applied for by ENMAX. ENMAX did not discourage the Board from exercising its discretion. [202]

437 The Board agrees with ENMAX that, notwithstanding its Application, the Board has discretion to approve a different carrying cost rate. [203] Since the Board has determined the 2001 carrying cost rate for all other DISCOs on the basis of WACC, the Board considers that it would be just and proper to allow ENMAX a 2001 carrying cost rate based on a WACC.

438 As approved in Decision 2001-88 , the Board considers that given the relative magnitude of the Board approved ENMAX deferral account compared to the Board approved EDI deferral account, it would be fair and appropriate for the Board to approve the same 2001 carrying cost rate for ENMAX's deferral account as approved by the Board for EDI's deferral account. Since the Board considers that ENMAX's deferral account should use the same WACC parameters as the Board approved for EDI's deferral account, the Board, in Decision 2001-88 directed ENMAX to recalculate and resubmit to the Balancing Pool

a revised 2001 carrying costs claim using the following approved parameters. The Board directs ENMAX to use a deemed capital structure of 85% debt and 15% equity, a 6.65% cost of debt for the year 2001 and a 9.50% cost of equity for its deferral account for the year 2001. This structure and these rates are inherent to the Board's approved carrying cost rate used in Decision 2001-88, issued December 4, 2001.

439 As with EDI, ENMAX's carrying cost rate for 2002 and beyond is a matter for its regulatory authority, Calgary City Council.

10 Red Deer Disco Deferral Account Debt / Equity Rates and Capital Structure

10.1 Background

440 The Board does not have any evidence to determine the relative size of Red Deer's pool price deferral account in relation to Red Deer's electric utility rate base. The total size of the Red Deer's pool price deferral account is $4.4 million. [204]

441 Red Deer has applied for 2001 carrying costs based on a WACC consisting of a short-term debt rate and an equity rate of return.

442 Red Deer and Lethbridge (the Cities) presented joint argument and reply argument in which they commented as follows on the manner in which they financed their respective 2000 deferral accounts:

> In addition to these observations, the Cities note that, in fact, their deferral accounts were financed entirely by equity by drawing on the Cities' reserves. [205]
>
> With respect to Red Deer it is clear that the funding came from an electric utility reserve account (Transcript 2570-2571).
>
> In effect the Cities used the equivalent of retained earnings to finance the deferral accounts. That in the Cities' submission is equity. The Cities note however, that in their applications they are not seeking financing costs on the basis of 100% equity, although that is how the accounts were actually financed. [206]

443 The Board further notes the Cities' comments regarding restrictions on municipal financing and borrowing:

> While the Cities are not seeking a recovery based on 100% equity, as that would result in inequities between customers in Alberta, they do note that restrictions on municipalities financing and budgeting activities contained in the *Municipal Government Act* create some barriers with respect to actual financing activities by the municipality which affect the Cities' DISCOs as they are departments of the Cities and not stand-alone corporations. The provisions governing financial administration are set out in Part 8 of the Act and include the following:
>
> > • Operating budgets must be established annually of revenues and expenditures and revenues must be sufficient to pay the estimated expenditures (s. 243)
> >
> > • Deficiencies must be rectified after three years (s. 244)
> >
> > • A separate capital budget must be prepared
> >
> > • Borrowing is subject to restrictions and debt limits(s. 251, 252)
> >
> > • Generally borrowing is for capital purposes
>
> While none of these provisions would specifically in and of themselves prohibit the borrowing contemplated for financing the deferral accounts, any such borrowing for operating expenditures reduces the municipality's' flexibility and therefore creates similar impediments to those referred to by the investor owned utilities with respect to covenants in their debt

> instruments. Consequently, the "self sustaining utilities" would normally cover shorter-term non capital expenditures through reserves rather than borrowing. That is what was done in this case by the Cities. [207]

444 Key to the Board is that, while Red Deer acknowledged that its 2000 deferral accounts were financed entirely by equity by drawing down its reserves, the DISCO still submitted that a WACC approach would be prudent to calculate the financing costs to be recovered from the Balancing Pool in 2001 pursuant to section 4(2) of the *Deferral Accounts Regulation*. [208]

445 For the purpose of determining the WACC for Red Deer's deferral accounts, Red Deer submitted the following with respect to a 2001 cost of debt:

> Finally, Red Deer proposes that its cost of debt should be constructed using the current one-year commercial lending rate available to the City. A one-year term is chosen to be consistent with Section 4(1) of the Regulation, which outlines that the Board is to approve "an amount that is payable in 2001 ... in respect of the cost of financing the amounts in the owner's deferral accounts in 2001". Added to this rate is a 25 basis point premium to approximate the benefit to consumers of Red Deer's ability to access lower borrowing rates on behalf of its utilities. Calculated on this basis, the current one-year lending rate available to Red Deer Electric Light and Power is 7.00%. [209]

446 For its 2001 carrying costs, Red Deer has applied for a 2001 after-tax WACC of 8.44%. The 8.44% WACC is based on a capital structure of 52.5% debt and 47.5% common equity that is applicable to deferral account financing, a 7.00% forecast cost of debt and a 9.75% common equity rate of return. [210] The Board notes, however, that Red Deer has not presented any evidence regarding the business risk of its deferral accounts in support of its recommended capital structure. In addition, Red Deer has not provided any evidence regarding its proposed deferral account recovery period.

10.2 Views of the Board — Red Deer's Capital Structure

447 The Board acknowledges Red Deer's submission that its prudent financing costs are a blend of debt and equity so that the WACC approach is appropriate to calculate Red Deer's 2001 financing costs under the *Deferral Accounts Regulation*. However, as the Board has already noted, Red Deer has not provided any evidence of the business and financial risk associated with its deferral account operations, including the impact of the deferral account balances on its DISCO operations or its "integrated" (i.e. DISCO and TRANSCO) operations.

448 In addition, the Board notes that the potential recovery period of Lethbridge's deferral account balance is considerably shorter than the recovery period of its distribution wires assets. Thus, the capital recovery risks associated with the deferral account operations are significantly less than those associated with the distribution wires business. Nevertheless, based on its analysis of other integrated electric utility operations, the Board is not persuaded that financing Red Deer's deferral account with 15% equity would cause material financial harm to the City of Red Deer as a whole.

449 Consistent with its generic findings and with its findings in relation to the other DISCOs, the Board considers that Red Deer's deferral account has very low capital recovery, sales forecast, financing cost and O&M risks. Accordingly, Red Deer's 2000 deferral account operation is exposed to very low business risk in comparison to the business risk for any of the business functions of "integrated" operations.

450 For these reasons, the Board has determined that it would be appropriate and prudent to use the generic deemed capital structure of 85% debt and 15% equity for the Red Deer DISCO deferral account for the year 2001.

451 Accordingly, the Board approves a deemed capital structure of 85% debt and 15% equity for the Red Deer DISCO deferral account for the year 2001. This structure is inherent to the Board's approved carrying cost rate used in Decision 2001-90 [*2000 Pool Price Deferral Accounts Proceeding, Re* (December 4, 2001), Doc. 2001-90 (Alta. E.U.B.)], issued December 4, 2001.

10.3 Views of the Board — Red Deer's Cost of Debt

452 The Board considers that Red Deer's deemed cost of debt should be similar to EDI's deemed cost of debt, given that they are both municipal utilities.

453 Accordingly, the Board considers that its previous generic finding of a 6.65% cost of debt for EDI's deferral account would also be appropriate and prudent for Red Deer's deferral account. Therefore, the Board approves a 6.65% cost of debt for the year 2001 for the Red Deer deferral account. This rate is inherent in the rate approved in Decision 2001-90, issued December 4, 2001.

454 As with the other municipal DISCOs, Red Deer's cost of debt for 2002 and beyond is a matter for its regulatory authority, Red Deer City Council.

10.4 Views of the Board — Red Deer's Cost of Equity

455 In the Board's view, there are no special circumstances that would warrant a change to the Board's generic finding respecting the 2001 cost of equity. Accordingly, the Board approves a 2001 cost of equity of 9.50% for Red Deer's deferral account. This rate is inherent in the rate approved in Decision 2001-90, issued December 4, 2001.

456 As with the other municipal DISCOs, Red Deer's cost of equity for 2002 and beyond is a matter for its regulatory authority, Red Deer City Council.

11 Lethbridge Disco Deferral Account Debt / Equity Rates and Capital Structure

11.1 Background

457 The Board does not have any evidence to determine the relative size of Lethbridge's 2000 pool price deferral account in relation to Lethbridge's rate base. The total size of the Lethbridge's deferral account or reconciliation account is $4.4 million. [211]

458 Lethbridge has applied for 2001 carrying costs based on a WACC consisting of a short-term debt rate and an equity rate of return.

459 Red Deer and Lethbridge (the Cities) presented joint argument and reply argument in which they commented as follows on the manner in which they financed their respective 2000 deferral accounts:

> In addition to these observations, the Cities note that, in fact, their deferral accounts were financed entirely by equity by drawing on the Cities' reserves. [212]
>
> While Lethbridge's witnesses may have used the term "borrowing" in a nontechnical sense to describe the internal movement of funds from the general municipal operations to the distribution utility operation, it is clear from a reading of the whole of the evidence that the City of Lethbridge financed the utility's shortfall with respect to power purchase costs through equity, namely, the City's reserve accounts (Transcript, 2432-2437)...
>
> In effect the Cities used the equivalent of retained earnings to finance the deferral accounts. That in the Cities' submission is equity. The Cities note however, that in their applications they are not seeking financing costs on the basis of 100% equity, although that is how the accounts were actually financed. [213]
>
> Lethbridge noted the same restrictions on municipalities financing and borrowing as did Red Deer and as noted by the Board earlier. [214]

460 Key to the Board is that, while Lethbridge acknowledged that its 2000 deferral accounts were financed entirely by equity by drawing down its reserves, the DISCO still submitted that a WACC approach would be prudent to calculate the financing costs to be recovered from the Balancing Pool in 2001 pursuant to section 4(2) of the *Deferral Accounts Regulation*. [215]

461 For its 2001 carrying costs, Lethbridge, like Red Deer, has applied for a 2001 after-tax WACC of 8.44%. The 8.44% WACC is based on a capital structure of 47.5% debt and 52.5% common equity that is applicable to deferral account financing, a 7.00% forecast cost of debt and a 9.75% common equity rate of return.[216] The Board notes, however, that Lethbridge has not presented any evidence regarding the business risk of its deferral accounts in support of its recommended capital structure. In addition, Lethbridge has not provided any evidence regarding its proposed deferral account recovery period.

11.2 Views of the Board — Lethbridge's Capital Structure

462 The Board acknowledges Lethbridge's submission that its prudent financing costs are a blend of debt and equity so that the WACC approach is appropriate to calculate Lethbridge's 2001 financing costs. However, as the Board has already noted, Lethbridge has not provided any evidence of the business and financial risk associated with its deferral account operations, including the impact of the deferral account balances on its DISCO operations or its "integrated" (i.e. DISCO and TRANSCO) operations. In addition, the Board notes that the potential recovery period of Lethbridge's deferral account balance is considerably shorter than the recovery period of its distribution wires assets. Thus, the capital recovery risks associated with the deferral account operations are significantly less than those associated with the distribution wires business.

463 Accordingly, based on its analysis of other integrated electric utility operations, the Board is not persuaded that financing Lethbridge's deferral account with 15% equity would cause material financial harm to the City of Lethbridge as a whole.

464 Consistent with its generic findings and with its findings in relation to other DISCOs, the Board considers Lethbridge's deferral account to have very low capital recovery, sales forecast, financing cost and O&M risks. Accordingly, Lethbridge's 2000 deferral account operation is exposed to very low business risk in comparison to the business risk for any of the business functions of "integrated" operations.

465 For these reasons, the Board has determined that it would be appropriate and prudent to use the generic deemed capital structure of 85% debt and 15% equity for the Lethbridge DISCO deferral account for the year 2001.

466 Accordingly, the Board approves a deemed capital structure of 85% debt and 15% equity for the Lethbridge DISCO deferral account for the year 2001. This rate is inherent in the rate approved in Decision 2001-91, issued December 4, 2001.

11.3 Views of the Board — Lethbridge's Cost of Debt

467 With respect to the 2001 cost of debt, for the purpose of determining the WACC for its deferral accounts, Lethbridge submitted the following:

> Lethbridge proposes a cost of debt based on its best commercially available lending rate for the one-year term established under Section 4(1) of the Regulation, plus a premium of 25 basis points. A premium is in accordance with Lethbridge City Council financial policy[217] and addresses the customer benefits from the utility's access to this comparatively lower borrowing rate available through the municipality. Based on this the current City of Lethbridge electric utility debt rate is 7.00%.[218]

468 However, the Board is not persuaded that Lethbridge's deferral account cost of debt should be different than that approved for EDI and Red Deer, given that they are all municipal utilities.

469 Accordingly, the Board considers that its previous generic finding of a 6.65% cost of debt for municipal utilities would also be appropriate and prudent for Lethbridge's deferral account. Therefore, the Board approves a 6.65% cost of debt for the year 2001 for the Lethbridge deferral account. This rate is inherent in the rate approved in Decision 2001-91, issued December 4, 2001.

470 As with the other municipal DISCOs, Lethbridge's cost of debt for 2002 and beyond is a matter for its regulatory authority, Lethbridge City Council.

11.4 Views of the Board — Lethbridge's Cost of Equity

471 In the Board's view, there are no special circumstances that would warrant a change to the Board's generic finding respecting the 2001 cost of equity. Accordingly, the Board approves a 2001 cost of equity of 9.50% for Lethbridge's deferral account. This rate is inherent in the rate approved in Decision 2001-91, issued December 4, 2001.

472 As with the other municipal DISCOs, Lethbridge's cost of equity for 2002 and beyond is a matter for its regulatory authority, Lethbridge City Council.

12 Views of the Parties - 2001 Genco Carrying Cost Rate for the Deferral Accounts

12.1 Introduction

473 Unlike the DISCOs, whose 2001 carrying costs are addressed in the *Deferral Accounts Regulation*, none of the GENCOs have been collecting or paying interim 2001 carrying costs on accumulated 2000 GENCO deferral account balances. Indeed, neither the GENCO deferral account balances nor their carrying costs are subject to the *Deferral Accounts Regulation*, which, by its terms, only applies to certain DISCO deferral accounts as defined in the *Regulation*.

474 Nevertheless, the Board considers it just and reasonable that the GENCOs be allowed carrying costs for the year 2001. The Board considers that these 2001 carrying costs should be added to the final GENCO balances determined by the Board. The Board notes that no carrying cost rate is required for years beyond 2001 since the GENCO final settlement will occur in early 2002. Accordingly, the Board will determine an appropriate 2001 carrying cost rate for TransAlta GENCO, AE GENCO and EGI.

12.2 Views of TransAlta GENCO

475 The TransAlta application of March 30, 2001 indicated that TransAlta was not proposing to make any interest payment to customers related to its filed 2000-deferral account surplus of $16.7 million. In this respect, TransAlta considered its application to be consistent with the provisions of the Board's Interest Policy since the net amount to be returned to customers was expected to be below the 3% threshold, in large part due to the interim payment made in September 2000, [219] and since the time lag was expected to be less than the threshold of one year. [220]

476 TransAlta noted that the carrying costs for the DISCOs are to be determined pursuant to specific regulations, applicable only to the DISCO amounts, but which could have been made applicable to the GENCO amounts had public policy so required.

477 Further, as noted in TransAlta's rebuttal evidence:

> Mr. Marcus opines that the utilities should not finance their deferral accounts balances with permanent capital (equity and long term debt), but suggests instead that such accounts should be financed by variable-rate short term debt (page 2). In so doing, he lumps together all the GENCO and disco deferral accounts being considered in this hearing. In TransAlta's view, such an approach is unreasonable.
>
> TransAlta's GENCO deferral amount is a refund of $16.7 million, and TransAlta has applied to refund such amount by means of a one-time payment to be made in July 2001. TransAlta also made an interim refund of year 2000 GENCO deferral amounts during 2000 itself, in the amount of $49 million in September, 2000.
>
> In TransAlta's understanding of the normal application of the Board's interest policy, the remaining amount to be refunded would not be subject to interest payments, and TransAlta has proposed such treatment. Regulations under the EUA have now prescribed alternative parameters for the Board to consider in respect of year 2000 disco deferral accounts, but the regulation does not extend to GENCO deferral accounts. The policy distinction inherent in the regulations is a rational one, in that the disco deferral accounts are both (i) relatively much larger in comparison to those of the GENCO and (ii) have

collection mandatorily deferred to the 2002-04 period, as contrasted to the prompt disposition of the GENCO accounts proposed. Mr. Marcus chooses to overlook such significant differences, and he should not do so.

In the case of TransAlta GENCO, in the event that the Board concludes that it will depart from its usual interest policy, then the proper treatment should still reflect the fact that most of the deferral amount was repaid during 2000 itself, and that the remaining balance is an amount to be outstanding for only a short period. In such a case, Mr. Marcus' recommendation of application of variable short-term interest would be appropriate. [221]

478 As set out in BR.TAU-9, the interim payment of $49.0 million made by TransAlta in September 2000 reduced the December 31, 2000 balance in TransAlta's GENCO pool price deferral account to $16.7 million. TransAlta paid this balance in August 2001 in accordance with Board Decision 2001-70 [*GENCO, Re* (August 8, 2001), Doc. 2001-70 (Alta. E.U.B.)]. Consequently, neither the amount nor the duration of amounts in the deferral account meets the conditions required for the payment of interest in the Board's Interest Policy. Therefore, TransAlta submitted that carrying costs should not be applied to the balance in its 2000 GENCO pool price deferral account.

479 TransAlta submitted that it has been consistent in terms of its approach to interest. TransAlta did not seek, nor did it receive, interest on the $8.9 million it was owed in respect of the 1999 GENCO pool price deferral accounts and Section 78 costs. [222] TransAlta also noted that it is not seeking interest in respect of the $18.8 million filed by TransAlta in respect of its U99099 Outstanding Matters Application.

480 TransAlta noted the statement by Mr. Way that the application of carrying costs should be considered on a case-by-case basis, and it would only be appropriate for the Board to vary from its Interest Policy when individual extenuating circumstances warrant. [223]

12.3 Views of AE GENCO

481 AE submitted that its 1999/2000 Settlement, in combination with its 2001/2002 TFO Settlement, established the basis upon which carrying costs should be paid on both the DISCO and GENCO 2000 deferral account balances.

482 Earlier in this Decision, in relation to AE's DISCO deferral account carrying costs, the Board outlined AE's general views on the applicability of its Settlements to the determination of deferral account carrying costs. The Board does not consider it necessary to repeat AE's views again here.

483 Anticipating that UNCA would attain a negotiated settlement of its 2001 Distribution revenue requirement (as contemplated by Clause 32 of AE's 2001/2002 DT Settlement, but which was not certain at the time of AE's Application), AE submitted that it would attempt to negotiate a rate for 2001 and 2002. If the negotiation failed, AE requested that the Board approve the rate for 2001 of 11.94% as outlined in Schedule 5.2 of the AE GENCO Application. However, during the course of the proceeding, AE submitted evidence related to the calculation of WACC for purposes of determining the 2001 carrying costs.

484 Based on this evidence, AE submitted that it was is important to clarify exactly what AE was seeking with respect to carrying charges on the outstanding balances in its GENCO and DISCO deferral accounts. In its original application, [224] AE sought to use, as AE viewed it, a "practical" approach to determining the appropriate carrying cost rate to be applied to these deferred accounts, which entailed using a common equity component and ROE previously approved by the Board for TransAlta in the 1999/2000 GTA.

485 However, based on various Information Requests from the Board, AE stated that it became clear that the Board was reluctant to adopt this approach. Therefore, AE recommended that the evidence filed on behalf of AE by Ms. McShane in the 2001/2002 General Rate Application for the DISCO operations be used to determine the missing components of the WACC for AE pursuant to clause 29 of the 2001/2002 TFO Negotiated Settlement. [225] AE submitted that Ms. McShane's evidence recommended a common equity component of 45% and an ROE of 11.0-11.25% for AE DISCO.

486 AE further noted that in response to the specific request from the Board to provide additional evidence, in this matter, Ms. McShane filed a further additional report on the derivation of a WACC that could be used for AE if its Negotiated Settlement Agreement were to be totally ignored by the Board. Ms. McShane proposed that, if settlement were to be overturned, a reasonable WACC for the DISCO deferral accounts would comprise 45% common equity and 55% short-term debt. The ROE to be applied to the common equity component should be the same as would be applicable to the DISCO operations, as updated to 11.5%.

487 In summary, AE submitted that it continued to seek carrying costs as per its original application, as modified to reflect the evidence of Ms. McShane from the 2001/2002 GTAs (i.e., not on the basis of the information which ignores the existence of the Negotiated Settlement Agreement).

12.4 Views of EGI

488 EGI noted that in Decision U99099, [226] the Board indicated it would consider the matter of interest on over-collections or under-collections at the time of the re-filings when the magnitudes of adjustments were known. The Board further indicated any determinations would be made in accordance with its guidelines on interest. The Board published the final version of this guideline as Informational Letter IL 2000-1 "General Policy for Payment of Interest" on February 16, 2000, subsequent to the release of Decision U99099 and Decision 2000-5.

489 EGI submitted that it had included interest on its 2000 pool price deferral accounts balances, having regard to the magnitude of the refund to customers. Using an assumed payment date for the refund of July 31, 2001 and interest rates as per the Board's Interest Policy equal to the Bank of Canada bank rate plus 1.5%, interest payable on EGI's deferral accounts surplus would total $4.351 million.

490 In contrast to EGI's filing, EDI requested carrying costs on its outstanding 2000 Deferral Account balance using an after-tax WACC of 8.47%, with interest calculations commencing January 1, 2000.

491 EGI noted in its Application [227] and again in response to BR-EGI-06, [228] the Board's indication in Decision U99099 that if interest were to apply it would be calculated in accordance with the Board's Interest Policy. In accordance with that Policy, EGI considered the magnitude of its deferral account refund relative to EGI's Aggregate Reservation Price for 2000 of $285 million and the materiality threshold contained in the Board's Interest Policy. [229]

492 EGI noted that no party submitted specific evidence or suggested during cross-examination that EGI's use of the Bank of Canada Rate plus 1.5% was inappropriate. EGI stated that no party took issue with the interest calculation method used to prepare Schedule 3 of EGI's Application.

493 EGI noted ACC's GENCO carrying cost argument:

> The ACC is of the position that the GENCO carrying costs, that is, the annual rate should be identical to that of the DISCO. The ACC will address the appropriate cost in its Argument on the DISCO deferral issues. [230]

494 EGI further noted that ACC's carrying cost witness, Dr. Rosenberg, gave evidence only in respect of the DISCO carrying costs of AE and UNCA. Therefore, ACC's GENCO and DISCO carrying cost arguments applied only in respect of AE and UNCA and not in respect of EGI.

495 In its DISCO Argument, ACC stated:

> If debt is utilized, the cost of debt should be limited to not more than 150 basis points above the DISCO commercial paper rate. [231]

496 Thus, EGI concluded that ACC either had taken no position in respect of EGI's applied-for carrying cost rate, or alternatively had taken the position that the carrying cost rate should be limited to not more than 150 basis points above the DISCO commercial paper rate.

497 EGI noted that FIRM addressed the question of GENCO carrying costs and concluded that:

• The Board's Interest Policy was not appropriate for the purpose of computing GENCO carrying charges. [232]

• The *Deferral Accounts Regulation* does not apply to the GENCOs. [233]

• The GENCO carrying cost rate should reflect the "actual cost of financing" or "prudent cost of financing" as described in the evidence of the IFE. [234]

498 EGI noted that the only party that took exception to the proposal to use the Board's Interest Policy was FIRM. As noted above, ACC appeared to take no position in respect of EGI's carrying cost rate. Alternatively, ACC might be taking the position that the EGI carrying cost rate should be no more than "...150 basis points above the DISCO commercial paper rate", a rate that is *less* than the applied-for Bank of Canada Rate plus 1.5%. [235] EGI noted that there was no basis in the evidence to support ACC's proffered cost rate. In fact, EGI noted that ACC's carrying cost witness, Dr. Rosenberg, took the position that the appropriate DISCO carrying cost rate for UNCA was the Bank of Canada Rate plus 1.5%, which was the cost rate submitted by EGI. [236]

499 EGI submitted that FIRM's basis for dismissing IL-2000-1 was unclear. EGI noted the following statement by FIRM:

> However, using an uniform rate will not necessarily be reflective of a particular utility's actual cost of financing. In addition, this cost does not result from "regulatory lag" (as it is normally understood to mean) but, rather, the uncertainty of generation costs, which are now market driven. It is therefore submitted that in this instance, the Board's guidelines are not appropriate. [237]

500 EGI provided several comments in response to FIRM's argument. First, EGI agreed that a "uniform rate will not necessarily be reflective of a particular utility's actual cost of financing" however FIRM did not provide any basis for concluding that this fact should lead the Board to reject the IL-2000-1 approach.

501 Second, EGI stated that it was not "financing" a deferral account balance. Instead, EGI is in a refund position. Thus, the "actual cost of financing" is irrelevant. EGI did, however, agree that the only practical investment option for EGI's short-term deferral account fund was an investment of surplus cash in short-term investments or a reduction of short-term debt. [238]

502 Third, even if the Board were to depart from IL-2000-1 and embrace the "actual cost of financing" standard proposed by FIRM, EGI submitted that there was no evidence on the record respecting the "actual cost of financing" to EGI or the "actual return on short-term investments". Thus, the Board could not reasonably implement FIRM's "proposal" even if it wanted to do so.

503 Fourth, EGI noted that the relationships among "regulatory lag", "uncertainty of generation costs", and the cost rate indicated by IL-2000-1 and cost rates arising from "actual costs of financing" were unclear and were not explained by FIRM.

504 EGI noted that ACC was the only party to endorse the position that the GENCO and DISCO cost rates should be the same. [239] However, EGI submitted that that no basis in either the evidence or in logic was provided by ACC for its position.

505 In sharp contrast, EGI noted FIRM's statement:

> Given the significant difference in amounts to be financed, the differing cost of financing and the intrusion of the regulation regarding DISCO deferral accounts, there would appear to be no justification for the GENCO rate and the DISCO rate, where applicable, to be equivalent. [240]

506 In the specific context of EGI and EDI, EGI provided the following statement:

> EGI's deferral account is in a surplus position, which will be refunded to customers in the third quarter of 2001. EGI's actual financial circumstances are that it can only invest the deferral account surplus in short-term obligations, and then return the deferral account surplus to customers with the accumulated short-term interest. While the amount of the deferral account surplus by itself is significant, it is relatively modest compared to the size of EGI's operations as measured by rate base. In contrast, EDI's deferral account is in a deficit position. EGI understands a combination of debt and equity financing is required to finance this deficit, due to the longer period of recovery and the relative magnitude of the deficit relative to the size of EDI's operations.[241]

507 EGI concluded that ACC did not address any of the significant differences that exist between GENCO and DISCO deferral accounts and circumstances generally, much less the specific differences that arose in the context of EGI and EDI. As a result, EGI submitted that the Board should reject ACC's position respecting the equivalency of the GENCO and DISCO carrying cost rates.

508 EGI submitted that the evidence clearly demonstrated that EGI's applied-for Bank of Canada plus 1.5% carrying cost refund rate as detailed in Schedule 3 to EGI's Application was consistent with the Board's guidelines for interest, was reasonable and appropriate in the circumstances and should be approved by the Board.

12.5 Views of FIRM

509 FIRM noted that each of the generating utilities had taken a different approach to determination of its carrying costs. For example:

- TransAlta GENCO[242] — based on the 3% threshold mentioned in the Board's Informational Letter IL2000-1, TransAlta GENCO was not proposing to pay interest on the amount of its over-recovery.

- AE GENCO[243] — based on an interpretation of clause 29 of its 2001-2002 Transmission Facility Owner Negotiated Settlement, AE GENCO proposed to use a weighted average cost of capital rate.

- EGI GENCO[244] — based on the Board's Informational Letter IL2000-1, EGI GENCO proposed to use the Bank of Canada rate plus 1.5%.

510 FIRM submitted that the deferral accounts in question were established pursuant to the provision of Board Decision U99099. In that decision, the Board stated that it "... expects that any determinations that it makes on interest will be in keeping with the Board's Guidelines on Interest."[245] For the special circumstances noted in the guidelines, the Board has suggested use of a rate equal to the Bank of Canada's Bank Rate plus 1.5% as compensation "for the time value of money over the period to which the adjustment applies."

511 Whatever rate is determined to be appropriate, FIRM believed that, for the deferral accounts which are the subject to this proceeding, the interest rate or method of calculating carrying costs should be the same for both under-recovered and over-recovered amounts.

512 However, FIRM noted that using an uniform rate will not necessarily be reflective of a particular utility's actual cost of financing. In addition, this cost does not result from "regulatory lag" (as it is normally understood to mean) but, rather, the uncertainty of generation costs, which are in present circumstances market driven. It was therefore submitted that in this instance, the Board's guidelines are not appropriate.

513 FIRM submitted that the size of the deferral accounts create an obligation, on the part of the Board, to determine actual financing costs to ensure that the approved carrying costs do not result in an unjustified benefit (or burden) to the utilities'

shareholders. Further, carrying costs should not be calculated based on an arbitrary rate applicable to all utilities or that does not fairly compensate for the actual cost of financing.

514 FIRM noted that although not applicable to the GENCO Deferral Accounts, the policy of the government regarding carrying cost is reflected in the *Deferral Accounts Regulation* — that is, compensation should be limited to the prudent "cost of financing". In this regard, the FIRM customers supported the evidence of the IFE.

515 FIRM noted that there is virtually no consistency between utilities as to the method of calculating carrying costs/interest on their respective deferral accounts. The following table summarized the positions advanced:

Table 11: Method of Calculating 2001 Carrying Costs/Interest (per FIRM)

		Over/Under Recovery	GENCO Accounts	DISCO Accounts
1.	AE	Under	WACC{1}	WACC{2}
2.	EGI	Over	Bank of Canada plus 1.5%{3}	NA
3.	EDI	Under	NA	WACC{4}
4.	TAU	Over	Nil{5}	NA
5.	UNCA	Under	NA	WACC{6}
6.	Lethbridge	Under	NA	Deemed Structure and ROE{7}
7.	Red Deer	Under	NA	Deemed Structure and ROE{7}

Notes: 1. Based on formula in Clause 29 of 2001-2002 TFO Settlement.2. Based on formula in Clause 29 of 2001-2002 TFO Settlement.3. Based on IL 2000-1.4. Based on notional capitalization and ROE.5. Based on IL2000-1.6. Based on actual capitalization and ROE.7. Based on notional debt/equity and ROE.

516 FIRM considered it interesting to note that EGI GENCO proposed to pay interest on its over-recovery at the Bank of Canada rate plus 1.5% (approximately 7.0%), whereas its sister company, EDI DISCO, expected to receive carrying costs on its under-recovery based on a notional calculation of its weighted average cost of capital, being approximately 8.47%. By comparison, TAU GENCO did not propose to pay any interest on its over-recovery.

517 FIRM submitted that the Board has the alternative of applying its guidelines to those deferral accounts, which are not the subject of the *Deferral Accounts Regulation*, or to look to each utility's actual cost of financing. Given the disparity in amounts and the ability of each utility to finance, it was submitted that the more accurate method is to provide compensation based on the actual cost of financing.

518 FIRM noted that, in their opening statement, that the IFE addressed the question of whether the deferral accounts are a new business of the DISCOs. They concluded that this is not the case and that the deferral accounts "... have materially less risk than the operating assets of the DISCOs." [246] They also stated "... the uncertainty of collection is apparently minimal." [247] The IFE concluded by stating:

> We continue to believe that the deferral account balances in most cases can be, as they have been, appropriately and competitively financed with short-term debt at rates more competitive than the application of WACC. [248]

519 FIRM concluded that, based on all of the evidence provided, in the absence of an agreement to the contrary or the existence of unusual financing situations, the carrying costs/interest should be based on the individual utility's short term borrowing rate. They noted that this would avoid the excess compensation, which would result by introducing a notional equity component, in the range of 40%, to the cost of financing.

520 FIRM noted that the major reason for including an equity and long-term debt component in carrying costs appeared to relate to a perception by the utilities that the deferral accounts will be long term in nature. This issue had generated considerable debate, particularly with regard to the notional capitalization employed by some of the utilities in their applications, the

uncertainty of the period for which the amounts will be outstanding and even the definition of "long term". However, in the event of securitization, the debate would end and all deferral accounts would be clearly short term.

521 FIRM noted that while TransAlta GENCO's application provided for a refund of $16.7 million, this was more than offset by its previous request for recovery of $18.8 million from the Balancing Pool in the Outstanding Matters proceeding. [249] FIRM further noted that since these amounts essentially offset each other and the net amount to be returned to customers is below the 3% threshold specified in the Board Guidelines, TransAlta GENCO was not proposing to pay anything to customers as compensation for the time value of money.

522 FIRM submitted it accepted TransAlta GENCO's position as well as the following statement provided by TransAlta in its rebuttal evidence:

> In the case of TransAlta GENCO, in the event that the Board concludes that it will depart from its usual interest policy, then the proper treatment should still reflect the fact that most of the deferral amount was repaid during 2000 itself, and that the remaining balance is an amount to be outstanding for only a short period. In such a case, Mr. Marcus' recommendation of application of variable short-term interest would be appropriate. [250]

523 Given the significant difference in amounts to be financed, the differing cost of financing and the intrusion of the regulation regarding DISCO deferral accounts, FIRM submitted that there would appear to be no justification for the GENCO rate and the DISCO rate, where applicable, to be 3, AE may be the one exception since it has been financing both GENCO and DISCO deferral accounts. Nevertheless, as previously stated, the rate approved should be the prudent cost of financing, to use the words of the *Deferral Accounts Regulation*.

12.6 Views of ACC

524 The ACC submitted that the GENCO carrying costs (i.e. the annual rate) should be identical to that of the DISCO and referred to its argument in relation to the DISCO deferral accounts in that respect.

13 GENCO 2001 Capital Structure and Carrying Cost Rate for the Deferral Accounts

13.1 Views of the Board — GENCO Capital Structures and Carrying Cost Rate

525 For the purposes of this Decision, consistent with its approach to the DISCO deferral accounts, the Board will review the GENCO deferral account operations on a stand-alone basis, representing a separate deferral account "business" within the integrated utility.

526 For the purpose of establishing 2001 carrying costs for the GENCO 2000 pool price deferral accounts, the Board has determined that it should be consistent with its determination of 2001 carrying costs for the DISCO deferral accounts. Accordingly, the Board will apply carrying cost rates that are equivalent to the 2001 carrying cost rates determined for the DISCO 2000 pool price deferral accounts. Although the Board acknowledges that the GENCO deferral accounts are not subject to the *Deferral Accounts Regulation*, the GENCO accounts have a purpose similar to that of the DISCO accounts. The Board considers this similarity of purpose to warrant similar carrying cost treatment.

527 The Board notes that, based on evidence presented in the proceeding, TransAlta's credit rating is A, similar to UNCA's credit rating. UNCA DISCO's 2001 carrying costs have already been determined in an earlier section of this Decision. In the circumstances, in order to determine TransAlta GENCO's 2001 carrying cost rate, the Board considers it just and reasonable to apply the 2001 carrying cost rate that it has determined for UNCA DISCO's deferral account, using the same deemed capital structure and the same costs of debt and equity.

528 For these reasons, the Board approves the following WACC parameters for the TransAlta GENCO and AE GENCO deferral accounts for the year 2001, namely a deemed capital structure of 85% debt and 15% equity, a 6.45% cost of debt and a 9.50% cost of equity. For the EGI GENCO deferral account, the Board will allow the same parameters except a 6.65% cost

of debt consistent with its cost of debt award for EDI. The Board directs TransAlta GENCO, AE GENCO, and EGI GENCO, in their refilings, to utilize these carrying cost parameters.

529 For the first quarter of 2002, consistent with the DISCO carrying costs rates, the Board approves a deemed capital structure of 85% debt and 15% equity, a 5.00% cost of debt and a 9.00% cost of equity as the WACC parameters for the TransAlta GENCO and AE GENCO GENCO deferral accounts.

530 The Board approves a deemed capital structure of 85% debt and 15% equity, a 5.20% cost of debt and a 9.00% cost of equity as the WACC parameters for the EGI GENCO deferral account for the first quarter of 2002. The 5.20% cost of debt for the first quarter of the year 2002 for EGI GENCO is consistent with the 20 basis point uplift in the cost of debt awarded to EGI GENCO in the year 2001.

14 Summary of Approved Disco and Genco Carrying Cost Rates for the Deferral Accounts

14.1 Board Calculation of Carrying Cost Rates

531 The Board's calculations respecting carrying cost rates for the period 2001 to the first quarter of 2002 are set out in Appendix 2. The Board has used an income tax rate of 41% for the year 2001 and 38.5% for the first quarter of 2002 as set out in the income tax sections of forthcoming Decisions 2001-93 [*2000 Pool Price Deferral Accounts Proceeding, Re* (December 22, 2001), Doc. 2001-93 (Alta. E.U.B.)] and 2001-94.

14.2 Summary of Board Approved 2001 Carrying Cost Rates

532 The following table summarizes the Board's calculations and findings respecting DISCO and GENCO 2001 carrying cost rates:

Table 12: Summary of Board Approved 2001 Carrying Cost Rates

DISCO/GENCO	Debt %	Debt Cost	Equity Ratio	Equity Cost	After Tax WACC	Before Tax WACC [251]
UNCA DISCO	85%	6.45%	15%	9.50%	6.91%	**7.90%**
AE DISCO	85%	6.45%	15%	9.50%	6.91%	**7.90%**
EDI DISCO	85%	6.65%	15%	9.50%	**7.08%**	N/A
ENMAX DISCO	85%	6.65%	15%	9.50%	**7.08%**	N/A
RED DEER	85%	6.65%	15%	9.50%	**7.08%**	N/A
LETHBRIDGE	85%	6.65%	15%	9.50%	**7.08%**	N/A
TAU GENCO	85%	6.45%	15%	9.50%	6.91%	**7.90%**
AE GENCO	85%	6.45%	15%	9.50%	6.91%	**7.90%**
EGI GENCO	85%	6.65%	15%	9.50%	**7.08%**	N/A

533 N/A means not applicable (i.e. Municipally owned utilities do not pay income tax on deferral account operations). Bolded larger numbers represent the carrying cost rates to be applied to the Board approved DISCO/GENCO deferral account balances.

14.3 Summary of Board Approved 2002 First Quarter Carrying Cost Rates

534 The following table summarizes the Board's findings respecting DISCO and GENCO 2002 first quarter carrying cost rates:

Table 13: Summary of Board Approved 2002 First Quarter Carrying Cost Rates

DISCO/GENCO	Debt %	Debt Cost	Equity Ratio	Equity Cost	After Tax WACC	Before Tax WACC [252]
UNCA DISCO	85%	5.00%	15%	9.00%	5.60%	**6.45%**

AE DISCO	85%	5.00%	15%	9.00%	5.60%	**6.45%**
TAU GENCO	85%	5.00%	15%	9.00%	5.60%	**6.45%**
AE GENCO	85%	5.00%	15%	9.00%	5.60%	**6.45%**
EGI GENCO	85%	5.20%	15%	9.00%	**5.77%**	N/A

535 N/A means not applicable (i.e. EGI GENCO does not pay income tax on deferral account operations). Bolded larger numbers represent the carrying cost rates to be applied to the Board approved UNCA DISCO and AE DISCO balances.

536 The bolded larger numbers for the GENCOs are to be applied to any outstanding balances or GENCO related matters that exist beyond December 31, 2001 and to any true-up calculations required in the first quarter of 2002.

15 Off-Balance Sheet Financing Options for 2002 and Beyond

537 Although the Board does not have jurisdiction to determine carrying costs for the municipally owned DISCOs for 2002 and beyond, the Board has included some of their views to the extent they are helpful in understanding and reviewing the financing options that should be considered for AE DISCO and UNCA. In addition, with respect to the so-called "securitization option" (discussed more fully below), the Board is of the view, as it has previously expressed, that the municipal DISCOs do have the option of participating voluntarily in such a financing scheme.

538 In addressing off-balance sheet financing for 2002 and onward, parties submitted their views on the following options:

• Securitization

• All debt with defeasance

• Balancing Pool payout

15.1 Views of UNCA

539 UNCA believes that all realistically available financing options have been considered by the Board and supports the Board's initiatives in exploring the possibilities for securitization.

540 UNCA did not take issue with the ability of the Board to require the Balancing Pool to pay out the DISCO's pool price deferral accounts and for the Balancing Pool to recover those amounts from the customers in the future. However, in the event of a securitization, defeasement or Balancing Pool payout, UNCA submitted that the full amount of the outstanding principal and carrying costs should be repaid. There is no reason to distinguish between principal and carrying costs and doing so would add unnecessary complexity to rate riders. UNCA emphasized that, until completion of this potential pay out at some future date, its carrying costs should be allowed at UNCA's WACC rate as proposed in its application.

541 UNCA considered that at this time, off-balance sheet securitization appears to be the preferred option. UNCA noted that FIRM, ACC and the IFE all support securitization.[253] IPCCAA supported the IFE recommendations.[254] UNCA supported securitization and had attempted to securitize its deferral account balances. However, UNCA submitted that it could not have achieved a securitization at the time the funds were required due to the perceived risks associated with the deferral account assets.[255]

542 UNCA noted that FIRM's Argument recognized that securitization requires a Board order and possibly a Provincial indemnity.[256] The IFE recognized that, at a minimum, a Board order is required.[257] IFE's views are embraced by IPCCAA; and ACC expresses no view on what is required to execute a securitization.[258]

543 UNCA considered that no party took issue with the ability to finance principle described in UNCA's Argument.[259] Indeed, the IFE embraced the ability to finance principle.[260] Therefore, the Board should only use a securitization cost rate on a going-forward basis after the consummation of a securitization transaction.

544 UNCA supported the current investigation of securitization of the Deferral Accounts and remains prepared to work with all parties to explore this option.

545 UNCA did not believe that any further orders with respect to process were necessary at this time.

15.2 Views of AE

546 AE DISCO did not make any specific comments regarding the potential securitization of the outstanding deferral account balances. However, AE DISCO stated that it would work diligently with parties to see if this option is available in a practical sense for these deferral accounts.

547 AE DISCO stated that it would like nothing better than to have the deferral account balances paid out immediately and, therefore, the issue of ongoing carrying charges would become somewhat moot.

548 However, AE DISCO noted that the Board would still be required to address the level of carrying charges to be awarded for 2000 and from 2001 to the date of any such payment to AE DISCO.

15.3 Views of EDI

549 EDI stated that it was a committed supporter of the Board's exploration of off-balance sheet financing options. EDI stated the financial institutions involved would be able to provide the most expert advice on the implications of each of these alternatives. Since the primary objective is to reduce carrying costs payable by customers, EDI stated that an effective transfer of the principal balance to a financial structure with lower carrying costs is essential.

550 EDI submitted their views of the following off-balance sheet financing options:

- Securitization
- All debt with defeaseance
- Balancing Pool Payout

Securitization

551 Securitization is an alternative proffered by Messrs. McCormick and Demcoe.[261] FIRM has adopted securitization as their "first choice" for dealing with the deferral accounts.[262] EDI stated that Mr. Marcus characterizes securitization as a "win-win for all of us".[263]

552 EDI supports the expeditious implementation of a securitization alternative, subject to three provisions.

- First, EDI should receive the 8.47% carrying cost rate up to the point of "pay out" by the securitization trust.
- Second, the securitized debt must be considered "off-balance sheet" for accounting and credit analysis purposes.
- Third, in order to be cost effective, EDI's deferral account balances must be combined with those of other utilities to create a sufficiently large asset pool. EDI stated that the Messrs. McCormick and Demcoe recognized the last consideration by saying that a minimum $200 million is required to establish a cost-effective securitization.[264]

553 Based on size alone, EDI stated that it could not have established a securitization trust on its own at the time the financing was required.[265] EDI stated that it is also unlikely that EDI could have participated in an existing multi-seller conduit due to differences between the nature of its deferral account assets and the assets in the existing conduit.[266]

554 EDI noted that UNCA has the largest of the deferral account balances.[267] EDI noted that UNCA's evidence is that it attempted to pursue the securitization option in late 2000/early 2001 and UNCA was told that the uncertainties surrounding collection of the deferral accounts would not permit it to securitize at that time.[268]

555 Thus, EDI stated that securitization was not an option that was available to EDI — either on its own or in combination with the other utilities — at the time the deferral account financing was required. Even now, EDI stated that one couldn't say with certainty that a securitization is possible. Dr. Evans says it is "quite likely" that additional legislation will be required to securitize the deferral account balances.[269] He concludes: "The U.S. experience suggests that specific legislation is certainly desirable and may be required in order to accomplish a securitization of the deferral account balances".[270]

556 EDI noted that Mr. Marcus observes: "I think it is something that many jurisdictions in North America have found they cannot do it without some kind of legislation or regulation, but I am not going to say where Alberta falls in that area".[271] Further, EDI noted that Mr. Marcus also acknowledges that: "It also involves the government, because at the very least, there will probably need to be some changes in regulations, and it is possible that some type of a guarantee structure could be worked that might simplify this process if that is what the government would be interested in doing".[272]

557 EDI noted that even if the parties were to commence work now on establishing a securitization for all of the utility deferral accounts, that process would realistically consume 5-6 months.[273] According to Mr. Marcus: "A commercial (securitization) transaction is going to take a longer period of time, and I think it is going to take — you are going to be from here to the end of the year trying to do one of those, because it is — because, essentially, the government has to look at its regulation, see what it wants to do, and, you know, work back with the Board".[274] And: "But I think realistically, it would take to the end of the year to do a commercial transaction".[275] And: "There are a lot of i's to be dotted and t's to be crossed in actually accomplishing a securitized financing".[276]

558 EDI submitted it is also unclear that the total cost of securitized debt and credit enhancements would be less than EDI's 8.47% applied-for carrying cost rate.[277]

559 EDI stated that Messrs. McCormick and Demcoe were asked to "indicate whether any legislative changes are needed to implement off-balance sheet financing". EDI stated that they replied that this question was "beyond the scope of our assignment".[278] During cross-examination, Mr. McCormick apparently changed his mind about the "scope of our assignment" and offered the view that the probability of legislation's being required was "quite low".[279] But when both witnesses were then pressed to identify *any* stranded cost securitization in the U.S. that did *not* have specific supporting legislation, they admitted that they could not identify any such securitization.[280]

560 EDI stated that Messrs. McCormick and Demcoe were asked to "detail in step by step fashion, including probable time frames, a likely process for off-balance sheet financing through securitization".[281]

561 EDI stated that Messrs. McCormick and Demcoe responded as follows:

> It would be impossible for us to identify the bridges that must be crossed in the future in any financing process. We can though highlight the principal steps that would apply in the process that we have suggested. Please see our responses to BR.FE-09, ATCO.FE-12 and BR.FE-13.[282]

562 EDI submitted that ATCO.FE-12 has nothing to do with the steps required to establish a securitization. [283] Aside from the observation that a regulatory decision is required, the response to BR.FE-13 says nothing about the steps that are required to establish a securitization. [284]

563 EDI stated that the Response to BR.FE-9 lists some broad steps, but Mr. McCormick admits that this list of broad steps does not constitute a detailed description. [285] To illustrate, the list of steps does not include regulatory decisions, additional legislation and negotiation of third-party credit enhancements. None of the responses cited by Messrs. McCormick and Demcoe provide "probable time frames".

564 EDI stated that a variety of securitization options might be available to the utilities. [286] For that reason, Dr. Evans suggested that an efficient method by which to assess the merits of a securitization and a determination of reasonable rating, cost of debt and credit enhancement options would be the formation of a task force. [287]

565 EDI would participate in a task force to assess the reasonableness of the securitization option. The FIRM Customers have indicated a willingness to participate in such an investigation. [288]

566 EDI submitted that while a securitization task force is making its enquiries and developing its recommendations, the Board should review EDI's deferral account balances and determine the 2001-weighted average cost of capital for carrying charge purposes. If a securitization trust is established in 2001 and the deferral account cash flow entitlements are transferred to that trust, EDI stated that the Board could then vary its prior decision on carrying costs to reflect the costs of debt and credit enhancements to the trust.

All Debt with Defeasance

567 EDI stated that defeasance is a process where a third-party trustee engages to make interest and principal payments to the holders of debt securities; and, as a result, the debt securities are removed from the balance sheet of the issuer. [289] The issuer of the debt or another party deposits a sum of money with the trustee sufficient for this purpose. [290]

568 EDI stated that a defeasance alternative would be acceptable to EDI, provided that EDI received its 8.47% carrying cost rate up to the point at which the defeasance took place and provided that the defeased debt was considered "off-balance sheet" for accounting and credit analysis purposes.

569 When asked for his views on defeasance, EDI stated that Mr. McCormick stated in response to a question from Board staff:

> Sir, you are hitting the number one problem I have got with the concept of defeasance, because the utility isn't sitting there with a bunch of money that they can deliver to the trustee to get rid of this obligation. [291]

570 EDI submitted that Mr. McCormick misunderstands the source of cash to be used in the defeasance alternative. As explained by UNCA: A defeasement requires that a third party (e.g., the Balancing Pool or the Province) contribute sufficient funds to an independent trustee to repay the interest and principal on the related debt when those payments come due. [292]

571 EDI submitted that Mr. McCormick's "problem" arises, because he does not understand that the proposal is to have the Balancing Pool or the Province (i.e., a third party) contribute the funds to defease the debt of the utilities.

572 EDI stated that Mr. Marcus says that he believes the "off-balance sheet" options are broad enough to encompass the possibility of defeasance. [293]

573 EDI stated that the defeasance alternative was not available at the time the deferral account financing was required nor is it clear that such an alternative is available at the present time. [294] Indeed, as a supplier of funds, the Balancing Pool takes

the position that "There does not appear to be an authority for the Balancing Pool to play a role in a defeasance program or a securitization program".[295] Therefore, consistent with the ability to finance principle, EDI stated that the defeasance alternative does not apply to the carrying cost rate that the Board should establish for the period leading up to any defeasance.

Balancing Pool Payout

574 EDI stated that the possibility that the Balancing Pool could finance the deferral accounts with or without a Provincial guarantee using 100% debt is referred to as the Balancing Pool alternative. The utilities would collect the following from customers[296] :

- the principal in the deferral accounts,
- the interest required to be paid to the Balancing Pool, and
- the financing costs of the utilities to the date of "pay out" by the Balancing Pool.

575 EDI stated that this alternative is acceptable to EDI, provided that EDI receives a carrying cost rate of 8.47% to the point of "pay out" by the Balancing Pool. Dr. Evans agrees that this alternative is reasonable.[297]

576 EDI noted that the Balancing Pool alternative is acceptable to Messrs. McCormick and Demcoe.[298] However, Messrs. McCormick and Demcoe are unable to advise whether the Balancing Pool would have the ability to invest in the deferral accounts.[299]

577 EDI noted that this alternative is not acceptable to the FIRM Group.[300] However, the reasons that this alternative is not acceptable to the FIRM Group are unclear.[301] When asked to describe the "public interest rationale for not using the Balancing Pool as a vehicle to establish an off-balance sheet financing scheme", EDI noted that Mr. Marcus said:

> I think I basically gave that answer, which is that there is concern that, essentially, the Balancing Pool could become a dumping ground for all sorts of things to be paid by ratepayers at some later time. It wasn't set up for this purpose. I won't say that there is — that that rises to the point of under absolutely under no circumstances could it be used. But I would say it would be the group's preference not to do that for that reason, because we are concerned about the precedent. I don't think I can speak to the details of the letter beyond what I have just said.[302]

578 Indeed, EDI noted that Mr. Marcus, in referring to the possibility of having the Balancing Pool securitize the deferral account balances says: "If you were to do something through the government or the Balancing Pool, I think the structures are easier, and it may also be that the process of raising debt financing may also be faster. So, I think you could get that one done more quickly (than a securitization directly through the utilities)."[303]

579 EDI stated that the Balancing Pool alternative is consistent with the stand-alone principle and would only violate the available financing and actual cost principles if applied retrospectively.

580 In an effort to determine whether the Balancing Pool alternative was an option that might be reasonably contemplated, EDI noted that the Board sent information requests to the Balancing Pool.[304]

581 EDI stated that it was unfortunate that the Balancing Pool chose not to provide "detailed responses to the questions presented to us, primarily because financing the Pool Price Deferral Accounts is not part of the mandate of the Balancing Pool and as such, further actions or expenditures would require direction from the Department of Energy".[305]

582 If the Balancing Pool did not have sufficient funds to totally finance the deferral accounts, the Board questioned the possibility that the Balancing Pool supplying its available cash as all or part of the "equity portion" of the required financing in the form of an "equity loan". [306]

583 For reasons set out in Exhibit 383, EDI stated that the "equity loan" alternative is not workable. [307] Dr. Evans indicated uncertainty respecting how such an "equity loan" could be achieved. [308]

584 In a subsequent exchange with the Chairman, Dr. Evans suggested that the available Balancing Pool funds could be used to pay down the deferral accounts with the balance to be financed at the weighted average cost of capital. [309]

Off-Balance Sheet Financing Conclusions

585 EDI concluded that at the present time, the three off-balance sheet financing alternatives that *may* be possible and which would respect the stand-alone, ability to finance and actual cost principles on a going forward basis are the defeasance alternative, the securitization alternative and the Balancing Pool alternative. EDI noted that third-party securitization was the only option embraced by all parties [310] .

586 EDI considered that, at this time, none of these three alternatives is ripe for consideration. EDI stated that a substantial source of cash is required to implement the defeasance and Balancing Pool options; and there is no evidence to support the conclusion that the Balancing Pool or some other party is able or willing to supply that cash at this time. Indeed, t EDI noted that he Balancing Pool has indicated that its cash balance at year-end 2001 will likely be only $115 million. [311]

587 EDI noted that a myriad of legal, accounting, credit and financing decisions must be made in order to create a securitization trust. Although EDI is willing to participate in a task force whose objective is to crystallize the possibility of a securitization, EDI submitted that the Board should not withhold its decision on the appropriate carrying cost rate until such time as the task force completes its work.

588 EDI submitted that in the event that a lower-cost form of financing is available, municipalities should be allowed to decide whether to opt in or out of the arrangement.

589 If they decide to opt in, EDI submitted that the appropriate amounts that could be included in the financing arrangement would be the balances on which the Board has approved 2001 carrying costs, net of 2000 carrying costs and any effects of hedges entered into.

590 EDI stated that collection of deferral account amounts through Balancing Pool charges to retailers appropriately bypasses the issue of municipal authority over distribution tariffs.

591 EDI stated that Balancing Pool charges should be specific to the individual Wires Service Provider service area and should be based on the specific amounts included in the financial arrangements. In this way, customers in each service area would pay only those deferral account amounts that relate to their individual area.

592 EDI supports the exploratory process initiated by the Board and concurs with the appropriateness of participation by senior financial experts, rather than regulatory or legal specialists. EDI stated that the form of Board orders required depends on the outcome of these discussions and the sequence of events needed to implement them.

15.4 Views of Red Deer/Lethbridge

593 With respect to alternate financing, the Cities stated that they believe that the Board is considering securitization on a go forward basis.

594 The Cities make no submissions on whether this solution is appropriate or permissible with respect to the utilities that the Board traditionally regulates.

15.5 Views of IPCCA

595 IPCCAA submitted that the question of securitization is a customer issue and not just a utility issue. IPCCAA agrees with the concept of securitization and supports the evidence and argument of the Independent Financial Experts ("IFE").

596 IPCCAA's position is that customer involvement in securitization is imperative, however, before the Board can proceed with securitization, the Board has to first make a decision around the question of carrying costs.

597 IPCCAA supports the position of the IFE on this point, but disagrees with the IFE's recommendation that the Balancing Pool be used for this form of financing.

15.6 Views of FIRM

598 The FIRM customers do not support the use of the Balancing Pool for payment of the deferral account balances. The main reason is that each DISCO has undertaken management decisions that differ and result in different levels of deferral account at the end of 2000. These include some starting the collection of Riders early in 2000 resulting in reduced balances now to be recovered, some carrying out hedging strategies which reduced the balances to be recovered.

599 FIRM stated that the Balancing Pool covers all consumers in the province and it would not be appropriate and difficult to try and resolve these differences in management actions through the Balancing Pool.

600 FIRM stated that the Board by letter dated August 23, 2001 initiated a securitization investigation process, which is still ongoing. The FIRM customers support securitization of the 2000-deferral account balances, if feasible, as the least cost method of carrying these outstanding balances until they are fully repaid.

601 FIRM stated that use of a securitization vehicle would provide fairness between municipal and investor owned DISCOs. Those entities that want to be part of the securitization initiative can participate. FIRM stated that their regulators would need to provide orders that satisfy the indemnity requirements of the financial vehicle chosen to achieve the financing.

15.7 Views of ACC

602 The ACC is of the opinion that once a definitive amount of recoverable deferral balances have been determined in these proceedings, securitization would likely be the optimal source of financing. Presuming the willingness of financial institutions to issue securitization notes at a reasonable cost, ACC stated that the DISCO should be directed to repurchase debt and equity securities in a manner that produces the equity and debt capital structure ratios found appropriate by the Board for a DISCO.

603 The ACC holds to this view for two primary reasons. First, securitization is off balance sheet financing and hence would be least disruptive to the capital structure of the investor owned utilities. Second, because a distinct, identifiable and assured revenue stream secures the repayment of principal and interest, ACC stated that such financing should entail the lowest possible interest rate.

604 From the perspective of the ACC, the only downside to securitization that it obligates the customers to repay the approved balances and carrying cost. However, since these balances will be determined once and for all after the issuance of the Decisions in this proceeding, with no provision for revision, ACC stated that there is little danger of "over-securitization".

15.8 Views of Independent Financial Experts

605 The Independent Financial Experts (IFE) was of the opinion that, with the appropriate level of clarity in the regulatory environment, all deferral account balances are capable of being financed on an "off balance sheet" basis using the securitization option and an equity level between zero and ten percent. The IFE stated that the defeasance option [312] is not viable.

606 The IFE further elaborated as follows:

> Off balance sheet securitization of the deferral accounts for certain, if not all of the DISCOs, would provide the most cost-effective, least disruptive form of financing of the deferral accounts. A securitization would require a clear decision and authority from this Board. [313]

607 The IFE submitted that the opinion of the IFE was based on their experience and knowledge. The IFE submitted that TOPGAS was instructive. Off balance sheet financings were ultimately employed to fund the take-or-pay obligations of TCPL. A syndicate of banks created the TOPGAS companies to make advances to producers for take-or-pay gas, with the advances to be recovered through the delivery of prepaid gas in future years. Details of the TOPGAS financings appear in the IFE Evidence [314] and information request responses. [315] The IFE stated that the financing was successful.

608 The IFE stated that it is also instructive to review the extent of securitizations that exist today. The IFE believes that the existing credit card and trade receivable financings precedents are relevant. For example, the IFE stated that there are over $20 billion of securitizations of credit card receivables and trade receivables, which have been implemented without the substantial equity layer proposed by most of the DISCOs.

609 Further, the IFE stated that securitization of accounts is not a concept that is foreign to utilities. The financial statements of Nova Scotia Power, Telus, Shaw Communications, Bell Canada and Gaz Metropolitan all contain note references to sales of receivables. [316]] The "credit enhancements" in the credit card securitizations, which are the over-collateralization that Dr. Evans agrees is "effectively equity", [317] amount to 12 to 16 percent of the total.

610 Anticipating a "true up" provision, which would effectively reduce the default risk. The IFE concluded that a lower level of credit enhancement would be required in a securitization of the deferral amounts. The IFE reached the opinion that the requisite credit enhancement or equity layer to underpin the securitization of the deferral account balances would be between zero and ten percent. [318]

611 The zero percent equity layers are derived from the TCPL financing of the take-or-pay liability, which ultimately became the TOPGAS precedent. The ten percent equity layer is derived from the recognition that the collectability of the deferral accounts is superior to that of credit card obligations in that a true-up provision will ensure that there will be no "uncollectible amounts".

612 The IFE stated that the level of credit enhancement and the market rates for capital relate to the risk of the asset. In this case, the IFE stated that the asset is the deferral account balance. The risk relates to the ability of the DISCOs to recover the assets. The IFE stated that the uncertainty of collection of deferral account balances is apparently minimal. It is apparent from the evidence that the deferral accounts in question are unusual and non-recurring. [319] The timeframe for collection is relatively short — January 1, 2002 through December 31, 2004.

613 The IFE stated that it is abundantly clear from the evidence, therefore, that the risk relating to the deferral account balances is significantly less than the risk of the normal operating assets of the utility. The time period over which the cost of the asset is recoverable is short. The IFE noted that the Board would approve the amount of the asset, as well as the method of collection. The IFE stated that the combination would create a high level of confidence and a certainty of collection in the financial markets.

614 The IFE noted that it was suggested that the amounts of the deferral account balances were insufficient to allow for securitization. While this may be true looking solely at the cases of Lethbridge and Red Deer, a comparison to the securitization

information on the record of this proceeding suggests that the amount is not a problem. [320] The IFE noted that the overall total of the deferral account balances exceeds $600 million. Grouping of amounts so as to have an adequate balance, and the administration of the payments, are both logistical issues that have been solved in many similar multi-party securitizations. [321]

615 In the light of all of the relevant circumstances, the IFE reached the opinion that a securitization, with credit enhancements of between zero and ten percent, would be a cost-effective form of financing the deferral account balances. The IFE stated that this opinion is supported by the evidence and by the experience of the IFE.

616 The IFE took the view that three things are critical to the success of a securitization. The first is the Decision of the Board. The second is a true-up provision. The third is a "can-do" attitude.

617 The Decision of the EUB is important because it determines the amount of the deferral accounts including the carrying costs to date and creates a level of confidence and a certainty of collection. The IFE stated that a successful financing requires the financial markets to be comfortable with a certainty of collection.

618 Again, the IFE stated that the TOPGAS precedent is instructive. The IFE stated that Legislation was not required to establish the requisite certainty to permit the financing to proceed. The legislation was only passed several years after the initial off balance sheet financing, when producers were seeking to bypass recovery. [322] The regulatory decision of the Alberta Petroleum Marketing Commission concerning TCPL's take-or-pay obligations is also interesting in that it allowed for the recovery of the identifiable financing costs. [323]

619 The IFE stated that the certainty of collection is further enhanced by a true-up provision that would allow for adjustments to ensure that unanticipated changes would not imperil the collection of adequate funds to repay the financing. [324]

620 The IFE expressed the opinion, from their experience in financings and corporate financial management, that the ultimate success in doing a financing has a lot to do with approach and attitude. An organization that approaches a financing looking for barriers to success, rather than hurdles to overcome, is more likely to fail. An attitude of problem solving and negotiation is one of the keys to success in financings. If there is little motivation for a utility to follow particular financing options, the IFE stated that it is unlikely that those options will be pursued with the same vigor as others. [325]

621 The IFE noted that ultimately only the lenders involved can determine whether legislation is required to provide the level of confidence necessary for a securitization. The IFE recognized that legislation has been utilized in other jurisdictions to facilitate recovery of the costs of stranded assets. [326] The IFE, however, also looked to the TOPGAS, credit card and trade receivable situations as precedents. The opinion of the IFE, that a strong Board order is sufficient, will be tested in the financial markets.

622 The IFE are also had the view that the participation of the Balancing Pool, a creature of the Province, as an investor would assist in a securitization. [327] The IFE are confident that the testing will reveal that the Board order is sufficient to allow the securitization to proceed.

623 Expressing qualified acceptance of the securitization option, the IFE noted that EDI takes the position that the Board should not retrospectively apply a carrying cost consistent with a securitization transaction until such time as that transaction actually takes place. [328] The IFE noted that EDI also conditioned its participation in a securitization transaction on receipt of a WACC carrying cost rate up to the point of pay out by the securitization trust. [329] Both of these positions ignore the TCPL and A&S precedents of 100 percent on balance sheet financing of similar assets.

15.9 Views of the Board — Securitization and other Alternatives

624 In addressing off-balance sheet financing for 2002 and onward, parties submitted their views on the following options:

• Securitization

• All debt with defeasance

• Balancing Pool payout

625 The Board, in this Decision, will focus on the Securitization option as this option had support from almost all parties. The Board agrees with parties that securitization should be supported with vigor. Other options could be dealt with, if necessary, after the Final Report from the Securitization Committee is received. The progress and future steps associated with the most attractive option, securitization, is discussed below.

626 With respect to the securitization option, at the close of the omnibus hearing, the Board directed that a group be formed to investigate the feasibility of this option (Securitization Investigation Group). The Group was to include representatives of the affected utilities, as well as one customer representative selected by the various interested customer groups and a Board staff observer. [330]

627 At the time of this Decision, the Securitization Investigation Group had not yet completed its investigation and had not yet filed with the Board a final report. However, on November 29, 2001, the Securitization Investigation Group filed with the Board an interim report coupled with a request for an extension of its mandate (Interim Securitization Report) and they indicated that they could file a report with the Board by the end of January. At the same time, the Interim Securitization Report was circulated to all interested parties on the Deferral Accounts proceeding list.

628 The Interim Securitization Report identifies certain key activities still remaining to be undertaken by the Securitization Investigation Group to determine the feasibility of any securitization scheme. The two key remaining elements identified in the Report are appropriate indemnification and negotiation of the key elements of a purchaser/seller term sheet

629 The Report suggests that a final report on the securitization option could be made to the Board and parties by the end of January 2002. The Report goes on to suggest that if securitization were accepted as a feasible option, it could be in place "early in the second quarter of 2002". In any event, the Board notes that the scheme could not be in place on January 1, 2002.

630 The Board notes the following observations from the Interim Securitization Report with respect to the potential benefits of a securitization scheme in relation to the DISCO deferral accounts:

> Rather than trying to precisely calculate the exact savings the Investigation Group simply wants to provide an approximate indication of the benefits of securitization.
>
> Since the time of the Deferral Account hearing interest rates have declined significantly. The expected cost of carriage for securitization is expected to be in the order of 30 (+/-) basis points above the rate for Commercial Paper.
>
> Currently the conduits are funding one-month Commercial Paper at about 2.30%. This would indicate an all-in cost of funds of approximately 2.60%. Compared to the alternative of WACC which is above 10% considerable funding savings could be achieved through securitization. On a net balance of $600 million the annual funding cost savings are in the tens of million dollars (E.g. 7.5% carrying cost savings on average annual balances of $500 million, $300 million and $100 million would result in savings to Alberta electricity consumers of approximately $68 million).

631 Whether or not securitization proves ultimately feasible, it is clear to the Board that an application to the Board for the securitization scheme could be in place before the second quarter of 2002. However, based on Board implementation of the securitization scheme, the scheme would likely commence in the second quarter of 2002.

632 The Board notes section 5(1) of the *Deferral Accounts Regulation*, which provides that the Board may approve the collection of AE's and UNCA's Board-approved DISCO deferral account balances over a period January 1, 2002, through

December 31, 2004. Earlier in this Decision, the Board approved a one-year recovery period for AE commencing April 1, 2002 and a two-year recovery period for UNCA commencing in 2002.

633 In the Board's view, given the magnitude of the benefit of the cost savings to the customers and the benefits to the DISCOs from an early payout of their deferral account balance, the Board encourages parties to continue to pursue the securitization option for implementation at the earliest possible time.

634 During a reasonable period time to allow for investigation leading to the goal of a successful securitization of these balances, the Board considers that it must ensure that the DISCOs are entitled to appropriate carrying costs pending the resolution of the securitization option and up to the implementation of the option, if successful.

635 The Board acknowledges that the Interim Securitization Report is just that, an interim report, and parties have not had an opportunity to comment on any definite securitization proposal, the Board does consider the suggested "all-in cost of funds" of 2.60% to be an indication of the potential prudent financing cost should a securitization scheme be deemed feasible by parties and the Board. Accordingly, for interim purposes, the Board will accept the 2.60% as a prudent carrying cost rate for interim purposes from April 1, 2002.

636 Accordingly, the Board approves the 2.60% cost to be the carrying cost rate for UNCA and AE DISCO starting on April 1, 2002 on an interim basis. This interim carrying cost rate for UNCA and AE DISCO will be in effect until one of two following outcomes:

• Board approval of the securitization scheme and the related approval of the final "all-in cost of funds" for the scheme and the consequent implementation of the scheme.

• The rejection by the Board of the securitization scheme as a viable option, upon application by the parties.

637 The Board does consider the Interim Securitization Report to be an indication of a downward trend in the prudent cost of financing in 2002. Moreover, in light of this Interim Report, the Board considers it prudent for AE and UNCA, as members of the Securitization Investigation Group, to vigorously pursue the investigation of the securitization option.

638 The Board agrees with the view of the IFE that three elements are critical to the success of a securitization as follows:

• The first is the Decision of the Board.

• The second is a true-up provision.

• The third is a "can-do" attitude.

639 The Board will address these three critical elements in the following findings of the Board.

640 In this section of the Decision, the Board will address the following matters in the determination of the appropriate carrying costs and the pursuit of securitization:

• The "Second Quarter 2002 and onward" carrying cost rate if securitization does not proceed.

• Implementation of the Securitization Option

• Securitization Decisions of the Board

• True-Up Provisions

• Can-Do Attitude and Responsibility of AE, UNCA, and Customers

15.9.1 "Second Quarter 2002 and Onward" Carrying Cost Rate

641 The Board considers that failure by AE or UNCA to vigorously pursue the securitization option could negatively impact the Board's final determination of carrying costs, commencing with the second quarter of 2002.

642 The Board expects that AE and UNCA will apply for approval of a securitization option, if viable, in a prompt and expeditious manner, including any necessary revisions to the 2002 and onward carrying cost rates. The Board considers that it will address the final report from the Securitization Implementation Group and the final determination of carrying costs for the period after April 1, 2002 in a separate module of this proceeding.

643 The Board can accept that it was likely that the financial community might have preferred to delay implementing a securitization option for the AE DISCO and the UNCA DISCO deferral accounts at the time the deferral account balances were created, due to the perceived uncertainty associated with the electrical market at that specific time. [331]

644 The Board was hopeful that the resolution of this matter would have occurred by December 31, 2001. The Board notes that the statement by the FIRM witness "realistically, it will take to the end of the year to do a commercial transaction" [332] and "There are a lot of i's to be dotted and t's to be crossed in actually accomplishing a securitized financing". [333]

645 Accordingly, the Board considers it would be unfair to retroactively back-cast any "2002 and onward" financing option market rate back into a period prior a reasonable start date to the consummation of the financing option. Accordingly, the Board will not apply a retrospective back-cast before April 1, 2002 and will allow the previously determined 2002 first quarter WACC on a final basis for the period January 1, 2002 to March 31, 2002.

15.9.2 Implementation of the Securitization Option

646 As discussed earlier, the Board agrees with parties that at this time, an off-balance sheet securitization option would provide substantial benefits to all parties and should be pursued vigorously.

647 Accordingly, the Board directs AE DISCO and UNCA to aggressively pursue implementation of the securitization option and to report the status to the Board at the time of their refilings, if an appropriate report from the Securitization Implementation Group has not yet been provided on their behalf.

648 The Board considers that in the event of a securitization, defeasement, or Balancing Pool payout, the full amount of any outstanding principal and carrying costs should be repaid to the DISCOs. This repayment would, of course, exclude the 2001 carrying costs paid by the Balancing Pool and the first quarter 2002 carrying costs previously approved.

649 The Board is not averse to using its full authority, as justified, to direct the Balancing Pool to participate in helpful financial manners that benefits both the utilities and the customers in achieving lower costs for consumers and a faster payout of outstanding balances and carrying costs to the utilities.

15.9.3 Securitization Decisions of the Board

650 With respect to Decisions from the Board, the Board is prepared to support the securitization approach with all reasonable orders and directions to provide the necessary certainty to the financial community.

651 The Board is open to using all reasonable options in its jurisdiction and in its authority. Further, the Board is prepared to address any matters in an urgent manner as requested. Further, the Board would make the necessary Decisions required for the effective operation of the "true up" provision as discussed below.

15.9.4 True-Up Provisions

652 With respect to the second element identified by the IFE, the Board notes that a "true up" provision for the deferral accounts would effectively reduce or effectively eliminate any default risk. The Board understands from the evidence of the

IFE and Dr. Evans that the requisite credit enhancement or equity layer to underpin the securitization of the deferral account balances should be relatively small.

653 The Board understands that options for the credit enhancement could involve the Balancing Pool, the Government, or other options such as a higher or front ended loaded level of collection from customers at the beginning in order to create the necessary credit enhancement.

654 The Board directs AE DISCO and UNCA DISCO, in their refilings, to develop true-up provisions that would allow for adjustments to ensure that unanticipated changes would not jeopardize the collection of adequate funds from customers to repay the deferral account balances and financing, regardless of whether securitization proceeds, if these provisions have not already been addressed in the Final Report of the Securitization Implementation Group. Further, UNCA and AE, in their refilings, are to provide the appropriate suggested wording for inclusion in the Board Order approving the refilings.

655 The Board considers that these provisions would resolve any default risk. However, the Board considers that it is the market that will determine the precise requisite credit enhancement given the determinations and directions in this Decision.

656 In the event that securitization is realized, the Board considers that there may be timing differences, which occur between revenue collection by the utilities and transfer of the amounts to the persons holding the security. In effect, this revenue will be held by the utilities and available for their use as working capital for any such period. Accordingly, the Board directs UNCA and AE to review this timing possibility and to include any benefit, which occurs as an item in the true up to the benefit of retiring the security.

15.9.5 Can-Do Attitude and Responsibility of AE, UNCA, and Customers

657 The Board agrees with parties that at this time, an off-balance sheet securitization option would provide substantial benefits to all parties and should be pursued vigorously.

658 Given the cost of electricity that customers are experiencing that includes the collection of various deferral accounts, the securitization option could provide lower costs. At the same time, securitization would benefit AE and UNCA and be fair to their shareholders by returning the outstanding principal and carrying costs in a quicker fashion.

659 Although the Board considers that customers have an important role to play, the Board wishes to be clear that it is not delegating its authority to the customer representatives to determine the outcome of the securitization option or to unduly influence the outcome of this option. The Board considers that there are individual differences in philosophical approaches to this issue or differences arising from differences in the use of available options, such as the use of the Balancing Pool. The Board wishes to make clear that it is prepared to use its authority to direct the Balancing Pool to participate, if justified.

660 The Board considers that the roles of the customer representatives are more in the nature of observers such that any concerns can be addressed during the process. Certainly, the Board considers it would be desirable if all parties were able to expeditiously have their issues addressed such that any future regulatory proceeding would be efficient and short.

661 The Board expects that AE and UNCA will recommend to the Board the appropriate course of action given the Board's views in these matters and the acceptability of certain approaches to the financing entity.

662 Further, for clarity, the Board considers that AE and UNCA are NOT required to achieve an "uncontested negotiated settlement" on the securitization issue with the customer representatives.

16 Collection Issues

16.1 Introduction

663 In the context of determining the recovery periods for the DISCOs pursuant to the *Deferral Accounts* Regulation, the Board noted that it has jurisdiction over the collection of the DISCO deferral account balances only of the investor-owned

DISCOs for whom the Board is "regulatory authority" (i.e. AE and UNCA DISCOs). As the Board also noted, the respective city councils have the regulatory responsibility to address any collection issues for the municipal DISCOs of ENMAX, EDI, Red Deer and Lethbridge.

664 In relation to AE and UNCA DISCO, therefore, the Board will consider the following issues in this section:

1) Collection of Deferral Account Balances

a) Collection from Customers under 2 MW

b) Collection from Customers over 2 MW — Normal Circumstances

c) Collection from Customers over 2 MW — Collection Deficiencies

d) Audit and Verification Issues

e) Summary of Findings

2) Customer Payment Options

3) Special Board Orders Required

16.2 Collection of Deferral Account Balances

16.2.1 Views of UNCA

665 UNCA proposed that customers with demands less than 2 MW in 2000 be charged the deficiency rider based on their actual consumption in the collection period. UNCA's proposal included the following:

• any customers with demands less than 2 MW in 2000 who might have already left the system would escape the rider.

• any such customers who leave at some time during the collection period will, from that date forward, be exempt from the rider.

• new customers joining the system after January 1, 2001 will pick up a portion of the pool price deferral account.

666 UNCA stated that this approach is driven largely by practical billing considerations and is appropriate for customers under 2 MW, as it is administratively efficient and consistent with normal regulatory practice.

667 However, UNCA proposed a deviation from the above approach for customers with demands greater than 2 MW in 2000.[334] The result was that customers in rate classes 6300, 6500 and 8100 in 2000 would have a rider calculated on the basis of actual hourly consumption in 2000, resulting in a fixed, known rider amount that, unlike the proposal for smaller customers, was not a function of future consumption. The intent was that all customers in this group would be responsible for their calculated share amount of the deferral account[335] , regardless of whether they continue to consume similar amounts of energy as they did in 2000.

668 UNCA stated that the customer-specific approach also allowed the ultimate amount determined to be attributable to large customers to be corrected for precisely the amount that had already been paid via the Interim rider in place from September to December 2000, which was designed and collected on bundled rates.

669 UNCA stated that this approach allows the appropriate share of the deferral account to be collected from large customers who have "left the system" (other than due to bankruptcy) and thus, to a large degree, prevents significant deferral amounts from being stranded and being transferred to customers who were not originally responsible for them.

670 Accordingly, UNCA stated that new customers who have demands greater than 2 MW, who commence service after January 1, 2001, would not be allocated a portion of the Pool Price Deferral Account, and will therefore generally be exempt from the rider.

671 UNCA considered, as an exception, that, should a >2 MW customer leave the system due to bankruptcy, or if their allocated portion of the deferral account should become uncollectible, then all customers left in the >2 MW category, including any newcomers, would share in the collection of the amount stranded by this customer. UNCA stated that this would require the otherwise fixed deferral amounts determined for large customers to have to be adjusted at the time of the loss of a >2 MW customer and would mean that new >2 MW customers would be allocated a small portion of the deferral account after all.[336]

672 In examination, UNCA noted the following with respect to >2 MW customers:

> A. MS. KIRRMAIER: So, we don't know to what extent consumers have left or reduced consumption. In fact, we are not aware of any greater-than-2-megawatt consumers who have left — possible exception of one, Mr. Martin just pointed out. I think there may have been an industrial system.[337]

673 UNCA proposed that for customers with demands greater than 2 MW in 2000, a customer specific rider based on actual 2000 consumption is appropriate, for the reasons described in its application[338] and in the following statement:

> Customers with demands greater than 2 MW have interval meters, and hence UNCA has hourly consumption data for 2000 for these customers. Therefore, it is possible to determine each such customer's share of the deferral account based on this data. Moreover, customer specific charges based on individual amounts of 'fixed rate' consumption in 2000 (i.e. the period in which the deferral amount was incurred, rather than consumption in the periods over which the deferral amount is to be collected) will better reflect the portion of the deferral amount attributable to these customers. For example, this method attributes the appropriate amount of the deferral amount even in the event a customer has switched a significant portion of his load from opportunity to firm rates in 2000 and beyond, or in the case of a standby customer; the customer's outage rate differs greatly in 2002-4 from that in 2000. In other words, the larger customers have less homogeneous and predictable characteristics respecting loads and load factors, and therefore a rider applicable to energy consumption in 2002 — 04 is less likely to be reflective of their share of the deferral account based on their consumption in 2000. Arguably, it would be ideal if all customers' deferral account share could be determined this way, but it is not possible to do so. Thus UNCA proposed that 2 MW is a reasonable breakpoint for distinguishing between which approach should and can be used.[339]

674 With respect to the diligence of collecting from customers over 2 MW, UNCA provided the following evidence:

> Q. ... in UtiliCorp's proposal, would they be proposing that if a customer of 2 megawatts or greater was to leave the service territory that UtiliCorp would, in fact, have an exit fee associated with it? Is that your intention?
>
> A. MS. KIRRMAIER: I think that is what it would amount to. And it is a bit unusual, but under the circumstances, we felt that was probably the most appropriate way to treat those customers, in this case, mostly not to unnecessarily burden other consumers with the costs that were incurred on their behalf.
>
> Q. So, you are seeking the authority from the Board in this proceeding to do that, to collect from a customer that is exiting? In other words, I don't recall in the evidence, and can you sure correct me if I am wrong, if you did specifically discuss an exit and an exit strategy around those types of customers.
>
> A. MS. KIRRMAIER: I don't think we actually used the term "exit fee," but I think that is a really good way of summarizing what we are intending to do. I think there was an IR response, and I don't remember which number it was, that we explained in general what we are proposing to do and what the intent there is.

> And again, the mechanism — I don't know if there is a perfect mechanism to accomplish the desired result here, but the desired result is to, as best as possible, collect the money from the consumers that it was incurred on their behalf. [340]
>
> A. MS. KIRRMAIER: Now, I think the only case that we wouldn't do that is if we truly were not able to collect the money from that customer if, for example, went bankrupt. Otherwise, we would try to get the money from them.
>
> Q. So, again, if he goes bankrupt, your intention would be to ...?
>
> A. MS. KIRRMAIER: Well, I don't think we could collect the money from them, then, and that is where we would then allocate that deficiency across the rest of the customers in that rate class. [341]

675 Although UNCA had proposed that the rider amounts for these customers would be fixed, UNCA proposed to collect the amounts via 36 equal monthly payments, to be consistent with the proposed collection period for the smaller customers.

676 Notwithstanding this consideration, UNCA stated it would be willing to allow a one-time payment by the large (>2 MW) customers, if that is deemed appropriate.

677 UNCA interpreted the phrase "Customers who have left the System" to mean customers who are no longer customers of a Retailer who is subject to the Distribution Tariff of UNCA. Customers could fall into this category for various reasons, namely:

• They have become customers of the TA (through Section 18 of the EU Act);

• They have become an industrial system designated under the *Hydro and Electric Energy Act*;

• They have moved outside UNCA's service territory (either elsewhere in Alberta or outside the province);

• They have gone out of business altogether (i.e. bankrupt) or UNCA is otherwise unable to collect from the customer.

678 UNCA noted that only in the last case, in UNCA's Application, would the customers escape the deferral rider.

679 In such case, UNCA proposed to recover the deficiency from all customers remaining in the class, as described in Section 5.4 of its Argument.

16.2.2 Views of AE

680 With respect to the recovery of the deferral account balances from customers over 2 MW in size, AE reiterated the position contained in its rebuttal evidence [342] wherein it requested that the Board confirm that any amounts not collected from customers which has not been directly allocated in this fashion can be collected from all remaining customers.

681 In this regard, AE submitted in Argument that its Negotiated Settlement Agreement explicitly indicated that AE would be entitled to recover the full balance of these deferral accounts from customers and this is merely a safeguard in case the proposed cost allocation method results in a shortfall.

682 While AE proposed to use best efforts to obtain the appropriate payments related to the recovery of the Deferral Accounts directly from these >2 MW customers, in the event that it is not possible to recover the payments from them, AE proposed to recover from all remaining customers any shortfall in payments from this category of customers. Some of these customers may leave the province, or go bankrupt, or otherwise default on these payments, which is beyond AE's control. [343]

683 However, in examination, AE agreed that its Negotiated Settlement was not definitive as to the allocation of any shortfall:

> Q. .... There are a number of places where, I guess, the negotiated settlement is not really that specific on the collection of the deferral account from customer groups.

> A. MR. BECKETT: I think that is a fair characterization. I can't think of anything other than the discussion that balances positive or negative will be collected from or refunded to customers.
>
> There is no description of the mechanism behind that. I think it was clearly understood that that would either be negotiated or litigated in front of the Board. [344]
>
> Q. ... So, from your perspective, it is clear in your mind that the negotiated settlement provides that all of those risks are on the customer and not on ATCO Electric; is that correct?
>
> A. MR. BECKETT: No. I can't point to anything in the negotiated settlement that says that this risk particularly is on customers and not ATCO Electric.
>
> This was simply our proposal in our application to collect these amounts. [345]

684 AE indicated that customers over 2 MW could likely pay off their deferral balances early and reduce their carrying charges. AE estimated that there were about 104 customers greater than 2 MW. [346]

16.2.3 Views of IPCCAA

685 IPCCAA noted that UNCA has proposed that if deferral amounts for loads greater than 2 MW are not collectable other loads in the rate class should recover the amounts.

686 However, it was UNCA's proposal that, should a customer >2MW leave the system due to bankruptcy, or if their allocated portion of the deferral account should become uncollectible (as described in section 5.3), then all customers left in the >2MW category, including any newcomers, would share in the collection of the amount stranded by this customer. This would require the otherwise fixed deferral amounts determined for large customers to have to be adjusted at the time of the loss of a >2MW customer, and would mean that new >2MW customers would be allocated a small portion of the deferral account after all. [347]

687 As there are relatively few customers greater than 2 MW, recovering any unrecoverable deferral amount from a single customer could have a significant impact on the remaining customers. IPCCAA noted that UNCA acknowledged this in testimony as follows:

> And I think what Mr. Crowther was trying to demonstrate is that, on the other hand, for the greater-than-2-megawatt consumers, if only one should leave and if it happens to be the biggest one and we have actually provided the answer to the undertaking there, the biggest consumer in Rate 6500 constitutes 12 percent of the consumption there.
>
> So, if he should leave, go bankrupt, whatever, not be able to pay his share of the deferral account, then that would cause the rest of the consumers in that rate class to pick that up.
>
> So, the impact there is potentially larger just because of the fact that there are fewer customers, but each of those customers consumes far more than any other rate classes. [348]

688 IPCCAA noted that as the largest customer is more than 10% of the rate class load, a bankruptcy resulting in the inability to collect deferral amounts could, under UNCA's proposal, result in an additional $1.5-2.0/MWh for the other customers. For a 20 MW (80% load factor) load this could amount to a $300,000 - $400,000 cost resulting from the bankruptcy of an unrelated company. IPCCAA submitted that such a result could not be contemplated and recommended that the Board reject UNCA's proposal.

689 IPCCAA noted that AE recommended an approach that effectively spreads the risk of default over all loads. With respect to the recovery of the deferral account balances from customers over 2 MW in size, AE reiterated the position contained in its

rebuttal evidence [349] wherein it requested that the Board confirm that any amounts not collected from customers which has not been directly allocated in this fashion can be collected from *all remaining customers*. [350]

16.2.4 Views of FIRM

690 FIRM stated that customers that consumed energy during 2000 and contributed to the 2000 Pool Price Deferral Account should pay for the deficit that was incurred on their behalf. FIRM stated that implementation of this principle may become impractical for small customers. FIRM noted that the actual responsibility for the 2000 Pool Price Deferral Account could be calculated only for those customers with interval recording meters.

691 For ease of administration and simplicity of understanding, FIRM supported the AE DISCO and UNCA proposals to collect the 2000 Distribution Pool Price Deferral Account on the basis of forecast energy consumption for all customers smaller than 2 MW. [351]

692 FIRM did not object to the AE DISCO and UNCA proposals to recover costs for the 2000 Distribution Pool Price Deferral Account from new customers connected after January 1, 2001 for customers smaller than 2 MW.

693 FIRM submitted that with the ability to accurately assign costs on a customer-by-customer basis, and the recovery of 2000 Pool Price Deferral Account costs on a customer-by-customer basis for customers larger than 2 MW, it follows those customers larger than 2 MW that connected after January 1, 2001 should not be subject to any charges resulting from the 2000 Distribution Pool Price Deferral Account.

694 FIRM noted that large consumers are generally sophisticated and may have had the ability to control their costs by reducing load during periods of high hourly Pool prices. Those customers that did respond to high hourly Pool prices should be assigned a lesser amount of the 2000 Distribution Pool Price Deferral Account, in accordance with their reduced energy consumption. FIRM submitted that the use of forecast load (that did not consider curtailment resulting from high prices) would mask pool price, and would claw back any benefits of load curtailment by that particular customer.

695 FIRM noted that the Board in Decision 2000-3 [*TransAlta Utilities Corp., Re* (2000), 2000 CarswellAlta 1820 (Alta. E.U.B.)], states, "The Board considers that it clearly stated in the decision that pool price variance should be covered by deferral accounts and be to the account of customer and that volume variance is not included in deferral accounts and should be to the account of shareholders". This indicates that the original load forecast is to be used in deferral account calculations. However, the amount of load was a function of the hourly Pool price, particularly for those customers with price sensitive load. FIRM noted that a trend could be established for Option G customers in IPPSA/SPPA.UNC-2 and 3(a and c) where load is lower during hours of high hourly Pool price.

696 FIRM noted that AE DISCO [352] and UNCA DISCO [353] indicated that 2000 actual consumption data will be used to calculate the actual deferral amount incurred on a customer-by-customer basis.

697 FIRM requested that the Board direct the distribution functions to implement measures to insure that deferral amounts by rate class are reconciled when customers switch rates. If a customer switches from one rate class to another rate class, the deferral amount by rate class should be adjusted for both rate classes. The recovery of funds to dispose of the deferral account should also be adjusted for both rate classes to account for the customer switching rate classes. This mechanism will ensure that the initial rate class is not burdened with the deferral amount, while the new rate class accrues the revenue to pay off its deferral amount. [354]

698 Further, FIRM noted that the cost of administering a program to track customers who have left the system must be considered. In order to address the ability to assign costs to a specific customer, and the administration of tracking customers that have left the system, those customers that are larger than 2 MW that have left the system should be charged for their portion of the 2000 Pool Price Deferral Account. [355]

699 FIRM noted that recovery of these costs would ensure that other customers are not subjected to stranded costs as a result of customers leaving the system.

700 FIRM stated that the Applicants proposal is consistent with the Board Directives #6 and #7 to TransAlta in Decision 2000-60 as follows:

> 6. The Board directs TransAlta to calculate and implement a customer specific rate rider designed to recover the load's share of the deficit in the year-2000 deferral account for any fixed price load that switches to the DAT in 2000. This customer specific rider will be based on energy consumption in 2000 up to the time of switching, for any fixed price customer who switches to the DAT during the balance of 2000. Further, the Board directs TransAlta to provide a report to the Board, at the time of the final reconciliation of the 2000-deferral accounts on the results of this implementation of customer specific rate riders. This report is to address the details of the implementation of the DAT switching rate rider program, and to include in its report the number of individual customers that have switched to DAT as well as the calculation of the related customer specific riders.
>
> 7. The Board directs TransAlta to calculate and record the share of the liabilities related to co-generation additions or other material load reductions by specific customer for the remaining balance of 2000. Further, the Board directs TransAlta to report the details of the liabilities related to load reductions resulting from co-generation additions and/or other material load reductions by customer, and outline its recommended method of collecting the liabilities, at the time of the final reconciliation of the 2000 deferral accounts.

701 FIRM submitted that it did not object to the Applications by AE DISCO and UNCA DISCO to pursue customers who have left the system when the customer is larger than 2 MW.

702 FIRM further addressed the situation where customers switch rate classes, as addressed in the following statement:

> A. MR. REIMER: Yes. That's correct. And the one other issue that we did raise in IRs, which we haven't raised recently, is the rate-class switching. So, if a customer switches from one rate class to another in order to avoid the collection of this deferral account, that should be tracked.
>
> And specifically with the REAs, there is a sale of an REA and the REA customers become UtiliCorp or ATCO customers, the deferral amount and the revenue associated to pay off that deferral should track where the customers move. [356]

703 FIRM also addressed the issue of a need for the ability of customers to audit the collection process, as presented in the following exchange:

> So, I would see the other instance where you were below 2 megawatts and you increased your load. So, that may be unlikely to happen.
>
> But in that case, I would suspect that if a customer was below 2 megawatts in the year 2000 and grew, that they should still be subject to the same charges as below 2 megawatts. So, an energy charge as proposed based on energy consumption.
>
>> Q. Thank you.
>>
>> And do you feel that if there were some significant quirk that came in there, do you think that customer groups would be watching for those types of things, and do you think they would have an opportunity to request a review and variance if that occurred?
>>
>> A. MR. REIMER: Yes. I think the customer groups should have the ability to audit these accounts to ensure that they are appropriately recovered. [357]

16.2.5 Views of ACC

704 The ACC submitted that customers who have left the system should not be liable for any deferral account charges that are the subject of these proceedings. Indeed, it was not clear to the ACC how the DISCOs could collect these costs, or any costs, from customers who have left the system, or indeed have left the province.

705 ACC noted that both AE and UNCA proposed different recovery approaches for larger customers. ACC stated that both of these proposals should be rejected.

706 ACC stated that there was no intrinsic reason for treating customers with load greater than 2 MW differently from customers with load less than 2 MW. While the 2 MW demarcations was a convenient benchmark for which to ascertain costs and develop tariffs based on observable service characteristics, ACC stated that there is no good reason why policy issues should differ based solely on size. In other words, ACC stated that while the factual circumstances may differ from customer class to customer class, fairness dictates that the ratemaking philosophy be constant across the Province.

707 Specifically, ACC stated that the proposal to retrospectively "recalculate" some type of revenue requirement for 2000 for specific customers and send those customers a bill is nothing if not retroactive ratemaking. Mr. Martin attempted to coin the euphemism "retroactive cost allocation" (22T4742) but ACC stated that the Board should not be fooled by rhetorical flourishes and recognize these proposals for what they really are.

708 Consistent with the ACC's position on customers who have left the system, the ACC position was that new customers connected after January 1, 2001 should be treated no differently from customers who had been on the system prior to that date.

709 But putting aside this question, the ACC submitted that there are three fundamental reasons why such an approach to recovery would be poor policy:

• First, it would be discriminatory unless it was applied to all customers who, for whatever reason, reduced load subsequent to the year 2000.

• Second, the ACC does not believe that it wise to attempt to penalize customers who make rational decisions to reduce their load for sound economic reasons.

• Finally, it is the position of the ACC that, although these deferral balances were accrued during the year 2000, these balances do not give rise to an obligation on the part of consumers until the Board in these proceedings has approved them for amortization.

710 To do otherwise, ACC stated would be to charge customers a different rate than that which was specified in the tariff under which the customers thought were operating at the time. As a result, ACC argued that such an outcome would constitute retroactive ratemaking. Just as a merchant or manufacturer cannot go back to its customers in 2000 and "rebill" those customers because its costs were higher than it anticipated when it made the sale, it would be unfair for utilities to do precisely that for the deferral accounts.

711 ACC submitted that although it understood the Board's goal to hold the appropriate classes and customers responsible for the costs that they impose, ACC did not believe that this goal should outweigh the well established reluctance of regulators to charge customers rates for historic consumption that are different than the rates established and published at the time that the energy was actually taken.

16.2.6 Views of SPPA

712 SPPA submitted that it supported IPCCAA's position with respect to the issues of Collections.

16.2.7 Views of the Board - Collection of Deferral Account Balances

713 The Board will address the following issues in this section of the Decision:

1. Collection from Customers under 2 MW
2. Collection from Customers over 2 MW — Normal Circumstances
3. Collection from Customers over 2 MW — Collection Deficiencies
4. Audit and Verification Issues
5. Summary of Findings.

16.2.7.1 Collection from Customers under 2 MW

714 The Board notes that both UNCA and AE have proposed that all customers <2 MW, by rate class, would share equally in the recovery of the deferral accounts based on actual consumption during the recovery period, regardless of when a customer became active on the system. The Board also notes that no party objected to the proposed approaches of UNCA and AE for customers < 2 MW.

715 In the circumstances, the Board considers the proposals by AE and UNCA to be reasonable. Therefore, the Board approves the collection approach of AE and UNCA for customers < 2 MW in that all customers <2 MW will share equally in the recovery of the deferral accounts based on actual consumption during the recovery period, regardless of when a customer became active on the system.

716 The Board notes FIRM's concern with respect to rate-class switching. Specifically, FIRM was concerned that customers could switch from one rate class to another in order to avoid the collection of this deferral account or for other reasons. FIRM cited the example of a sale of an REA with the REA's customers becoming either UNCA or AE customers In FIRM's view, the deferral amount and the revenue associated to pay off that deferral should follow the customer's move to a different rate class. [358]

717 However, the Board agrees with FIRM that rate-class switching could be subject to abuse or, in any event, could result in inequities simply from customer movement among classes for otherwise legitimate reasons. The Board considers that AE and UNCA should track rate-class switching so that deferral amounts to be collected from various rate classes can be appropriately reconciled.

718 Therefore, the Board directs AE and UNCA, in their refilings, to update their balances in each class after accounting for customer switching between rate classes so that liability for the deferral account amounts is attributed to the proper rate class. This direction applies to all rate classes.

719 Also, the Board directs AE and UNCA, in their refilings, to provide updated estimates of collection rates and total recovery from customers for all rate classes from 1999 to and through the collection period on both a cents per kWh basis and on a monthly dollars per customer basis. The information should be provided in the form previously filed with the Board in the June 2001 Distribution Tariff refilings and recently filed in the RROT and interim DT rate proceedings.

720 Finally, the Board directs AE and UNCA, in their refilings, to advise the Board of any difficulties experienced in relation to collection mechanics to implement the Board's findings in this Decision.

16.2.7.2 Collection from Customers over 2 MW — Normal Circumstances

721 The Board notes that both UNCA and AE have proposed that individual year-2000 customers >2 MW will be individually responsible for their share of the 2000 deferral account balance based on their consumption in the year 2000. Each customer will be subject to an individual rider based on an assessment of their rate class responsibility and their actual year-2000 consumption.

722 Similarly, new customers >2 MW after January 1, 2001, will not "normally" be expected to contribute to the deferral account recovery. Some of these exceptions are noted later in this Decision. However, the Board realizes that not all

circumstances can be anticipated or prescribed exactly. The Board expects that AE and UNCA will be diligent in pursuing costs and in avoiding situations where the practices could be "gamed", resulting in stranded costs for other customers.

723 The Board accepts that it is practical to track costs for the small number of large use customers, but that it is not practical to do so for the large number of smaller users.

724 The Board notes that UNCA clarified its approach for 2 MW and larger customers. UNCA proposed that it would divide the total year 2000 deferral account balance number for the rate class by the year 2000 actual consumption for that same rate class to derive a unit rate of the deferral account for that rate class. The same average unit rate would apply to all customers in each of the Rate Classes 6300, 6500 or 8100. UNCA proposed that the rate would not be determined on a customer-specific basis; rather, it would be determined on a rate class basis. [359]

725 The Board also notes that FIRM, SPPA, and IPCCAA did not oppose these proposed approaches and no party, other than ACC, objected to the approaches of UNCA and AE for customers >2MW. The Board considers that FIRM, SPPA and IPCCAA represent the large majority of consumers >2 MW who would be affected by these collection proposals and, accordingly, the Board gives greater weight to their views than to the views of ACC, which represents a limited number of customers.

726 For these reasons, the Board approves AE's and UNCA's approaches for collecting the deferral account balance from large customers over 2 MW, in "normal" circumstances.

727 The Board also considers reasonable the proposals by AE and UNCA that new >2 MW customers will not be responsible for additional costs beyond those directly generated by them in year 2000, except in the case of the bankruptcy of, or otherwise uncollectible amounts owed by other customers. In the Board's view, this mechanism is complementary to the proposal that those large-use customers who reduced consumption during periods of high pool price in 2000 should be assigned a correspondingly lower amount of the deferral account balance aligned with their reduced consumption in 2000. In this fashion, parties who could, and did, take measures to reduce the pool price impact in year 2000 will not be penalized but will receive a corresponding benefit during the deferral account recovery period.

728 Accordingly, the Board also approves UNCA's and AE's proposals that new >2 MW customers will not be responsible for additional costs beyond those directly generated by them in year 2000, except in the case of the bankruptcy of, or otherwise uncollectible amounts owed by, other customers.

729 The Board directs AE and UNCA in their refilings to submit their approaches or business principles that they will utilize to prevent or avoid "gaming". Further, the Board directs AE and UNCA to propose corresponding wording to the Board to be considered for the final Board Order to provide the utilities with any necessary authority that is required to proactively address and resolve potential "gaming" problems. The Board expects AE and UNCA to be diligent in pursuing all customers in the >2 MW category for recovery of their individual deferral account balances.

16.2.7.3 Collection from Customers over 2 MW — Collection Deficiencies

730 The Board notes that UNCA and AE have proposed significantly different approaches to collection of any outstanding or residual amounts related to customers >2 MW who have left the system or have gone bankrupt as follows:

- UNCA's treatment proposed to recover these amounts only from the customers remaining in the respective rate class, regardless of whether they are new customers or were customers in 2000,

- AE's treatment proposed to recover any unrecoverable unallocated outstanding amounts over all remaining customers in all rate classes, regardless of whether they were new customers or not.

731 According to UNCA's proposal, new customers >2 MW joining the system after January 1, 2001 would not pay for the year 2000 deferral account balance, except in the case of bankruptcy (and presumably otherwise uncollectible amounts) within their respective rate classes.

732 AE proposed to recover from all remaining customers any shortfall in payments from large >2 MW customers. AE stated that some of these customers might leave the province, become bankrupt, or otherwise default on these payments, all of which are beyond AE's control.

733 In the Board's view, to the extent reasonably possible, customers who caused the deferral account deficiencies should be responsible for those costs.

734 In the case of customers <2 MW, the deficiency will be allocated to all customers in each rate class, after adjusting for rate-class switching. Then all customers, regardless of their vintage (i.e. "new" and "old"), will be jointly responsible for the balance, including deficiencies, within their rate class based on their consumption during the recovery period. The Board considers it would not be fair for these same (<2 MW) customers to be responsible for the bankruptcies, deficiencies, and system changes in their own rate classes, as well as being responsible for sharing in any large customer shortfalls, given that the large customers are not responsible for any shortfalls in the <2 MW customer rate classes.

735 For these reasons, the Board does not approve AE's proposal to make all rate classes responsible for any shortfalls in the large, >2 MW customer rate classes.

736 Further, the Board understands IPCCAA's concern about the potential for some customers to be adversely affected if a large customer in a given rate class becomes bankrupt or the amount owed by that customer otherwise becomes uncollectible. The Board agrees that it could be unfair to the remaining parties in the rate class to absorb the amount of the outstanding balance. However, the Board is not convinced that the concern of IPCCAA would be realized to the large extent suggested in IPCCAA's example, given UNCA's assessment of known changes to date. Nonetheless, the Board considers that IPCCAA's concern has some merit and should be addressed.

737 Since the <2 MW rate classes are responsible for their deferral account balances by rate class, the Board considers that the >2 MW should also be responsible for their shortfalls without involving the <2 MW customers. In order to address IPCCAA's concern, the Board considers that a broader pooling within the grouping of all >2 MW customers is necessary to avoid the potential unfairness of pooling only within rate classes for the >2 MW customers. Therefore, the Board considers that a pooling of all customers >2 MW, regardless of vintage (i.e. "new" or "old") should be made for purposes of collecting any shortfall class for the large >2 MW customer rate classes.

738 Accordingly, the Board does not approve UNCA's proposal to allocate the shortfalls contained within each rate class for the large > 2 MW customer rate classes.

739 In addition, the Board directs AE and UNCA in their refilings, to submit revised allocation methodologies, business principles, and wording that will be communicated to customers with respect to deferral account balance collection over the recovery period. The description of the revised allocation methodologies should be sufficiently detailed to allow future audits, by the Board or customer representatives, for compliance with the approved process. The revised methodologies should reflect the Board's finding that pooling of all customers >2 MW, regardless of vintage (i.e. "new" or "old") should be implemented for purposes of collecting any shortfalls from bankruptcies or similar uncollectible deficiencies in each class for the large, >2 MW customer rate classes.

740 Notwithstanding the Board's conclusions and directions, the Board is open to considering future applications from any party for modifications to the resulting, Board-approved collection procedures in order to allow recovery from a broader group of customers if an unreasonable or unsustainable allocation of costs to a residual group of customers is known to be occurring.

741 Regardless of the method used, the Board will ensure that the utility will recover the entire amount of the approved Deferral Account deficiency.

16.2.7.4 Audit and Verification Issues

742 Parties in other electrical proceedings have addressed the need for, and desirability of, audit rights by customer representatives. In some cases, audit provisions or verification procedures have been included in negotiated settlements.

743 In this case, the Board notes FIRM's view that customers be able to audit the collection process in a variety of circumstances. FIRM relied on the example of a customer who was below 2 MW in 2000 but increased its load to >2 MW in 2001. FIRM recommended that this customer should not be treated as a "new >2 MW" customer in 2001 and so avoids its responsibility for deferral account recovery. FIRM considered that audit rights would allow customers to ensure that potential abuses do not occur and that all customers bear their fair shares of deferral account recovery. [360]

744 The Board agrees that audit rights for customers are reasonable and will contribute to fairer administration and collection of the 2000 deferral accounts.

745 The Board notes that neither AE nor UNCA commented on audit or verification issues. However, Clause 43(b) of AE's 2001/2002 DT Settlement provides parties with certain audit rights.

746 EGI tabled Exhibit 204 that was a letter dated May 14, 2001 inviting parties to engage in a negotiated settlement discussion and to engage in an audit process. EGI stated that this relates directly to general Directive 63 and 64 of Decision U99099. [361] The Board, notes that while this statement is made in the context of EGI and not EDI, it is likely indicative of EPCOR policy.

747 Therefore, the Board directs AE and UNCA to cooperate with customers and provide them with appropriate audit rights or agreed upon verification procedures on the reconciliation of the retirement of the deferral account balances on a basis similar to that the audit rights provided for in Board decisions approving, for example, AE's 2001-2002 DT Settlement. The Board expects that parties should be able to address these matters without unnecessary Board involvement. However, if necessary, the Board will adjudicate this issue and will consider it to be addressed as part of these proceedings.

16.2.7.5 Summary

748 The Board acknowledges that both UNCA and AE DISCOs must track the balances by rate classes on a monthly basis over their respective recovery periods to ensure accurate reconciliation.

749 In this regard, the Board directs UNCA and AE DISCO to provide a statement of reconciliation to the Board and interested parties at the end of the collection period.

750 The Board's approved treatment of customers who have left the system is tabulated in Table 14 for UNCA and AE DISCO.

751 The Board's approved treatment is presented in the following table:

Table 14: Board Approved Treatment of Customers Who Leave the System

Impact on a Customer who	Customer > 2 MW	Customer < 2 MW
Leaves Alberta (Collectible)	Customer pays share based on 2000 actuals	Nothing — remaining customers in rate class share based on current consumption
Becomes Bankrupt (Or Otherwise Uncollectible)	All customers > 2 MW share and pay for deficiencies within the rate class.	Nothing — remaining customers in rate class share based on current consumption
Becomes a New Customer after January 1, 2001	No share of 2000 deferral balance for new customer, except for uncollectible portions of other customers in rate class.	New customer pays share of 2000 deferral account like all other customers in rate class based on current consumption

16.3 Customer Payment Options — One Time vs. Monthly

752 AE and UNCA proposed that large customers, >2 MW, should receive a flat monthly charge to recover their specific deferral account balance [362] .

753 Some parties considered that large customers could be advantaged by the option of a one-time, up-front payment of their deferral account balance, rather than incurring carrying costs. Individual customers would presumably make this decision after they were informed of the carrying cost rate approved by the Board. Smaller customers might also find the flexibility of a one-time payment option to be advantageous.

16.3.1 Views of UNCA

754 UNCA indicated that it is prepared to provide a one-time prepayment option to customers with loads greater than 2 MW. This option would see the customer pay the appropriate deferral account principal amount plus carrying costs to the date of payment. Unfortunately, UNCA stated that was not able to offer a prepayment option to customers smaller than 2 MW due to administrative complexity. [363]

16.3.2 Views of FIRM

755 FIRM noted that if securitization were carried out, the payment options would depend on the terms of the notes issued. FIRM noted that it could be possible to structure different repayment terms, provided the entity receiving the early payment has a means of segregating the funds and flowing them back to the securitization vehicle in accordance with the cash flow requirements of the financial instruments. FIRM noted that the early payment would create issues of equity between customers relative to the carrying costs built into a securitization option.

756 FIRM would support a monthly rider but was not in favour of a one-time payment option for small customers.

16.3.3 Views of IPCCAA

757 IPCCAA submitted that all recoveries should be paid within the 2002 calendar year.

16.3.4 Views of SPPA

758 SPPA recommended that the outstanding deferral account balances be collected on a ¢/kWh basis for all customer accounts without time-of-use meters. For customers with time-of-use meters, or for large customer accounts above a size threshold, SPPA supported IPCCAA's position on this issue.

16.3.5 Views of the Board - Customer Payment Options — One Time vs. Monthly

759 The Board accepts that many customers want choices. The Board also understands that customers may not be able to make the choices until after they know the Board approved carrying cost rate and recovery period associated with the deferral account balances and are able to assess available options. In particular, in that respect, the Board agrees with FIRM that the securitization option, if implemented, could affect the fairness associated with providing prepayment options.

760 The Board notes that both UNCA and AE have agreed that they would be willing to provide an option to large, >2 MW customers to make a one-time prepayment. The Board acknowledges that an allowed prepayment would result in avoidance of carrying costs.

761 Given the willingness of both AE and UNCA to provide a prepayment option to large, >2 MW customers and the need to avoid the potential impact of stranded costs on other customers from any securitization option, the Board considers that the prepayment issue should be addressed in the refilings giving consideration to the impact on the potential securitization terms.

762 Further, the Board is sympathetic to IPCCAA's submission, supported by SPPA that all recoveries should be paid within the 2002 calendar year. The Board has already addressed recovery periods earlier in this Decision and has approved a one-year

period for AE, and a two-year period for UNCA. Nevertheless, the Board recognizes that some customers may want to settle their year 2000 obligations in a shorter time frame than other customers, for a variety of reasonable and important corporate or financial reasons.

763 For all of these reasons, the Board directs AE and UNCA, in their respective refilings, to provide the methodology and terms, if any, of any prepayment options for large customers over 2 MW that are consistent with the potential securitization option, as appropriate. In their refilings, AE and UNCA should provide their assessments of whether stranded costs could result for the remaining customers from accepting prepayment, accelerated or single payment options. Further, AE and UNCA should address whether a one-time payment option and an accelerated recovery period (e.g. all recovery within the 2002 period for UNCA) can be provided to customers and if so, on what terms and conditions.

764 In preparing their refilings, AE and UNCA should note the Board's expectation that any prepayment option will not result in material stranded costs for other customers, including any material risk that could arise from customers in sharing the deficiencies from customers who go bankrupt or leave the system in the same rate class. The Board considers that discussion with customers before refiling on this issue could minimize the regulatory process for approval of these matters.

765 The Board accepts UNCA's argument that extending this prepayment option to customers of <2 MW would add excessive administrative burden to the DISCOs. Accordingly, the Board will not direct AE or UNCA to provide a prepayment option to customers <2 MW. However, the Board directs AE and UNCA, in their refilings, to advise whether any prepayment or accelerated payment options by <2 MW customers would be practical and recommended. The Board would give favourable consideration to any such proposals after taking into account the same issues as for >2 MW customers.

766 In Decision 2001-102, the Board determined that the riders for AE's collection of the 2000 Pool Price Deferral Account proceeding would be implemented commencing April 1, 2002. Accordingly, the Board directs AE, prior to December 31, 2001, to contact each customer >2 MW and to provide, prior to December 31, 2001, an approximation of that customer's 2000 Deferral Account Pool Price Proceeding liability if that customer so desires.

767 The Board has also determined that the riders for UNCA's collection of the 2000 Pool Price Deferral Account proceeding will commence in 2002. A future Board Decision will determine the exact commencement date in 2002. Accordingly, the Board directs UNCA, prior to December 31, 2001, to contact each customer >2 MW and to provide, prior to December 31, 2001, an initial approximation of that customer's 2000 Deferral Account Pool Price Proceeding liability if that customer so desires.

16.4 Special Board Orders Required

16.4.1 Views of UNCA

768 The only collection problems anticipated by UNCA were with respect to >2 MW customers who "leave the system" as discussed in the preceding section. These concerns arise because the current regulatory regime only contemplates collection of deferral amounts through UNCA's Distribution Tariff, which presently applies only to Retailers who have customers in UNCA's service area. To the extent that the portion of the deferral account proposed to be recovered from these customers is not recoverable from them, UNCA sought recovery of those amounts from all of the remaining customers in the >2 MW rate classes.

769 UNCA suggested that the Board make it clear in its final order that the outstanding portion of the share of UNCA's 2000 pool price deferral account allocated to any >2 MW customer (after adjustment for the already received interim rider revenue) is due and payable by that customer, even if the customer is no longer subject to UNCA's Distribution Tariff (i.e. has "left the system").

16.4.2 Views of FIRM

770 FIRM submitted that, to the extent securitization is an option, the work of the investigation group with a selected financial institution will determine the requirements that would have to be specified in any Board order to accomplish the issuance of these asset backed securities.

16.4.3 Views of ACC

771 ACC agreed that a Board Order "institutionalizing" the collection mechanism would be a prerequisite to securitization.

16.4.4 Views of SPPA

772 SPPA suggested that the Board could order the collection of the deferral account balances on an interim basis effective January 1, 2002 over a set period of time, say 12 months.[364] The amount to be collected, on a unit ¢/kWh basis, could be set for each DISCO. Any subsequent adjustments from the Board could be used to reduce the time frame over which the funds are collected, or to adjust the 11th or 12th month charge.

16.4.5 Views of the Board - Special Board Orders Required

773 The Board will address the following issues in this section:

- Any necessary orders to facilitate securitization and,
- The treatment of customers who leave the distribution system

774 The Board agrees with FIRM and SPPA that some form of Board Order facilitating collection of rate riders and subsequent remittance to the securitization financial institution would be required to facilitate securitization. The Board would provide the necessary Orders to support the Board approved findings on securitization. The Board welcomes any recommendations from parties as to the formal wording being requested when the results of the Securitization Investigation Group are finally submitted to the Board.

775 The treatment of customers who leave the distribution system was addressed in an earlier section of this Decision. However, the Board acknowledges UNCA's request that >2 MW customers be obliged to pay their share of the deferral account balances, regardless of whether or not they are still served from the distribution system.

776 Accordingly, the Board directs UNCA and AE, in their refilings, to recommend the specific wording necessary to provide the clear authority to UNCA and AE to collect from any customer who has an obligation to pay a share of the deferral account balances pursuant to the terms of the Boards findings in the Decisions in this proceeding.

777 The Board will address these issues in a process and Decision following the refilings.

17 Disco Hedging Issues

17.1 Introduction

778 In this section of the Decision, the Board will deal with a variety of DISCO hedging issues, including the following:

- Availability of Hedges for all DISCOs;
- Prudence and Timing of Hedging Behaviour;
- Penalty for any Imprudence.

779 In 2000, approximately 85% of the DISCO load was protected from price volatility as a result of legislated hedges under the EU Act. The balance of the DISCO load was subject to pool price fluctuations, which could be either greater or less than forecast. Average monthly Pool Prices escalated by a factor in the order of seven times those prices that were forecast for the later part of 2000.

780 Some DISCOs elected to protect their customers from potential price volatility by purchasing financial or physical products that removed all or a portion of the risk associated with future price escalation spikes. Inherent in this process was the consideration that the DISCOs would, with many hedging products, relinquish the ability to obtain the cost savings associated with market prices dropping below forecast. Many DISCOs who hedged their load considered the hedging cost to be analogous to purchasing an insurance policy to protect against losses, rather than as a tool to provide the lowest possible customer prices. Others, who elected not to hedge, indicated their belief that the lowest, long-term customer costs result from avoiding the cost associated with hedging and simply paying market rates for commodities.

781 Each of the municipal DISCOs, including ENMAX, EDI and the Cities, implemented some form of hedging program. These programs all resulted in a favourable net position for 2000. The investor owned DISCOs, AE and UNCA, did not implement hedging programs.

782 Hedging results are summarized in the following table:

Table 15: All DISCOs - Net Hedging Benefits - Year 2000

DISCO	***Net Hedging Benefit (Year 2000) ($)***
ENMAX	*30,140,201 (31,909,505 less 1,769,304 trading floor costs)*
Red Deer	7,276,761
Lethbridge	1,338,240
EDI	551,265
UNCA	No hedging program
AE	No hedging program

783 The Board dealt with hedging by the municipal DISCOs in Decisions 2001-88 through 2001-91. This section of the Decision will primarily examine the availability of hedging products for year 2000 and the prudence of the investor owned utilities, AE and UNCA, respecting their hedging programs.

17.2 Views of the Parties — DISCO Hedging Issues

784 *For editorial reasons, the Board has decided not to reproduce the Views of the Parties — DISCO Hedging Issues in the body of this Decision. Instead, the interested reader is referred to Appendix 7 of this Decision for a complete, detailed description of the views of the parties in relation to DISCO hedging issues as submitted by way of evidence and argument in the course of these proceedings. The Board has considered all of this material in arriving at the following findings in relation to DISCO Hedging Issues.*

17.3 Views of the Board — DISCO Hedging Issues

785 In assessing the prudence associated with DISCO hedging activities, the Board has evaluated the evidence particularly respecting:

• The necessity of incremental hedges given the level of hedges already in place,

• The responsibility of DISCOs or customers for hedging decisions,

• The level and suitability of hedging products available, and

• The anticipated financial outcome of hedging at the decision time.

786 The Board agrees with the positions advanced by ENMAX, EDI, Red Deer and Lethbridge. The Board notes all of these parties implemented some degree of hedging program and commented that the availability of hedges declined throughout the year 2000. The Board notes that the associated cost for hedges increased as electricity prices escalated.

787 Many DISCOs, that obtained successful hedging results, implemented their hedges in 1999 or early 2000. The products that were available earlier were also more closely aligned with the load profile characteristics of the DISCO load. Many DISCOs were of the view that if all the Alberta DISCOs had been actively shopping for hedging products, the availability would have declined and associated prices would have risen.

788 For the following reasons, the Board does not find any imprudence associated with the 2000 DISCO hedging activities for either the investor-owned or municipal DISCOs.

789 The prudence of the initial decision by a utility to hedge is not clear because the net outcome can turn out to be positive or negative from a financial perspective. The Board considers that a utility's decision to hedge, as a form of insurance to mitigate risk, may be prudent, but may not result in the lowest possible customer cost. Similarly, the Board considers that a utility's decision not to hedge may be prudent from the perspective of endeavouring to minimize customer costs in the long run.

790 The Board does not believe that it is strictly appropriate to judge prudence on the financial outcome. Rather, in any prudence assessment, it is appropriate to consider the circumstances and alternatives available at the time the decision was made. The Board encourages the electrical utilities and customers to continue to discuss hedging perspectives, the prevailing customer risk appetite and possible mechanisms to share risk between customers and shareholders. The Board recognizes that parties have actively discussed the RRO energy procurement strategy. The Board considers these discussions and agreements to be appropriate, given the current state of electrical industry transition.

791 In reaching its conclusion with respect to prudence of the DISCOs' hedging activities, the Board considered the following factors, each of which will be discussed below:

• The legislated hedges were already in place for 85% of load

• The customers and DISCOs share responsibility for hedging practices

• The mechanism for approval of hedging practices

• The limited amount of hedge products available

• The mismatch between load shape and available hedge product shape

• The uncertainty of financial outcome.

17.3.1 The legislated Hedges were already in place for 85% of load

792 Legislated hedges were established for the year 2000 on approximately 85% of the Alberta load, under the provisions of Decision U99099.

793 The Board considers that this factor removed a significant portion of consumer risk potentially arising from upward price volatility. As indicated by Mr. Tim Simard of Risk Management,

> First, consumers did not have 100% exposure to price movements in 2000 — the legislated entitlements provided protection on approximately 90% of the exposure.
>
> Retaining a 10% exposure to market prices does not appear to be unreasonable to the Board when one looks at utility risk management practices in the gas and power markets across North America. In many instances, the Board notes that consumers retain much more than a 10% exposure to market movements." [365]

17.3.2 The Customers and DISCOs share responsibility for Hedging Practices

794 The Board is of the view that both the utilities and customers share responsibility to communicate their perspectives related to risk and to agree upon methodologies that establish "if and how" the utilities should mitigate risk on behalf of the customers. However, the Board considers that the utilities have the primary responsibility for acting on their customers' behalf.

795 The Board considers that large customers are more often sophisticated users and are normally more aware of pricing issues and alternatives. For example, members of IPCCAA have suggested that they consume 50% of the Alberta electrical load. Notwithstanding this large consumption of the Alberta load, the Board notes that the IPCCAA members do not appear to have made any requests for the DISCOs to hedge to a greater level on their behalf for year 2000 either during the U99099 proceedings or during the year 2000. Similarly, the smaller consumers, and those organizations representing them, do not appear to have made requests for the DISCOs to hedge to a higher level than provided by the legislated hedges before or during the year 2000.

796 The Board considers that the DISCOs are in the best position to monitor actual market pricing development and communicate the results to consumers. However, in many situations, the communication of this information may be too late to adjust philosophies. Consequently, the Board encourages early dialogue between the customers and utilities to clearly establish a risk management philosophy and general procedures that the utility can follow.

17.3.3 The Mechanism for approval of Hedging Practices

797 Additionally, the Board notes that a mechanism to obtain approval for hedging is available through section 56 of the EU Act if customers and DISCOs had reached agreement to hedge. This arrangement would have protected the interests of both customers and shareholders.

798 The Board notes that this process appears to have been successfully implemented by AE and its customers in the AE RROT proceeding.[366] Additionally, the Board notes AE's comments suggesting as follows:

> Unless the framework is established in advance, with the agreement of all parties and approval of the Board (such as for the RROT) there is no possible way that the type of process contemplated by SPPA could be implemented on a timely basis for someone to actually acquire a hedge in the market.[367]

799 As mentioned previously, the Board encourages parties to pre-establish the infrastructure and ground rules for risk management at an early stage.

800 Further, the Board considers that, if necessary, it has the ability and willingness to deal with urgent matters of importance to parties, such as a request for hedging approval pursuant to section 56 of the EU Act on an accelerated basis. The Board notes that it was not asked by any parties to deal with a hedging request in 1999 or 2000.

17.3.4 The limited amount of Hedge products available

801 The Board notes the views of parties that the availability of hedges declined throughout the year 2000. Many parties have quoted the perspective of Red Deer's Mr. Roth:

> And particularly in probably the latter three quarters of that year hedges were very, very difficult to come by. The prices were extremely high if you could, in fact, find one. It was almost impossible to find a hedge that was tailored to your actual load profile. You had to, sort of, take what was on the market. It was a seller's market.[368]

802 ENMAX also confirmed that hedges were not readily available during 2000.[369]

803 Conversely, the Board notes that the associated cost of hedges increased as electricity prices escalated. The Board notes that many DISCOs that obtained successful hedging results stated that they implemented their hedges in 1999 or early 2000. These DISCOs stated that products that were available earlier were also more closely aligned with the load profile characteristics

of the DISCO load. The Board notes the view of many DISCOs that if all the Alberta DISCOs had been actively shopping for hedging products, their availability would have declined and associated prices would have risen.

17.3.5 The mismatch between load shape and available hedge product shape

804 As the year 2000 progressed, the availability of hedging products with a load profile matching the desired load diminished. As AE DISCO indicated:

> ... the unhedged portion of its load had a very awkward load shape, for which a product was not readily available in the hedging market.[370]
>
> It was not a 7×24 or 6×16 load product. ... It was just random.[371]

805 As noted above, some DISCOs stated that products that were available earlier in the year were also more closely aligned with the load profile characteristics of the DISCO load.

806 The Board notes that another hurdle associated with imports of hedged products relates to the potential difficulty in arranging tie line transmission capacity.

17.3.6 The Uncertainty of Financial Outcome

807 The Board agrees that the financial outcome of a hedging arrangement is uncertain. As a result, the Board understands that a reasonable decision to either hedge or not hedge at a specific point in time may have either a favourable or unfavourable outcome. In other words, the final result can be positive or negative. As it turned out, decisions to hedge for the year 2000 generally had positive financial outcomes. However, the Board considers that the reverse could as easily have occurred as suggested by Red Deer's Mr. Roth's allusion to "many sleepless nights"[372] .

17.3.7 Summary of Board Views

808 In summary, after considering these factors, the Board does not find imprudence associated with the lack of hedging by the investor-owned DISCOs, AE and UNCA.

809 Accordingly, the Board approves UNCA's position that no adjustment is required to UNCA's pool price deferral account balance for the lack of benefits or costs associated with the absence of a hedging program for electricity in the year 2000. Similarly, the Board finds that no adjustment is required to AE DISCO's pool price deferral account balance for the lack of benefits or costs associated with the absence of a hedging program for electricity in the year 2000.

17.4 Inclusion or Exclusion of Net Hedging Benefits into Deferral Account Balance

810 The Board thoroughly discussed the inclusion of hedging costs and benefits in the Decisions recently issued in these proceeding for the municipal DISCOs.

811 In the municipal DISCO Decisions, the Board did approve the inclusion of hedging benefits as a credit against the deferral account balances, excluding the costs of operating the trading floor in the case of ENMAX. The Board refers interested readers to those municipal DISCO Decisions for the Board views on these matters.[373]

812 Since neither AE nor UNCA engaged in hedging activities, no discussion of this issue is required here.

18 Summary of Approvals

813 This section is provided for the convenience of readers. In the event of any difference between the Approvals in this section and those in the main body of the report, the wording in the main body of the Decision shall prevail.

1.	Accordingly, for all of the above reasons, the Board approves AE DISCO's request for a one-year recovery period of its pool price deferral account balance beginning in the year 2002. __________	17
2.	Accordingly, for the purpose of calculating the 2001 carrying cost rate, the Board approves a prudent cost of debt for a high-grade investor-owned utility would be 6.45% (i.e., 6.00% +1.05% +0.05%-0.65%) and for a municipal utility would be 6.65% (i.e., 6.00% +1.25%+0.05%-0.65%). __________	64
3.	Accordingly, the Board considers prudent and the Board approves a deemed cost of debt equal to 5.0% for the purpose of calculating the carrying cost rate for a high-grade investor-owned utility for the first quarter of 2002. __________	65
4.	The Board considers that a forecast risk free of 6.00% is reasonable and the Board approves a risk free rate of 6.0% for the purpose of determining the 2001 equity rate of return. The Board notes that this forecast risk free rate is approximately 25 basis points higher than the litigated 2000 risk free rate of 5.75%. __________	67
5.	As a result, the Board approves a rate of 9.50% as the appropriate equity rate of return for the purpose of determining the 2001 carrying cost rate, comprising of a risk free rate of 6.00% and an equity risk premium of 3.50% __________	67
6.	Accordingly, based on the long-term Government of Canada bond yield in late November 2001, the Board has determined that the appropriate long-term debt benchmark for the year 2002 should be 5.5% and the Board approves that rate for the purpose of determining the equity rate of return for the first quarter of 2002. __________	68
7.	As a result, the Board approves 9.0% as the appropriate equity rate of return for the first quarter of 2002, comprising a risk free rate of 5.50% and an equity risk premium of 3.50% __________	68
8.	Accordingly, the Board approves a deemed capital structure of 85% debt and 15% equity for the UNCA DISCO deferral account for the period 2001 to the first quarter of 2002. __________	73
9.	The Board will ensure that UNCA, as viewed on an integrated basis, is compensated for its debt costs by using a conservative A level credit rating in determining the cost of debt for deferral account operations. Accordingly, the Board's previous generic finding of a 6.45% cost of debt for high-grade investor-owned utilities for the year 2001 would be appropriate and prudent for the UNCA DISCO deferral account. Accordingly, the Board approves a 6.45% cost of debt for the year 2001 for UNCA DISCO's deferral account __________	73
10.	Further, the Board considers its generic finding that a 5.0% cost of debt for the first quarter of 2002 would also be appropriate and prudent for the UNCA DISCO deferral account. Accordingly, the Board approves a 5.0% cost of debt for the first quarter of 2002 for UNCA DISCO's deferral account. __________	73
11.	In the Board's view, there are no special circumstances that would warrant a change to the Board's generic finding respecting the cost of equity for the period 2001 to the first quarter of 2002. Accordingly, the Board approves a 2001 cost of equity of 9.50% and a cost of equity of 9.00% for the first quarter of 2002 for the UNCA DISCO deferral account. __________	73
12.	Accordingly, the Board approves a deemed capital structure of 85% debt and 15% equity for the AE DISCO deferral account for the period 2001 through to the first quarter of 2002. __________	80
13.	The Board will ensure that AE, as viewed on an integrated basis, is compensated for its debt costs by using a conservative A level credit rating in determining the cost of debt for deferral account operations. Accordingly, the Board's previous generic finding of a 6.45% cost of debt for high-grade investor-owned utilities would be appropriate and prudent for the AE DISCO deferral account. Accordingly, the Board approves a 6.45% cost of debt for the year 2001 for AE DISCO's deferral account. __________	81
14.	Further the Board considers its generic finding that a 5.0% cost of debt for the first quarter of 2002 would also be appropriate and prudent for the AE DISCO deferral account. Accordingly, the Board approves a 5.0% cost of debt for the first quarter of 2002 for AE DISCO's deferral account. __________	81
15.	Similar to UNCA, in the Board's view, there are no special circumstances that would warrant a change to the Board's generic finding respecting the cost of equity for the period 2001 through to the first quarter of 2002. Accordingly, the Board approves a 2001 cost of equity of 9.50% and a cost of equity of 9.00% for the first quarter of 2002 for the AE DISCO deferral account. __________	81

16.	Accordingly, the Board approves a deemed capital structure of 85% debt and 15% equity for the EDI deferral account for the year 2001. This structure is inherent to the Board's approved carrying cost rate used in Decision 2001-89, issued December 4, 2001. __________	84
17.	The Board notes that EDI is a municipal utility. Therefore, the Board's previous generic finding of a 6.65% cost of debt for municipal utilities would be appropriate and prudent for the EDI deferral account. Accordingly, the Board approves a 6.65% cost of debt for the year 2001 for EDI's deferral account. This rate is inherent in the rate approved in Decision 2001-89, issued December 4, 2001. __________	84
18.	In the Board's view, there are no special circumstances that would warrant a change to the Board's generic finding respecting the 2001 cost of equity. Accordingly, the Board approves a 2001 cost of equity of 9.50% for the EDI deferral account. This rate is inherent in the rate approved in Decision 2001-89, issued December 4, 2001. __________	84
19.	Accordingly, the Board approves a deemed capital structure of 85% debt and 15% equity for the Red Deer DISCO deferral account for the year 2001. This structure is inherent to the Board's approved carrying cost rate used in Decision 2001-90, issued December 4, 2001. __________	88
20.	Accordingly, the Board considers that its previous generic finding of a 6.65% cost of debt for EDI's deferral account would also be appropriate and prudent for Red Deer's deferral account. Therefore, the Board approves a 6.65% cost of debt for the year 2001 for the Red Deer deferral account. This rate is inherent in the rate approved in Decision 2001-90, issued December 4, 2001. __________	88
21.	In the Board's view, there are no special circumstances that would warrant a change to the Board's generic finding respecting the 2001 cost of equity. Accordingly, the Board approves a 2001 cost of equity of 9.50% for Red Deer's deferral account. This rate is inherent in the rate approved in Decision 2001-90, issued December 4, 2001. __________	89
22.	Accordingly, the Board approves a deemed capital structure of 85% debt and 15% equity for the Lethbridge DISCO deferral account for the year 2001. This rate is inherent in the rate approved in Decision 2001-91, issued December 4, 2001. __________	91
23.	Accordingly, the Board considers that its previous generic finding of a 6.65% cost of debt for municipal utilities would also be appropriate and prudent for Lethbridge's deferral account. Therefore, the Board approves a 6.65% cost of debt for the year 2001 for the Lethbridge deferral account. This rate is inherent in the rate approved in Decision 2001-91, issued December 4, 2001. __________	91
24.	In the Board's view, there are no special circumstances that would warrant a change to the Board's generic finding respecting the 2001 cost of equity. Accordingly, the Board approves a 2001 cost of equity of 9.50% for Lethbridge's deferral account. This rate is inherent in the rate approved in Decision 2001-91, issued December 4, 2001. __________	91
25.	For the first quarter of 2002, consistent with the DISCO carrying costs rates, the Board approves a deemed capital structure of 85% debt and 15% equity, a 5.00% cost of debt and a 9.00% cost of equity as the WACC parameters for the TransAlta GENCO and AE GENCO GENCO deferral accounts. __________	102
26.	The Board approves a deemed capital structure of 85% debt and 15% equity, a 5.20% cost of debt and a 9.00% cost of equity as the WACC parameters for the EGI GENCO deferral account for the first quarter of 2002. The 5.20% cost of debt for the first quarter of the year 2002 for EGI GENCO is consistent with the 20 basis point uplift in the cost of debt awarded to EGI GENCO in the year 2001. __________	102
27.	Accordingly, the Board approves the 2.60% cost to be the carrying cost rate for UNCA and AE DISCO starting on April 1, 2002 on an interim basis. This interim carrying cost rate for UNCA and AE DISCO will be in effect until one of two following outcomes: __________ • Board approval of the securitization scheme and the related approval of the final "all-in cost of funds" for the scheme and the consequent implementation of the scheme. • The rejection by the Board of the securitization scheme as a viable option, upon application by the parties.	118
28.	In the circumstances, the Board considers the proposals by AE and UNCA to be reasonable. Therefore, the Board approves the collection approach of AE and UNCA for customers < 2 MW in that all customers <2 MW will share equally in the recovery of the deferral accounts based on actual consumption during the recovery period, regardless of when a customer became active on the system. __________	132

29.	For these reasons, the Board approves AE's and UNCA's approaches for collecting the deferral account balance from large customers over 2 MW, in "normal" circumstances.	134
30.	Accordingly, the Board also approves UNCA's and AE's proposals that new >2 MW customers will not be responsible for additional costs beyond those directly generated by them in year 2000, except in the case of the bankruptcy of, or otherwise uncollectible amounts owed by, other customers. __________	134
31.	For these reasons, the Board does not approve AE's proposal to make all rate classes responsible for any shortfalls in the large, >2 MW customer rate classes. __________	135
32.	Accordingly, the Board does not approve UNCA's proposal to allocate the shortfalls contained within each rate class for the large > 2 MW customer rate classes. __________	136
33.	The Board's approved treatment of customers who have left the system is tabulated in Table 14 for UNCA and AE DISCO __________	137
34.	Accordingly, the Board approves UNCA's position that no adjustment is required to UNCA's pool price deferral account balance for the lack of benefits or costs associated with the absence of a hedging program for electricity in the year 2000. Similarly, the Board finds that no adjustment is required to AE DISCO's pool price deferral account balance for the lack of benefits or costs associated with the absence of a hedging program for electricity in the year 2000. __________	147

19 Summary of Directions

814 This section is provided for the convenience of readers. In the event of any difference between the Directions in this section and those in the main body of the report, the wording in the main body of the Decision shall prevail.

1.	Accordingly, the Board directs UNCA to recover its pool price deferral accounts over a two-year period beginning in the year 2002. The Board, in a subsequent Decision, will determine the commencement of the recovery period for UNCA. __________	18
2.	Since the Board considers that ENMAX's deferral account should use the same WACC parameters as the Board approved for EDI's deferral account, the Board, in Decision 2001-88 directed ENMAX to recalculate and resubmit to the Balancing Pool a revised 2001 carrying costs claim using the following approved parameters. The Board directs ENMAX to use a deemed capital structure of 85% debt and 15% equity, a 6.65% cost of debt for the year 2001 and a 9.50% cost of equity for its deferral account for the year 2001. This structure and these rates are inherent to the Board's approved carrying cost rate used in Decision 2001-88, issued December 4, 2001. __________	85
3.	For these reasons, the Board approves the following WACC parameters for the TransAlta GENCO and AE GENCO deferral accounts for the year 2001, namely a deemed capital structure of 85% debt and 15% equity, a 6.45% cost of debt and a 9.50% cost of equity. For the EGI GENCO deferral account, the Board will allow the same parameters except a 6.65% cost of debt consistent with its cost of debt award for EDI. The Board directs TransAlta GENCO, AE GENCO, and EGI GENCO, in their refilings, to utilize these carrying cost parameters __________	102
4.	Accordingly, the Board directs AE DISCO and UNCA to aggressively pursue implementation of the securitization option and to report the status to the Board at the time of their refilings, if an appropriate report from the Securitization Implementation Group has not yet been provided on their behalf. __________	120
5.	The Board directs AE DISCO and UNCA DISCO, in their refilings, to develop true-up provisions that would allow for adjustments to ensure that unanticipated changes would not jeopardize the collection of adequate funds from customers to repay the deferral account balances and financing, regardless of whether securitization proceeds, if these provisions have not already been addressed in the Final Report of the Securitization Implementation Group. Further, UNCA and AE, in their refilings, are to provide the appropriate suggested wording for inclusion in the Board Order approving the refilings.	121
6.	In the event that securitization is realized, the Board considers that there may be timing differences, which occur between revenue collection by the utilities and transfer of the amounts to the persons holding the security. In effect, this revenue will be held by the utilities and available for their use as working capital for any such period. Accordingly, the Board directs UNCA and AE	121

	to review this timing possibility and to include any benefit, which occurs as an item in the true up to the benefit of retiring the security. __________	
7.	Therefore, the Board directs AE and UNCA, in their refilings, to update their balances in each class after accounting for customer switching between rate classes so that liability for the deferral account amounts is attributed to the proper rate class. This direction applies to all rate classes. __________	133
8.	Also, the Board directs AE and UNCA, in their refilings, to provide updated estimates of collection rates and total recovery from customers for all rate classes from 1999 to and through the collection period on both a cents per kWh basis and on a monthly dollars per customer basis. The information should be provided in the form previously filed with the Board in the June 2001 Distribution Tariff refilings and recently filed in the RROT and interim DT rate proceedings. __________	133
9.	Finally, the Board directs AE and UNCA, in their refilings, to advise the Board of any difficulties experienced in relation to collection mechanics to implement the Board's findings in this Decision. __________	133
10.	The Board directs AE and UNCA in their refilings to submit their approaches or business principles that they will utilize to prevent or avoid "gaming". Further, the Board directs AE and UNCA to propose corresponding wording to the Board to be considered for the final Board Order to provide the utilities with any necessary authority that is required to proactively address and resolve potential "gaming" problems. The Board expects AE and UNCA to be diligent in pursuing all customers in the >2 MW category for recovery of their individual deferral account balances. __________	134
11.	In addition, the Board directs AE and UNCA in their refilings, to submit revised allocation methodologies, business principles, and wording that will be communicated to customers with respect to deferral account balance collection over the recovery period. The description of the revised allocation methodologies should be sufficiently detailed to allow future audits, by the Board or customer representatives, for compliance with the approved process. The revised methodologies should reflect the Board's finding that pooling of all customers >2 MW, regardless of vintage (i.e. "new" or "old") should be implemented for purposes of collecting any shortfalls from bankruptcies or similar uncollectible deficiencies in each class for the large, >2 MW customer rate classes __________	136
12.	Therefore, the Board directs AE and UNCA to cooperate with customers and provide them with appropriate audit rights or agreed upon verification procedures on the reconciliation of the retirement of the deferral account balances on a basis similar to that the audit rights provided for in Board decisions approving, for example, AE's 2001-2002 DT Settlement. The Board expects that parties should be able to address these matters without unnecessary Board involvement. However, if necessary, the Board will adjudicate this issue and will consider it to be addressed as part of these proceedings. __________	137
13.	In this regard, the Board directs UNCA and AE DISCO to provide a statement of reconciliation to the Board and interested parties at the end of the collection period. __________	137
14.	For all of these reasons, the Board directs AE and UNCA, in their respective refilings, to provide the methodology and terms, if any, of any prepayment options for large customers over 2 MW that are consistent with the potential securitization option, as appropriate. In their refilings, AE and UNCA should provide their assessments of whether stranded costs could result for the remaining customers from accepting prepayment, accelerated or single payment options. Further, AE and UNCA should address whether a one-time payment option and an accelerated recovery period (e.g. all recovery within the 2002 period for UNCA) can be provided to customers and if so, on what terms and conditions. __________	139
15.	However, the Board directs AE and UNCA, in their refilings, to advise whether any prepayment or accelerated payment options by <2 MW customers would be practical and recommended. The Board would give favourable consideration to any such proposals after taking into account the same issues as for >2 MW customers. __________	140
16.	In Decision 2001-102, the Board determined that the riders for AE's collection of the 2000 Pool Price Deferral Account proceeding would be implemented commencing April 1, 2002. Accordingly, the Board directs AE, prior to December 31, 2001, to contact each customer >2 MW and to provide, prior to December 31, 2001, an approximation of that customer's 2000 Deferral Account Pool Price Proceeding liability if that customer so desires. __________	140

17. The Board has also determined that the riders for UNCA's collection of the 2000 Pool Price Deferral Account proceeding will commence in 2002. A future Board Decision will determine the exact commencement date in 2002. Accordingly, the Board directs UNCA, prior to December 31, 2001, to contact each customer >2 MW and to provide, prior to December 31, 2001, an initial approximation of that customer's 2000 Deferral Account Pool Price Proceeding liability if that customer so desires. __________ 140

18. Accordingly, the Board directs UNCA and AE, in their refilings, to recommend the specific wording necessary to provide the clear authority to UNCA and AE to collect from any customer who has an obligation to pay a share of the deferral account balances pursuant to the terms of the Boards findings in the Decisions in this proceeding. __________ 142

Appendix 1 — 20 Financial Risk Analysis

Assessment of UNCA Financial Risk — **Appendix 1**

	TransAlta GENCO	UNCA DISCO	UNCA Out Matters	TAU Gen Out Matters	Total
January 1, 2001	$16,700,000	$364,554,000	$76,099,000	$18,788,022	**$476,141,022**
Average 2001	$8,350,000	$352,537,859	$38,049,500	$9,394,011	$408,331,370
January 1, 2002	$0	$340,521,717	$0	0	**$340,521,717**
Average 2002		$255,391,288	$0		$255,391,288
January 1, 2003		$170,260,859	$0		**$170,260,859**
Average 2003		$85,130,429	$0		$85,130,429
January 1, 2004		$0	$0		**$0**

UNCA Integrated

Rate Base	**$2,839,000,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate	(Note 3)			41.00%
Debt	49.77%	7.70%	3.83%	3.83%
Preferred	9.23%	7.69%	0.71%	1.20%
Equity	41.00%	9.25%	3.79%	6.43%
WAAC			8.33%	11.46%
Tax Timing				1.69%
Return plus Tax				13.15%
Before Tax Interest Coverage				3.43
Depreciation Expense as % of Rate Base				8.29%
EBITDA				21.45%
Debt to EBITA Covenant Ratio				**2.32**

UNCA DISCO

Rate Base	**$473,000,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				41.00%
Debt	49.77%	7.70%	3.83%	3.83%
Preferred	9.23%	7.69%	0.71%	1.20%
Equity	41.00%	9.25%	3.79%	6.43%
WAAC			8.33%	11.46%
Tax Timing				4.14%
Return plus Tax				15.61%
Before Tax Interest Coverage				4.07
Depreciation Expense as % of Rate Base				16.34%
EBITDA				31.95%
Debt to EBITA Covenant Ratio				**1.56**

DISCO Deferral Account

Rate Base	**$476,141,022**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				41.00%
Debt	85.00%	6.45%	5.48%	5.48%
Equity	15.00%	9.50%	1.43%	2.42%
			6.91%	7.90%
Before Tax Interest Coverage				1.44
Debt to EBITA Covenant Ratio				**10.76**

DISCO Deferral Account

Rate Base	**$476,141,022**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				41.00%
Debt	72.50%	6.45%	4.68%	4.68%
Equity	27.50%	9.50%	2.61%	4.43%
			7.29%	9.10%
Before Tax Interest Coverage				1.95
Debt to EBITA Covenant Ratio				**7.96**

Composite Integrated with Deferral Account

Rate Base	**$3,315,141,022**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				41.00%
Debt	54.83%	7.42%	4.07%	4.07%
Preferred	7.90%	7.69%	0.61%	1.03%
Equity	37.27%	9.26%	3.45%	5.85%
WAAC			8.13%	10.95%
Tax Timing				1.45%
Return plus Tax				12.40%
Before Tax Interest Coverage				3.05
Depreciation				7.10%
EBITDA				19.50%
Debt to EBITA Covenant Ratio				**2.81**

Composite DISCO with Deferral Account

Rate Base	**$949,141,022**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				41.00%
Debt	61.17%	6.96%	4.26%	4.26%
Preferred	4.60%	7.69%	0.35%	0.60%
Equity	34.23%	9.35%	3.20%	5.42%
WAAC			7.81%	10.28%
Tax Timing				2.07%
Return plus Tax				12.34%
Before Tax Interest Coverage				2.90
Depreciation				3.96%
EBITDA				16.30%
Debt to EBITA Covenant Ratio				**3.75**

Note 1 Rate Base, Capital Ratios and Costs Rates from U99099 Vol 2 Appendix 3 Pg 1of 4
Note 2 Depreciation Expense from December 16,1999 refiling
Note 3 Federal Tax rates as per Feb 28, 2000 budget and Provincial Tax rates are a weighted average of rates per Alberta 2001-2002 budget

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Graphic 1

PART K: RECOVERY PERIOD, CARRYING COST RATES, COLLECTION ISSUES, AND HEDGING ISSUES

GENCO and DISCO 2000 Pool Price Deferral Accounts Proceeding

Assessment of UNCA Financial Risk

	TransAlta GENCO	UNCA DISCO	UNCA Out Matters	TAU Genco OM	Total
January 1, 2001	$16,700,000	$364,554,000	$76,099,000	$18,788,022	**$476,141,022**
Average 2001	$8,350,000	$352,537,859	$38,049,500	$9,394,011	$408,331,370
January 1, 2002	$0	$340,521,717	$0	0	**$340,521,717**
Average 2002		$255,391,288	$0		$255,391,288
January 1, 2003		$170,260,859	$0		**$170,260,859**
Average 2003		$85,130,429	$0		$85,130,429
January 1, 2004		$0	$0		**$0**

UNCA Integrated

Rate Base	**$2,839,000,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate	(Note 3)			37.00%
Debt	49.77%	7.70%	3.83%	3.83%
Preferred	9.23%	7.69%	0.71%	1.13%
Equity	41.00%	9.25%	3.79%	6.02%
WAAC			8.33%	10.98%
Tax Timing				1.69%
Return plus Tax				12.67%
Before Tax Interest Coverage				3.31
Depreciation				3.95%
EBITDA				16.62%
Debt to EBITA Covenant Ratio				**2.99**

UNCA DISCO

Rate Base	**$473,000,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				37.00%
Debt	49.77%	7.70%	3.83%	3.83%
Preferred	9.23%	7.69%	0.71%	1.13%
Equity	41.00%	9.25%	3.79%	6.02%
WAAC			8.33%	10.98%
Tax Timing				1.69%
Return plus Tax				12.67%
Before Tax Interest Coverage				**3.31**
Depreciation				3.95%
EBITDA				16.62%
Debt to EBITA Covenant Ratio				**2.99**

DISCO Deferral Account

Rate Base	**$340,521,717**		After tax	Before tax
	Capital Ratios	Cost Rate	WACC	WACC
Tax Rate				37.00%
Debt	85.00%	5.00%	4.25%	4.25%
Equity	15.00%	9.00%	1.35%	2.14%
			5.60%	6.39%
Before Tax Interest Coverage				1.50
Debt to EBITA Covenant Ratio				**13.30**

DISCO Deferral Account

Rate Base	**$340,521,717**		After tax	Before tax
	Capital Ratios	Cost Rate	WACC	WACC
Tax Rate				37.00%
Debt	63.50%	5.00%	3.18%	3.18%
Equity	36.50%	9.00%	3.29%	5.21%
			6.46%	8.39%
Before Tax Interest Coverage				**2.64**
Debt to EBITA Covenant Ratio				**7.57**

Composite Integrated with Deferral Account

Rate Base	**$3,179,521,717**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				37.00%
Debt	53.54%	7.24%	3.88%	3.88%
Preferred	8.24%	7.69%	0.63%	1.01%
Equity	38.22%	9.24%	3.53%	5.60%
WAAC			8.04%	10.49%
Tax Timing				1.51%
Return plus Tax				12.00%
Before Tax Interest Coverage				3.09
Depreciation				3.53%
EBITDA				15.52%
Debt to EBITA Covenant Ratio				**3.45**

Composite DISCO with Deferral Account

Rate Base	**$813,521,717**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				37.00%
Debt	55.52%	6.41%	3.56%	3.56%
Preferred	5.37%	7.69%	0.41%	0.66%
Equity	39.12%	9.15%	3.58%	5.68%
WAAC			7.55%	9.89%
Tax Timing				0.98%
Return plus Tax				10.88%
Before Tax Interest Coverage				**3.06**
Depreciation				3.96%
EBITDA				14.84%
Debt to EBITA Covenant Ratio				**3.74**

Note 1 Rate Base, Capital Ratios and Costs Rates from U99099 Vol 2 Appendix 3 Pg 1of 4
Note 2 Depreciation Expense from December 16,1999 refiling
Note 3 Federal Tax rates as per Feb 28, 2000 budget and Provincial Tax rates are a weighted average of rates per Alberta 2001-2002 budget

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Graphic 2

PART K: RECOVERY PERIOD, CARRYING COST RATES, COLLECTION ISSUES, AND ASSESSMENT OF UNCA Financial Risk

GENCO and DISCO 2000 Pool Price Deferral Accounts Proceeding

	TransAlta GENCO	UNCA DISCO	UNCA Out Matters	TAU Genco OM	Total
January 1, 2001	$16,700,000	$364,554,000	$76,099,000	$18,788,022	**$476,141,022**
Average 2001	$8,350,000	$352,537,859	$38,049,500	$9,394,011	$408,331,370
January 1, 2002	$0	$340,521,717	$0	0	**$340,521,717**
Average 2002		$255,391,288	$0		$255,391,288
January 1, 2003		$170,260,859	$0		**$170,260,859**
Average 2003		$85,130,429	$0		$85,130,429
January 1, 2004		$0	$0		**$0**

UNCA Integrated

Rate Base	**$2,839,000,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate	(Note 3)			33.38%
Debt	49.77%	7.70%	3.83%	3.83%
Preferred	9.23%	7.69%	0.71%	1.07%
Equity	41.00%	9.25%	3.79%	5.69%
WAAC			8.33%	10.59%
Tax Timing				1.69%
Return plus Tax				12.28%
Before Tax Interest Coverage				3.20
Depreciation				3.95%
EBITDA				16.23%
Debt to EBITA Covenant Ratio				**3.07**

DISCO Deferral Account

Rate Base	**$170,260,859**		After tax	Before tax
	Capital Ratios	Cost Rate	WACC	WACC
Tax Rate				33.38%
Debt	85.00%	5.00%	4.25%	4.25%
Equity	15.00%	9.00%	1.35%	2.03%
			5.60%	6.28%
Before Tax Interest Coverage				1.48
Debt to EBITA Covenant Ratio				**13.54**

Composite Integrated with Deferral Account

Rate Base	**$3,009,260,859**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				33.38%
Debt	51.76%	7.45%	3.86%	3.86%
Preferred	8.71%	7.69%	0.67%	1.01%
Equity	39.53%	9.24%	3.65%	5.49%
WAAC			8.18%	10.35%
Tax Timing				1.59%
Return plus Tax				11.94%
Before Tax Interest Coverage				3.10
Depreciation				3.73%
EBITDA				15.67%
Debt to EBITA Covenant Ratio				**3.30**

UNCA DISCO

Rate Base	**$473,000,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				33.38%
Debt	49.77%	7.70%	3.83%	3.83%
Preferred	9.23%	7.69%	0.71%	1.07%
Equity	41.00%	9.25%	3.79%	5.69%
WAAC			8.33%	10.59%
Tax Timing				1.69%
Return plus Tax				12.28%
Before Tax Interest Coverage				**3.20**
Depreciation				3.95%
EBITDA				16.23%
Debt to EBITA Covenant Ratio				**3.07**

DISCO Deferral Account

Rate Base	**$170,260,859**		After tax	Before tax
	Capital Ratios	Cost Rate	WACC	WACC
Tax Rate				33.38%
Debt	73.00%	5.00%	3.65%	3.65%
Equity	27.00%	9.00%	2.43%	3.65%
			6.08%	7.30%
Before Tax Interest Coverage				**2.00**
Debt to EBITA Covenant Ratio				**10.00**

Composite DISCO with Deferral Account

Rate Base	**$643,260,859**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				33.38%
Debt	55.92%	6.77%	3.78%	3.78%
Preferred	6.79%	7.69%	0.52%	0.78%
Equity	37.29%	9.20%	3.43%	5.15%
WAAC			7.74%	9.72%
Tax Timing				1.24%
Return plus Tax				10.96%
Before Tax Interest Coverage				**2.90**
Depreciation				3.96%
EBITDA				14.92%
Debt to EBITA Covenant Ratio				**3.75**

Note 1 Rate Base, Capital Ratios and Costs Rates from U99099 Vol 2 Appendix 3 Pg 1of 4

Note 2 Depreciation Expense from December 16,1999 refiling

Note 3 Federal Tax rates as per Feb 28, 2000 budget and Provincial Tax rates are a weighted average of rates per Alberta 2001-2002 budget

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Graphic 3

PART K: RECOVERY PERIOD, CARRYING COST RATES, COLLECTION ISSUES, AND HEDGING ISSUES

GENCO and DISCO 2000 Pool Price Deferral Accounts Proceeding

Assessment of AE 2001 Financial Risk

	AE GENCO	AE DISCO	AE Out Matters	AE GENCO OM	Total
January 1, 2001	$24,400,000	$97,900,000	$25,846,000	$6,454,000	**$154,600,000**
Average 2001	$12,200,000	$91,762,500	$12,923,000		$120,112,500
January 1, 2002	$0	$85,625,000	$0		**$85,625,000**
Average 2002		$42,812,500	$0		$42,812,500
January 1, 2003		$0	$0		**$0**

AE Integrated

Rate Base	**$1,857,000,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate	(Note 3)			41.00%
Debt	49.66%	9.67%	4.80%	4.80%
Preferred	8.73%	5.82%	0.51%	0.86%
No Cost	1.79%	0.00%	0.00%	0.00%
Equity	39.82%	9.25%	3.68%	6.24%
WAAC			8.99%	11.91%
Tax Timing	(Note 4)			1.02%
Return plus Tax				12.93%
Before Tax Interest Coverage				2.69
Depreciation				5.63%
EBITDA				18.56%
Debt to EBITA Covenant Ratio				**2.68**

DISCO Deferral Account

Rate Base	**$154,600,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				41.00%
Debt	85.00%	6.45%	5.48%	5.48%
Equity	15.00%	9.50%	1.43%	2.42%
			6.91%	7.90%
Before Tax Interest Coverage				1.44
Debt to EBITA Covenant Ratio				**10.76**

Composite Integrated with Deferral Account

Rate Base	**$2,011,600,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				41.00%
Debt	52.38%	9.27%	4.85%	4.85%
Preferred	8.06%	7.69%	0.62%	1.05%
Equity	37.91%	9.26%	3.51%	5.95%
WAAC			8.98%	11.85%
Tax Timing				0.94%
Return plus Tax				12.80%
Before Tax Interest Coverage				2.64
Depreciation				5.20%
EBITDA				17.99%
Debt to EBITA Covenant Ratio				**2.91**

AE DISCO

Rate Base	**$470,000,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				41.00%
Debt	49.66%	9.67%	4.80%	4.80%
Preferred	8.73%	5.82%	0.51%	0.86%
No Cost	1.79%	0.00%	0.00%	0.00%
Equity	39.82%	9.25%	3.68%	6.24%
WAAC			8.99%	11.91%
Tax Timing				0.27%
Return plus Tax				12.17%
Before Tax Interest Coverage				2.53
Depreciation				6.58%
EBITDA				18.76%
Debt to EBITA Covenant Ratio				**2.65**

DISCO Deferral Account

Rate Base	**$154,600,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				41.00%
Debt	82.00%	6.45%	5.29%	5.29%
Equity	18.00%	9.50%	1.71%	2.90%
			7.00%	8.19%
Before Tax Interest Coverage				1.55
Debt to EBITA Covenant Ratio				**10.02**

Composite DISCO with Deferral Account

Rate Base	**$624,600,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				41.00%
Debt	57.67%	8.54%	4.92%	4.92%
Preferred	6.57%	7.69%	0.51%	0.86%
Equity	34.42%	9.28%	3.20%	5.42%
WAAC			8.62%	11.19%
Tax Timing				0.20%
Return plus Tax				11.40%
Before Tax Interest Coverage				2.31
Depreciation				3.96%
EBITDA				15.36%
Debt to EBITA Covenant Ratio				**3.76**

Note 1 Rate Base, Capital Ratios and Costs Rates from Exhibit 131 Schedule 8.0
Note 2 Depreciation Expense from Exhibit 131 Schedule 4.0
Note 3 Federal Tax rates as per Feb 28, 2000 budget and Provincial Tax rates are a weighted average of rates per Alberta 2001-2002 budget
Note 4 Income Tax data from Exhibit 131 Schedule 5.1

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Graphic 4

PART K: RECOVERY PERIOD, CARRYING COST RATES, COLLECTION ISSUES, AND HEDGING ISSUES

GENCO and DISCO 2000 Pool Price Deferral Accounts Proceeding

Assessment of AE 2002 Financial Risk

	AE GENCO	AE DISCO	AE Out Matters	AE GENCO OM	Total
January 1, 2001	$24,400,000	$97,900,000	$25,846,000	$6,454,000	**$154,600,000**
Average 2001	$12,200,000	$91,762,500	$12,923,000		$120,112,500
January 1, 2002	$0	$85,625,000	$0		**$85,625,000**
Average 2002		$42,812,500	$0		$42,812,500
January 1, 2003		$0	$0		**$0**

AE Integrated

Rate Base	**$1,857,000,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate	(Note 3)			37.00%
Debt	49.66%	9.67%	4.80%	4.80%
Preferred	8.73%	5.82%	0.51%	0.81%
No Cost	1.79%	0.00%	0.00%	0.00%
Equity	39.82%	9.25%	3.68%	5.85%
WAAC			8.99%	11.46%
Tax Timing	(Note 4)			1.02%
Return plus Tax				12.48%
Before Tax Interest Coverage				2.60
Depreciation				5.63%
EBITDA				18.11%
Debt to EBITA Covenant Ratio				**2.74**

DISCO Deferral Account

Rate Base	**$85,625,000**		After tax WACC	Before tax WACC
	Capital Ratios	Cost Rate		
Tax Rate				37.00%
Debt	85.00%	5.00%	4.25%	4.25%
Equity	15.00%	9.00%	1.35%	2.14%
			5.60%	6.39%
Before Tax Interest Coverage				1.50
Debt to EBITA Covenant Ratio				**13.30**

Composite Integrated with Deferral Account

Rate Base	**$1,942,625,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				37.00%
Debt	51.22%	9.33%	4.78%	4.78%
Preferred	8.34%	7.69%	0.64%	1.02%
Equity	38.73%	9.25%	3.58%	5.68%
WAAC			9.00%	11.48%
Tax Timing				0.98%
Return plus Tax				12.46%
Before Tax Interest Coverage				2.61
Depreciation				5.38%
EBITDA				17.84%
Debt to EBITA Covenant Ratio				**2.87**

AE DISCO

Rate Base	**$470,000,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				37.00%
Debt	49.66%	9.67%	4.80%	4.80%
Preferred	8.73%	5.82%	0.51%	0.81%
No Cost	1.79%	0.00%	0.00%	0.00%
Equity	39.82%	9.25%	3.68%	5.85%
WAAC			8.99%	11.46%
Tax Timing				0.27%
Return plus Tax				11.72%
Before Tax Interest Coverage				2.44
Depreciation				6.58%
EBITDA				18.31%
Debt to EBITA Covenant Ratio				**2.71**

DISCO Deferral Account

Rate Base	**$85,625,000**		After tax WACC	Before tax WACC
	Capital Ratios	Cost Rate		
Tax Rate				37.00%
Debt	85.00%	5.00%	4.25%	4.25%
Equity	15.00%	9.00%	1.35%	2.14%
			5.60%	6.39%
Before Tax Interest Coverage				1.50
Debt to EBITA Covenant Ratio				**13.30**

Composite DISCO with Deferral Account

Rate Base	**$555,625,000**			
	Capital Ratios	Cost Rate	After tax WACC	Before tax WACC
Tax Rate				37.00%
Debt	55.11%	8.56%	4.72%	4.72%
Preferred	7.38%	7.69%	0.57%	0.90%
Equity	36.00%	9.23%	3.32%	5.28%
WAAC			8.61%	10.89%
Tax Timing				0.23%
Return plus Tax				11.12%
Before Tax Interest Coverage				2.36
Depreciation				3.96%
EBITDA				15.08%
Debt to EBITA Covenant Ratio				**3.65**

Note 1 Rate Base, Capital Ratios and Costs Rates from Exhibit 131 Schedule 8.0
Note 2 Depreciation Expense from Exhibit 131 Schedule 4.0
Note 3 Federal Tax rates as per Feb 28, 2000 budget and Provincial Tax rates are a weighted average of rates per Alberta 2001-2002 budget
Note 4 Income Tax data from Exhibit 131 Schedule 5.1

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Graphic 5

Appendix 2 — 21 Disco Carrying Cost Rates

Carrying Cost Rates for The 2000 DISCO Deferral Accounts

	Requested 2001				***Board Approved 2001***				***Board Approved 2002 - 1st Quarter***			
	Cost %	**Capital Structure**	**After Tax WACC**	**Before tax WACC**	**Cost %**	**Capital Structure**	**After Tax WACC**	**Before tax WACC**	**Cost %**	**Capital Structure**	**After Tax WACC**	**Before tax WACC**
UNCA				42.12%				41.00%				38.50%
Debt	6.45	60.00	3.87	3.87%	6.45	85.00	5.48	5.48%	5.00	85.00	4.25	4.25%
Equity	11.50	40.00	4.60	7.95%	9.50	15.00	1.43	2.42%	9.00	15.00	1.35	2.20%
			8.47	*11.82%*			6.91	*7.90%*			5.60	*6.45%*
							-1.56	*-3.92%*			-2.87	*-5.37%*
AE - Original				42.50%				41.00%				38.50%
Debt	9.32	32.34	3.01	3.01%	6.45	85.00	5.48	5.48%	5.00	85.00	4.25	4.25%
Preferred	5.22	7.27	0.38	0.66%	5.20	0.00	0.00	0.00%	5.20	0.00	0.00	0.00%
Equity	9.25	54.50	5.04	8.77%	9.50	15.00	1.43	2.42%	9.00	15.00	1.35	2.20%
			8.43	*12.44%*			6.91	*7.90%*			5.60	*6.45%*
							-1.53	*-4.54%*			-2.83	*-6.00%*
AE - 2001/2002 GTA				42.50%				41.00%				38.50%
Debt	9.30	47.50	4.42	4.42%	6.45	85.00	5.48	5.48%	5.00	85.00	4.25	4.25%
Preferred	5.20	7.50	0.39	0.68%	5.20	0.00	0.00	0.00%	5.20	0.00	0.00	0.00%
Equity	11.13	45.00	5.01	8.71%	9.50	15.00	1.43	2.42%	9.00	15.00	1.35	2.20%

			9.81	*13.80%*			6.91	*7.90%*	5.60	*6.45%*
							-2.91	*-5.90%*	-4.21	*-7.36%*
EDI										
Debt	6.65	62.50	4.16		6.65	85.00	5.65			
Equity	11.50	37.50	4.31		9.50	15.00	1.43			
			8.47				*7.08*			
							-1.39			
Lethbridge										
Debt	7.00	47.50	3.33		6.65	85.00	5.65			
Equity	9.75	52.50	5.12		9.50	15.00	1.43			
			8.44				*7.08*			
							-1.37			
Red Deer										
Debt	7.00	52.50	3.68		6.65	85.00	5.65			
Equity	9.75	47.50	4.63		9.50	15.00	1.43			
			8.31				*7.08*			
							-1.23			
ENMAX										
Debt	6.00		*6.00*		6.65	85.00	5.65			
					9.50	15.00	1.43			
							7.08			
							1.08			

Appendix 3 — 22 Relevant Decisions - 2000 Deferral Accounts

The following list of other relevant Decisions is provided for the convenience of readers and includes hyperlinks to those decisions on the EUB website. In some cases, the Decision may have been assigned a Decision number but may not have been issued yet.

Table 16: List of 2000 Deferral Account Related Decisions

Issue Date	**Decision Number**	**Part**	**Applicant**	**Decision Name**
Nov 25, 1999	U99099		AE EPCOR TransAlta	1999/2000 Electric Tariff Applications
May 10 1999	U99046		AE	1999/2000 Electric Tariff Applications — Negotiated Settlement
Jan 8, 2001	Letter IL 2000-1			"General Policy for Payment of Interest"
Feb 1, 2000	2000-2		AE	1999/2000 Electric Tariff Application Refiling
Feb 1, 2000	2000-3		TransAlta	1999/2000 Electric Tariff Application Refiling
Feb 1, 2000	2000-4		ETI	1999/2000 Electric Tariff Application Refiling
Feb 1, 2000	2000-5		EPGI	1999/2000 Electric Tariff Application Refiling
May 30 2001	2000-31		TransAlta	Closure of 1999 Generation Deferral Accounts, Adj Interest Refund Rider, 2000 Rate Reduction Rider and changes resulting from ESBII
July 27, 2000	2000-52	A	TransAlta	Interim Settlement of 2000 Distribution Deferral Account Part A: Initial Board Determinations
Aug 31, 2000	2000-60	B	TransAlta	Interim Settlement of 2000 Deferral Accounts Part B: Interim Board Determination
Nov 14, 2000	2000-69	C	TransAlta	Interim Settlement of 2000 Deferral Accounts Part C: Board Determination Regarding GENCO Interim Payments ordered in Decision 2000-60
Dec 19, 2000	2000-78	D	TransAlta	Interim Settlement of 2000 Deferral Accounts Part D: Rescission of Interim Rate Riders

				Ordered in Decision 2000-60 effective January 1, 2001
Jan 30, 2001	2001-7	A	UNCA	Part A: Interim Approval of 2001 Financing Costs for the 2000 Distribution Pool Price Deferral Account
Feb 6, 2001	2001-8	A	AE DISCO	Part A: Interim Approval of 2001 Financing Costs for certain 2000 Distribution Deferral Accounts
Feb 9, 2001	2001-10	A	EDI	Part A: Interim Approval of 2001 Financing Costs for the 2000 Distribution Pool Price Deferral Account
Feb 28, 200	2001-12	A	ENMAX	Part A: Interim Approval of 2001 Financing Costs for the 2000 Distribution Pool Price Deferral Account
Apr 24, 2001	2001-26	A	Red Deer	Part A: Interim Approval of 2001 Financing Costs for the 2000 Distribution Pool Price Deferral Account
Apr 24, 2001	2001-27	A	Lethbridge	The City Of Lethbridge Part A: Interim Approval of 2001 Financing Costs for the 2000 Distribution Pool Price Deferral Account
May 15 2001	2001-36	B	AE	Part B: Interim Supplementary Approval of 2001 Financing Costs for the 2000 Distribution Deferral Account
May 25 2001	2001-45	E	IPCCAA	Part E: IPCCAA Applications for review and Variance
Oct 31, 2000	2000-65	AE		2001/2002 Transmission Facility Owner (TFO) Negotiated Settlement
Aug 8, 2001	2001-70	F	ALL GENCOs	Interim Disposition of GENCO Deferral Account Balances
Nov 9, 2001	2001-82	A	GENCOs AE, TAU, EGI	2000 GENCO Outstanding Matters Deferral Accounts (Non Pool Price)
Nov 8, 2001	2001-83	B	DISCOs AE UNCA	2000 DISCO Outstanding Matters Deferral Accounts (Non Pool Price)
Dec 11, 2001	2001-83 Errata		AE DISCO	Errata to 2000 DISCO Outstanding Matters Deferral Accounts (Non Pool Price)
Dec 4, 2001	2001-88	G	ENMAX	Review of ENMAX DISCO 2000 Pool Price Deferral Accounts
Dec 4, 2001	2001-89	H	EDI	Review of EDI DISCO 2000 Pool Price Deferral Accounts
Dec 4, 2001	2001-90	I	Red Deer	Review of Red Deer DISCO 2000 Pool Price Deferral Accounts
Dec 4, 2001	2001-91	J	Lethbridge	Review of Lethbridge DISCO 2000 Pool Price Deferral Accounts
Today	2001-92	K	ALL 6 DISCOs	DISCO 2000 Pool Price Deferral Accounts - Carrying Costs, Collection and Hedging
To Come	2001-93	L	UNCA	DISCO Balances And Allocations
To Come	2001-94	M	AE DISCO	DISCO Balances And Allocations
To Come	2001-95	N	GENCOs	GENCO Deferral Account Balances
Dec 11, 2001	2001-102	F	AE DISCO	2001-2002 General Tariff Application Part F: 2002 Distribution Tariff Base Rates

Appendix 4 — 23 Abbreviations Used in the Decision

ACC	Alberta Cogenerators Council
AE	ATCO Electric Ltd.
AE DISCO	ATCO Electric Ltd. — Distribution Function

AE GENCO	ATCO Electric Ltd. — Generation Function
CCA	Consumers' Association of Canada
DAT	Direct Access Tariff
DISCO	Distribution company
DTS	Demand Transmission Service Tariff (A tariff of the Transmission Administrator)
EDI	EPCOR Distribution Inc.
EGI	EPCOR Generation Inc.
ENMAX PC	ENMAX Power Corporation
ETI	EPCOR Transmission Inc.
EU Act	Electric Utilities Act
EUB or Board	Alberta Energy and Utilities Board
EUI	EPCOR Utilities Inc.
FIRM or FIRM Group	Alberta Federation of REA's Ltd., the Alberta Association of Municipal Districts & Counties, the Alberta Irrigation Projects Association, the Alberta Urban Municipalities Association, the Consumers Coalition of Alberta, and the Public Institutional Consumers of Alberta
GENCO	Generation company
GRID	ATCO Electric's Generation Reserve for Injuries and Damages
GTA	General Tariff Application
IFE	Independent Financial Expert
IPCCAA	The Industrial Power Consumers and Cogenerators Association of Alberta
Municipal DISCOs	ENMAX Power Corporation, EPCOR Distribution Inc., the City of Red Deer and the City of Lethbridge
Outstanding Matters	The proceeding that was not a Pool Price Deferral Account.
POR	Pool Opportunity Rate
PPA	Power Purchase Arrangement
PPDA	Pool Price Deferral Accounts
SPPA	Senior Petroleum Producers Association
TA	Transmission Administrator
TAU	TransAlta Utilities Corporation
TSR	Temporary Suspension Regulation
UNCA/ UNCA DISCO	UtiliCorp Networks Canada (Alberta) Ltd.
UOV	Unit Obligation Value
VLCP	Voluntary Load Curtailment Program

Appendix 5 — 24 Participants - 2000 Pool Price Deferral Accounts

List of Interested Parties	***Representative(s)/Witnesses***
AE DISCO	*L. G. Keough, Esq.* *S. E. Young, Esq.* Kathy McShane Brian Bale Owen Edmondson Jim Beckett Derrick Ploof
AE GENCO	*L. G. Keough, Esq.* *S. E. Young, Esq.* James Beckett Vic Post Satar Parhar
Alberta Association of Municipal Districts and Counties	*L. J. Burgess, Q.C.*
Alberta Cogenerators Council	*R. C. Secord, Esq.* Alan Rosenberg
Alberta Federation of REAs Ltd.	*K. L. Sisson, Q.C.*
Alberta Irrigation Projects Association	*J. H. Unryn*
Alberta Newsprint/Millar Western	*A. W. Carpenter, Esq.*

	Jack Joys
	Bob Fell
	Doug Sullivan
Alberta Urban Municipalities Association	*C. R. McCreary, Esq.*
	J. A. Bryan, Q.C.
City of Calgary	*P. Quinton-Campbell, Esq.*
Consumers' Coalition of Alberta	*J. A. Wachowich, Esq.*
EDI	*D. R. Wright, Q.C.*
	Rick Cowburn
	Ed de Palezieux
	Robert Evans
EGI	*D. R. Wright, Q.C.*
	Guy Bridgeman
	Douglas Topping
	Trevor Smereka
ENMAX	*L. A. Cusano, Esq.*
	D. M. Wood, Esq.
	Ken Willis
	Randy Henderson
FIRM Group Witness respecting DISCO Balances	William Marcus
FIRM Group (except AIPA) Witness respecting allocation of DISCO Balances to rate class	Arnie Reimer
Independent Financial Experts	*C. K. Yates, Esq.*
	William Demcoe
	John McCormick
Independent Petroleum Producers Society of Alberta/Senior Petroleum Producers Association	*L. L. Manning, Esq.*
	M. S. Forster, Esq.
	Dean Short
	Dale Hildebrand
Industrial Power Consumers and Cogenerators Association of Alberta	*D. E. Crowther, Esq.*
	Mark Drazen
	Dan Macnamara
	Ron Mikkelsen
Lethbridge	*P. Smith, Q.C.*
	Otto Lenz
	Barry Sawada
	Nigel Chymko
Public Institutional Consumers of Alberta	*N. J. McKenzie, Esq.*
Red Deer	*P. Smith, Q.C.*
	Albert Roth
	Nigel Chymko
The Aboriginal Communities	*J. Graves*
The Peigan Nation, the Ermineskin Nation and the Montana Nation	*A. O. Ackroyd, Q.C.*
TransAlta Utilities	*T. Dalgleish, Q.C.*
	Vaughn Bend
	Richard Way
UNCA	*B. Wallace, Esq.*
	Heidi Kirrmaier
	Tim Simard
	Bill van Yzerloo
	Robert Evans
	John Martin
	Miles Stroh
Board	*Personnel*
EUB Panel	N. W. MacDonald, Presiding
	A. J. Berg, Member
	R. G. Lock, Member

EUB Staff	A. E. Domes, Legal Counsel R. M. Litt M. L. Asgar-Deen T. J. Storey B. D. Shand

Appendix 6

25 Views of the Parties - Carrying Cost Rate

25.1 Views of ENMAX

ENMAX applied to recover carrying costs for 2001 in respect of its Deferral Account at a rate calculated as the Bank of Canada Bank Rate plus 1.5%. This is the same rate as is prescribed by section 4(4) of the *Deferral Accounts Regulation*, for the purposes of the calculation of interim carrying costs. Taking into account its own circumstances, ENMAX selected this rate because this rate closely reflects ENMAX's cost of short-term debt for the relevant period. ENMAX believes that in the circumstances, debt financing is appropriate with respect to its own 2000 Pool Price Reconciliation Account, as it represents the least cost to customers, and promotes regulatory efficiency.

ENMAX took no position with respect to the applications of other DISCOs.

25.2 Views of TransAlta

TransAlta (TAU) was supportive of the position of UNCA as to the proper financing structure and appropriate cost of equity and cost of debt to support the UNCA deferral account balance, and of the evidence of Dr. Evans relating thereto. As indicated by Dr. Evans, [374] there would not be a material difference in financing costs between TAU DISCO on a stand-alone basis and UNCA. TAU noted that UNCA is essentially the TAU DISCO wires business on a stand-alone basis.

TransAlta stated that the Board for rates purposes adopted the stand-alone perspective for 1999 and 2000, and separate capital structures were established for each of TAU GENCO, TRANSCO and DISCO in Decision U99099. Thus, TAU argued that there should be no real question of now abandoning the stand-alone approach, which was in effect in 2000 and which is wholly consistent with the restructuring and re-regulation of the industry.

TransAlta stated that inclusion of the portion of the DISCO deferral account amounts attributable to the period of time that TAU owned the DISCO in 2000 in the overall financing of the UNCA deferral account makes sense given that there is in fact no TAU DISCO balance sheet for 2001 through 2004, and that as noted above, the UNCA balance sheet is a suitable surrogate for a stand alone TAU DISCO.

TAU noted that, as noted by Dr. Evans, [375] the average length of time that amounts are outstanding with respect to TAU's and UNCA's portions of the deferral account debts, respectively, are not materially different, both being approximately three years.

With respect to the No-Harm issue, TransAlta noted that the question of whether the 'no harm' test as applied by the Board in Decision 2000-41 should have a bearing on the DISCO deferral account financing parameters was first raised in the proceeding with the UNCA panel. [376] TransAlta noted that Mr. van Yzerloo representing UNCA responded:

> I know that through the last two revenue decisions, the Board took the approach of unbundling the TransAlta organization into its various business components of generation, transmission distribution, and retail consistent with restructuring of the market here in Alberta to create a competitive commodity environment.
>
> With that in mind, the stand-alone principle the Mr. Evans has provided in his evidence and spoken to needs to be, in my view, very carefully considered in applying the no-harm test in that the costs — if TransAlta had not sold the business

> — would be similar on a stand-alone basis as they are today on a stand alone basis. And the stand-alone principle would say that the distribution operations of TransAlta would not look to the larger size of the organization that is driven by a generation and transmission to support those operations. So, my answer is then that the stand-alone principle does apply in that case in my mind, and the no-harm test should be viewed with the stand-alone principle in front of us.

TransAlta submitted that Mr. van Yzerloo's views are proper, and are supported by TransAlta. In addition, the nature of the no harm test must be considered, as well.

TransAlta noted that the Board considered and defined the financial aspects of 'no harm' issues as part of the sale proceeding. Those issues, as they appear in Decision 2000-41, were treatment of the pension surplus, the level of available UCC for regulatory purposes and potential recovery of the premium paid in future rates. TransAlta submitted that in each case, the Board made a direction, or other observation that it saw as appropriate, to deal with the matter. In so doing, the Board had satisfied itself as to the no harm issues and then approved the transaction, conditioned as it saw appropriate with respect to no harm.

In a later case, the Board has confirmed this perspective on the no harm test as applied to UNCA and TransAlta. In Decision 2001-65, [377] the Board noted in respect of Decision 2000-41 that: "In Decision 2000-41, the Board was able to attach appropriate conditions to its approval of the transaction to satisfy itself that any potential harm to customers was adequately mitigated."

TransAlta argued that to go back at this time in hindsight and say that the financing of deferral accounts for years after 2000 should now be considered as a term of the sale approval did not represent a reasonable approach. Such a perspective would turn a vendor in a transaction long-since closed into a guarantor of unspecified amounts in respect of unforeseen and unlimited events.

TransAlta also noted that the cause of the carrying costs issue was a combination of the increase in pool prices and the government decision (not expected at the time of the D&R sale, and not foreseen until the government acted in late 2000) to pass regulations terminating the existing year 2000 collection and postponing right out of 2001 collection of the account. Moreover, the regulations so passed had prescribed the parameters for financing of the outstanding deferral account balances in recognition that collection was being postponed by government actions.

TransAlta noted that not only is it not the cause of the incremental carrying charge costs, but had TransAlta's earlier efforts to collect the growing deferral account balances not been disrupted by an unexpected change in government policy, the carrying cost matter would not have existed for UNCA customers. TransAlta noted that it had sought and the Board had approved in 2000 in Decision 2000-60 the early interim commencement of collection of the 2000 deferral account, and no interest was being calculated on or paid by customers as part of that collection. TransAlta noted that the interim order would have continued in its terms into 2001, had it not been overridden by the new regulations, and would have proceeded to collect the amounts needed — still without carrying cost charges.

TransAlta submitted that its approach would have thus obviated or mitigated the need for carrying costs to be charged to TransAlta/UNCA DISCO customers, until it was overridden by the new regulations.

For all of the foregoing reasons, TransAlta submitted that it would not be a reasonable application of the 'no harm' concept to deny or diminish the carrying costs otherwise applicable to the UNCA DISCO deferral account.

25.3 Views of UNCA

In addition to applying for recovery of the principal amount in its year 2000 pool price deferral account, UNCA also applied for an 8.47% carrying cost rate in respect of the period 2000-2004. [378] UNCA submitted that the 8.47% carrying cost is a rate that reflects the stand-alone risks of the deferral account operations and is fully supported in the evidence of Dr. Evans. [379]

UNCA submitted that the deferral accounts do not represent an "investment opportunity". [380] For example, speaking on behalf of UNCA and EDI, Dr. Evans stated:

> Believe me, no one would be happier than EDI and UNC to get these obligations off their balance sheets. No one, at least in respect of these companies that I (have) spoken with, has any idea that this is of any benefit to them in terms of earnings or anything else. They would much prefer to have this monkey off their back. [381]

> Mr. Chairman, these are not assets that UNCA or EDI, for that matter, are very happy to own. They would prefer, I think to have this problem off their balance sheets, particularly for UNCA, it has created some very real world practical problems in terms of being finance, in terms of being able to simply pay their bills. So in terms of the perception of these deferral account balances, I can tell you from my discussions with both companies that they are not perceived as an investment opportunity that they would have voluntarily taken up. They have done the best they can under trying circumstances to get what financing they could, because they had to. And they have put that in place. But if there were some option, lower-cost option, perhaps, that would enable them to remove these obligations from their balance sheets, I believe that both companies would be happy to do that. [382]

> Well, it certainly is an opportunity that was thrust upon them, if I can put it that way. I am not sure that they really had a choice about it. And what I am trying to convey to you is that if they had had a choice about this, I suspect, and this is to some degree speculation, but I suspect it is an opportunity that they would have passed up. But they didn't have the choice, and they went out and ultimately put a debt and equity structure in place, because that was what was available at that time. And so, the cost rates in my evidence are simply the cost of that money, and they should certainly be compensated for that up to the point of an possible payout, if that is what happens, by the Balancing Pool or some other entity. [383]

UNCA noted that Mr. Edmondson also rejected the notion of the deferral account financings as an "opportunity to earn", stating that ATCO would prefer to have a cash payout of the deferral accounts sooner rather than later. [384]

In addition, Mr. Marcus acknowledged "I think the utilities would just as soon not have this monkey on their balance sheet..." [385]

UNCA also noted that the IFE stated that a prime motivation for the utilities to securitize their deferral accounts is to remove the deferral account obligations from their balance sheets. [386]

UNCA argued that the deferral accounts did not represent an "investment opportunity" and submitted that it was not seeking to profit from the unfortunate and unanticipated sharp rise in power pool prices during 2000. UNCA noted that it had to finance its power purchases with a combination of debt and equity Thus, it is only reasonable that UNCA be compensated for the cost of those funds. [387]

UNCA submitted that in its determination of the appropriate carrying cost rate, the Board should have regard for the stand-alone principle, the ability to finance principle, the actual cost principle and the reasonable cost principle. UNCA dealt with the question of the "no harm" test as it applies to the possibility that TransAlta Utilities might have been able to finance the deferral accounts on a basis other than that adopted by UNCA.

UNCA submitted its views regarding the stand-alone principle. UNCA noted that under the stand-alone principle, a utility is regulated as if the provision of the regulated service were the only activity in which the company is engaged. Thus, the cost of providing utility service — and hence rates for service — reflect only the expenses, capital costs, risks and required returns associated with the provision of the regulated service. [388]

In summary, there are several reasons to adhere to the stand-alone principle:

- The stand-alone principle is a fundamental tenet of regulation and should be respected, because:
- The stand-alone principle promotes fairness to customers and investors.
- The stand-alone principle provides for regulatory consistency and therefore reduces regulatory risks.

The stand-alone principle promotes administrative simplicity.

UNCA submitted that Dr. Evans discussed these three reasons in some detail.[389] UNCA noted that Dr. Evans in particular addressed the potential for increased regulatory risk arising from a departure from the stand-alone principle:

> The difficulty, Mr. Lock, from a perception perspective is that the Board must maintain its credibility as an impartial regulator. And if it is seen by the investment community to be embracing the stand-alone principle, as it did in the Novagas transmission proceedings of 1992, 1993, and 1994, when the embracing of that principle results in lower rates to consumers, as it did in the computation, the cost of debt in those proceedings, but then abandoning the stand-alone principle when that also results in lower rates to customers, that kind of inconsistency is something that investors will look at and they will draw, perhaps, unfortunate inferences about whether there are, really, principles of regulation on which they can count in this province when companies come before you, and that would be a far more serious consequence than any of the dollars at stake in this proceeding. So, I would caution you, do not abandon the stand-alone principle. Stick with it. It happens — by the way, which is one reason it is such an almost immutable principle — it happens to correspond to reality here, because these companies could no more finance all of these deferral accounts with short-term debt either upstream or downstream. It just isn't possible. You have to have some equity backing it up.[390]

UNCA submitted that there is ample regulatory precedent for the stand-alone principle in this and other Canadian jurisdictions.[391]

On the matter of stand-alone, UNCA noted that Messrs. McCormick and Demcoe representing the IFE confirmed, "...the decisions of this Board have traditionally reflected the principle that the cost of capital to be applied to regulated utilities should reflect the business risks of those operations, not those of the parent".[392] Messrs. McCormick and Demcoe also stated that "In principle the ownership of a DISCO should have no impact on the appropriate carrying cost to be applied to deferral accounts".[393]

In conclusion, UNCA submitted that the stand-alone principle is sound and the Board should continue to adhere to it.

UNCA submitted its views regarding the ability to finance principle. UNCA noted that the ability to finance principle acknowledges that regulation should not impose on the utility financing options that could not be achieved *at the time the financing was required*. Dr. Evans indicated that for a number of the utilities, the available financing options were a "moving target"; and the relevant regulatory question is "What were the reasonable financing options that were available at the time the financing had to be done?"[394]

UNCA noted the following exchange between Mr. Wallace and Mr. McCormick regarding the ability to finance:

> MR. WALLACE: Now, turning to UNCA, wouldn't you agree with me that the reasonableness of the cost of capital associated with the deferral account assets has to be judged at the time that the company had to raise the money? In other words, when Mr. van Yzerloo had to go out and get the money to fund those growing accounts, it is that time that he had to do that that one judges the risks and the costs of the money?
>
> MR. MCCORMICK: Yes.[395]

Thus, UNCA submitted that the IFE also embraced the ability to finance principle.[396]

UNCA next submitted its views regarding the actual cost principle. UNCA submitted that the Board, as the carrying cost rate, should use the actual cost of financing the deferral accounts, unless there are compelling reasons to reject the actual cost. But in its assessment of the "actual cost", the Board should not ignore the fact that equity is required to underpin any debt financing of the deferral accounts.[397] In this regard, UNCA noted Dr. Evans' following statement:

> I agree with the principle that the utilities should be reimbursed their *actual* cost of financing. But the *actual* cost of financing is not simply the out-of-pocket interest payments on debt. Equity financing is required to backstop debt. Banks, financial institutions and private investors will not supply debt financing without an equity underpinning. Securitizations cannot be constructed without equity support through credit enhancements. Thus, the *actual* cost of financing is a blended cost of debt and equity. [398]

UNCA noted that Mr. Marcus agreed that UtiliCorp required "some amount" of equity to finance its deferral account balances and that shareholders should be compensated for the equity that they commit, assuming "that the choice to put up equity was a reasonable and prudent choice". [399]

In the context of on-balance sheet financing, Dr. Rosenberg argued that: "When you have $400 million worth of capital that is required, you need some equity to underpin that." [400] Dr. Rosenberg also agreed that, subject to a finding of imprudence, shareholders should be compensated for the equity that they have invested. [401]

UNCA noted that, with respect to the matter of prudence in the financing of UNCA's deferral accounts, Messrs. McCormick and Demcoe acknowledged, "We do not have sufficient evidence to contradict the proposals of UNCA which we assume were made with both prudence and practical market considerations in mind." [402]

In conclusion, UNCA submitted that the Board should rely on the actual cost principle. At the same time, in doing so, the Board must recognize that the *actual* cost is more than the out-of-pocket interest cost associated with financing of the deferral accounts.

UNCA also submitted its views regarding the reasonable cost principle. UNCA noted that some parties had suggested that the standard by which the Board should fix the carrying charge rate is the lowest cost method of financing the deferral accounts. However, UNCA submitted that the appropriate regulatory standard is "reasonable cost" and not "least cost".

As evidence, UNCA referred to the hearing that lead to *Decision U96001*, whereby parties invited the Board to adopt a capital structure for Nova Gas Transmission that lead to what was, in their view, the "least cost" financing. UNCA noted that in this case, the Board rejected that the "least cost" approach:

> The Board is not persuaded that an equity component in the range of 25%-27% as recommended by CAPP would not affect NGTL's ability to access financial markets at reasonable terms and conditions. The Board does not accept the arguments advanced in support of this position, nor the suggestion that NGTL's common equity ratio should be leveraged in order to identify the minimum acceptable level. In the Board's view, this would be unfair to NGTL's shareholders and to its ratepayers." [403]

UNCA also noted that the National Energy Board (NEB) rejected a similar invitation to apply the "least cost" standard in the context of its multi-pipeline rate of return hearing. The NEB stated:

> Contrary to what some parties advocated during the hearing, the Board is of the view that it is not appropriate to over-leverage a pipeline in order to identify the minimum acceptable deemed common equity ratio acceptable. [404]

UNCA submitted that the evidence of Dr. Evans supports UNCA's applied-for 8.47% carrying cost rate. [405] Dr. Evans examined the stand-alone business risks of the deferral account operations and established a stand-alone capital structure and cost rates for debt and equity. [406] The capital structure and cost rates reflect the lesser business risks associated with the deferral account operations *vis-à-vis* the distribution wires business. [407]

UNCA noted that the stand-alone debt and common equity financing alternative used by Dr. Evans respects the stand-alone principle and does not impose a financing option on UNCA that cannot be achieved. [408] Thus, this financing option *has* been achieved. [409] UNCA submitted that the 8.47% cost rate is reasonable, because that cost rate reflects reasonable estimates of the costs of debt and equity and a reasonable capital structure in light of the business risks to which the deferral account operations are exposed.

UNCA further noted that none of the other witnesses who offered views on UNCA's financing options and carrying cost rates provided estimates of the costs of equity — either common or preferred. In summary, UNCA submitted that there is no credible evidence contrary to that of Dr. Evans on the matter of the relative proportions of debt and equity required to finance the deferral accounts on a stand-alone basis.

With respect to FIRM's position regarding carrying costs, UNCA noted that Mr. Marcus's argument respecting the financing of the deferral accounts changed during the course of the proceedings.

UNCA noted that, in his original evidence, Mr. Marcus submitted:

> In my opinion the utilities should not finance their deferral account balances with permanent capital (equity and long-term debt). Irrespective of the method of financing adopted by the utilities the deferral account balances should be deemed by the Board to be financed with variable rate debt under the terms of the Board's existing policy for payment of interest on deferral accounts (Bank of Canada rate plus 1.5 percent). I would recommend that due to the short-term nature of the deferral accounts they should be financed by variable rate short-term debt. [410]

However, in terms of a revised recommendation, Mr. Marcus stated in his Opening Statement:

> Subsequent to the filing of my testimony, a considerable amount of interest has been expressed in securitized or off-balance sheet financing. The FIRM Group now believes that off-balance sheet financing should be the main option that is pursued. [411]

Thus, Mr. Marcus agreed with the position of FIRM that securitization "should be the main option that is pursued." [412]

UNCA argued that it is obvious that Mr. Marcus' current recommendation — securitization — can only be applied on a "going-forward" basis. In this regard, Mr. Marcus stated:

> I understand that, sir, but my suggestion is that if we are going in a securitized route, there will need to be a set of changes to — there is likely to be a need to change regulations in several areas, and this is one that I am not saying has to be looked at but could be looked at to make the process more cost effective. [413] It also involves the government, because at the very least, there will probably need to be some changes in regulations, and it is possible that some type of a guarantee structure could be worked that might simplify this process if that is what the government would be interested in doing. I am not trying to speak for the government on that matter. [414]

UNCA referred to Mr. McCormick statement that "Before the (securitization) transaction can close, yes, a Board order authorizing collectability, in my mind, is absolutely required." [415]

Further expanding this view, UNCA submitted that at the time the deferral account financings had to be done, there were no "changes in regulations" that would have enabled a securitization to take place. There was no Board order that would have permitted securitization. Thus, to respect the ability to finance principle, the Board should not retrospectively apply a carrying cost rate consistent with a securitization transaction when that transaction could not possibly have taken place due to the absence of necessary regulations and Board orders.

UNCA concluded that Mr. Marcus' current recommendation provides no assistance to the Board respecting the appropriate carrying cost rate prior to the point of "pay out" by the securitization trust.

With regard to Mr. Marcus' original recommendation, UNCA noted that the recommendation was that the utilities finance their entire deferral account balances using short-term, on-balance sheet debt. [416] Thus, at the outset, Mr. Marcus acknowledged:

> I have not presented detailed evidence with respect to something like rate of return on common equity. I do testify on issues that relate to it such as issues of business risk.[417]

UNCA noted that Mr. Marcus also agreed that he had no experience in investment banking or the "placement of either substantial amounts of debt or equity".[418] As a result, UNCA argued that the absence of finance-specific qualifications should lead the Board to place less reliance on Mr. Marcus' evidence, and instead focus on the evidence of experts such as Dr. Evans or Messrs. McCormick and Demcoe.

UNCA noted that during cross-examination, Mr. Marcus was unable to sustain the reasonableness of his 100% debt, on-balance sheet financing option. For example, UNCA noted the following response by Mr. Marcus:

> Q. But in principle, you would agree that if a shareholder put up equity, it should be compensated for that equity?
>
> A. Assuming that the choice to put up equity was a reasonable and prudent choice relative to other choices out there and relative to other options that were available.[419]

UNCA also noted the following responses by Mr. Marcus regarding UNCA's specific need for equity financing:

> Q. Can you tell me how UtiliCorp could have gone out and raised $400 million without some equity support?
>
> A. I think that something such as a parent company guarantee properly valued and priced into the deal might be cheaper than issuing common equity.
>
> Q. I didn't say "issue common equity." I said equity support. And you have described, I think, a guarantee as a form of equity support, isn't it?
>
> A. It is a form of equity support. I think you could raise preferred equity as well as common, but I would think that in the position that UtiliCorp finds itself, it may need to do some of those things —
>
> Q. It needs equity support, doesn't it, to raise $400 million. I'm sorry. I think I spoke over your answer.
>
> A. To some amount.[420]

UNCA concluded that Mr. Marcus conceded that UNCA would require an unspecified amount of equity to finance its deferral account balances. Further, Mr. Marcus also agreed that if equity is prudently required, then shareholders should be compensated for that equity. Thus, based on Mr. Marcus' own evidence, that the 100% short-term debt cost rate originally proffered by Mr. Marcus cannot reasonably be applied to the deferral accounts of UNCA.

UNCA disputed Mr. Marcus' reliance on U.S. precedent. In his filed evidence, Mr. Marcus attempted to provide the Board with comfort that U. S. utilities routinely received a "debt-only" cost as the carrying cost rate on deferral accounts.[421] However, UNCA noted that the U. S. precedent on which Mr. Marcus urged the Board to rely dealt with deferral accounts of significantly shorter duration than the deferral accounts in this proceeding.[422]

UNCA noted that Mr. Marcus specifically referred to the circumstances of Avista Utilities in his filed evidence.[423] However, based on Dr. Evans' research and cross-examination of Mr. Marcus, it became known that although a short-term debt rate was used for carrying costs on Avista purchased gas adjustment account. The Washington State Commission in respect of Avista's multi-year purchased power deferral account used the weighted average rate of return on rate base.[424] Thus, Mr. Marcus admitted that:

> I think the power cost deferral account may be a little closer to what we are talking about here. The purchase gas adjustment clause is certainly the long-standing policy since there were no power deferrals for 20 years in the state of Washington. [425]

In summary, UNCA submitted that the Board could not take comfort from U. S. precedent in respect of "all debt" deferral account financing. UNCA further submitted that the precedent cited by Mr. Marcus supports the use of a weighted average cost of capital carrying charge rate for its deferral account balances.

With respect to ACC's position regarding carrying costs, UNCA noted that Dr. Rosenberg's filed evidence on carrying costs was very brief, and was more in the nature of a "position statement". [426] Dr. Rosenberg stated:

> Yes. In that case, I believe the carrying charge should be based solely on the cost of debt, and not on the cost of capital. The Deferral Accounts Deficiency Regulation specifies the Bank of Canada Rate plus 1.5%. There are several reasons for this. First, the cost of debt is far less, on an after tax basis, than the cost of equity. Second, there is no reason to finance what is a temporary regulatory asset with equity, which is normally used for long-lived assets, such as utility plant. Third, I see no reason for the DISCO shareholders to profit on what is a very unfortunate situation for customers. Finally, there does not appear to be any regulatory or statutory requirement to use a weighted average cost of capital to fund these deferral accounts. [427]

UNCA responded to Dr. Rosenberg's four reasons for recommending a 100% short-term debt cost rate as the deferral accounts carrying charge rate.

With regard to the argument that "debt is cheap", UNCA noted that Dr. Rosenberg agreed that "...cheap isn't enough of a justification; it has got to be just and reasonable and fair in all the circumstances". [428]

With regard to the argument that the deferral accounts are "temporary assets", UNCA noted that Dr. Rosenberg acknowledged that the UNCA deferral account would be in "existence for a period of five years". [429] Dr. Rosenberg also stated:

> I don't believe it is long term, but I think in one of the responses to the IRs from the Board, I said that technically, short-term debt is one year, and this is more intermediate. But I also noted that there is not a bright green line necessarily between short-term and intermediate. [430]

UNCA submitted that, notwithstanding the debate between short-term and intermediate term, it is obvious that deferral accounts that will exist for periods up to five years are not "temporary assets".

With regard to the argument that shareholders should not profit from the misfortunes of customers, UNCA noted that Dr. Rosenberg does not explain how shareholders will "profit" from the misfortunes of customers in circumstances where shareholders are required to commit equity to the financing of the deferral accounts. UNCA referred to the following comments by Dr. Evans:

> And what I am trying to convey to you is that if they had had a choice about this, I suspect, and this is to some degree speculation, but I suspect it is an opportunity that they would have passed up. But they didn't have a choice, and they went out and ultimately put a debt and equity structure in place, because that was what was available at that time. And so, the cost rates in my evidence are simply the cost of that money, and they should certainly be compensated for that up to the point of a possible payout, if that is what happens, by the Balancing pool or some other entity. [431]

UNCA further noted that Dr. Rosenberg admitted that, subject to a finding of imprudence, it would be equally wrong "for DISCO shareholders to have to put up capital and not be compensated for the capital they have to put up." [432] In respect of the need for equity financing, UNCA noted the following exchange took place between Mr. Wallace and Dr. Rosenberg:

> Q. When you have $400 million worth of capital that is required, you need some equity to underpin that. Whether it is provided directly or by guarantee, you need equity.
>
> A. If it is on balance sheet, yes. If it is off balance sheet no. [433]

Dr. Rosenberg also admitted that he did not know the impact of his recommendation on UNCA. [434]

UNCA noted that while Dr. Rosenberg suggested that the impact of the deferral account financings on *UtiliCorp United*, the parent company of UNCA, would not be "that large", he offered no evidence to support that statement. [435] UNCA submitted that Dr. Rosenberg's attempt to assess the impact of the deferral account financings and the consequent need for equity financing in the context of UtiliCorp United is a flagrant violation of the stand-alone principle and ought to be rejected by the Board.

UNCA submitted that it did not view its forced "investment" in the year 2000 pool price deferral account as an "opportunity" that it would willingly have taken up. Messrs. Marcus, McCormick and Demcoe also recognized that the utilities would prefer not to have to finance these balances and therefore do not regard any return on the required funds as an "investment opportunity". [436] Thus, it was incorrect for Dr. Rosenberg to claim that the utilities are seeking to "profit" from the misfortunes of their customers.

UNCA noted that Dr. Rosenberg's fourth reason for recommending an all-debt carrying cost rate is that "...there does not appear to be any regulatory or statutory requirement to use a weighted average cost of capital to fund these deferral accounts". [437] But when questioned on his fourth reason, Dr. Rosenberg readily conceded, "...it is equally true there is no statutory requirement for straight debt". [438]

In summary, UNCA concluded that none of the reasons advanced by Dr. Rosenberg for adoption of an all-debt, on-balance sheet financing option were sustained during cross-examination. In addition, there is no reliable support for using the Bank of Canada Rate plus 1.5%.

With respect to the IFE's position regarding carrying costs, UNCA noted that Messrs. McCormick and Demcoe gave a considerable amount of evidence respecting the circumstances faced by UNCA and the unique difficulties faced by the Company in coping with the deferral account financing problem. UNCA submitted that it agrees with most of the broad conclusions drawn by these witnesses in respect of the unique situation faced by UNCA and its available financing options.

UNCA noted that Messrs. McCormick and Demcoe acknowledged that the deferral accounts are "significant relative to the rate base of the utility" and "...the size of the deferral account balances is an important factor in considering the financing options available to UNCA". [439] They also recognized that if UNCA's deferral accounts are financed entirely with short-term debt, there could be "negative impacts on the cost of financing". [440]

UNCA noted that, on multiple occasions, Messrs. McCormick and Demcoe referred to the fact that UNCA faced unique challenges in respect of its debt covenants. [441] As an illustration, the IFE stated:

> The UNCA application identifies a breach of certain covenants caused by the size of the deferral amounts as giving rise to the need for equity. In the absence of the availability of a short-term waiver this would clearly be one of the critical points which would require an equity component in the financing of the deferred balances. [442]

It was also noted that Messrs. McCormick and Demcoe acknowledged that UNCA had actually "put up" equity to finance the deferral accounts and that if one did "colour code" dollars of financing, then "it is pretty clear that the equity that they did for between $100 and $120 million is directly related to this transaction." [443]

In terms of the question of whether or not equity is required to underpin the on-balance sheet financing of the deferral accounts, UNCA noted that Messrs. McCormick and Demcoe repeatedly refused to take the position that UNCA could finance its obligations with 100% debt.[444] UNCA was frequently treated, if not identified, as an "exception". UNCA submitted the following statements as being illustrative:

> REQUEST: Based on the evidence provided by UNCA to date, and making reasonable assumptions, please provide an estimate of the proportion of preferred equity and/or common equity, if any needed to underpin short term debt financing for UNCA. Please identify all assumptions.
>
> RESPONSE: We do not have sufficient evidence to contradict the proposals of UNCA which we assume were made with both prudence and practical market considerations in mind.[445]

I think it is appropriate for us to remember UNCA, and our evidence in this document was that *it may not have been possible for them to finance it with 100 percent debt*.[446]

So, it is not my desire to force the Board into a zero equity layer point. We have tried, in our evidence, to show you there is a range of regulatory decisions, a number of examples of zero equity components. But similarly, *I can't sit here and tell you that UNCA could have done it on zero equity*.[447]

Well, sir, if you will forgive me, we were concentrating on the deferral accounts, and by suggesting that the deferral accounts can be financed with a substantially all short-term debt requirement, *with some exceptions — UNCA being one of them where we specifically differed from that* — when added to the existing capital structure for the wires, I think you can get there.[448]

UNCA also noted that the IFE did not take issue with the Chairman's summary of their recommendations, which included a summary of status of UNCA:

Is it your evidence, then, with all of the applications, *except for UNCA*, that the deferral accounts, then can be financed with short-term debt, and stretch would not cause any difficulties or any additional costs over and above the direct costs of the short-term debt?[449]

With regard to the issue of prudently financing the deferral account balances, UNCA noted that Messrs. McCormick and Demcoe repeatedly refused to suggest that UNCA had acted in any manner other than prudently in the financing of its balances.[450] UNCA submitted the following statements as being illustrative:

Upon review of the response of UNCA DISCO to BR.UNCA DISCO-32, we observe that UNCA has taken steps to mitigate the covenants in its existing financing. The outcome of the discussions and negotiations between UNCA and its lenders is presented in the UNCA response. We do not know if other options were pursued between the parties and *expect that both UNCA and its lenders acted prudently in resolving this issue*.[451]

We do not have sufficient evidence to contradict the proposals of UNCA which we assume were made with both prudence and practical market considerations in mind.[452]

> MR. WALLACE: But you didn't come out with any recommendations on UNCA to this point, at least in time, until the Board decision that in any way suggested UNCA has done something wrong, did you?
>
> MR. MCCORMICK: No, we did not.[453]

"...but having brought us back to this level, we now have UNCA in the unfortunate position where it had short-term financing arrangements with its bank at a time when there was volatility in electricity prices causing it to build up larger-than-anticipated deferral accounts. So, they didn't really begin this process on a firm footing, and I suspect that they negotiated, as best they could, to maintain their credit lines, and I am disappointed that we didn't have a Board order in

> advance saying something on the point so that they could have used that in their negotiations with the bank. But they ended up with a requirement that puts them very close to a 40 percent equity layer in terms of their required capitalization. *And I, for one, am loath to say that we ought to go back and penalize them for that position*. [454]
>
> With having said that, when someone has gone out and struggled to keep things together, and this is the result, *from the practical financial basis, it is really hard for me to say that they didn't do as well as they could*. But I am certainly of the view, and I know Mr. Demcoe is, that these assets can normally require with a much lower equity layer. But if you are the new kid on the block and trying to negotiate with the banks, you can't always get the best deal. [455]

UNCA submitted that the evidence of Messrs. McCormick and Demcoe respecting on-balance sheet financing options was not contrary to UNCA's application. Although these witnesses did not opine on the quantum of equity that would be required to underpin UNCA's deferral accounts, they did recognize UNCA's need for equity. Also, they recognized that UNCA took prudent steps to finance the deferral accounts.

UNCA submitted that while Messrs. McCormick and Demcoe encouraged UNCA to pursue an off-balance sheet securitization of its deferral accounts, [456] this suggestion could only apply on a "going-forward" basis.

UNCA noted that Messrs. McCormick and Demcoe agreed that for carrying charge purposes, the relevant cost is determined at the time the money had to be raised. [457] They did not contradict the evidence of Mr. van Yzerloo that a securitization could not be accomplished at the time the funds were required due to the "uncertainty over the recovery of the deferral accounts". [458]

Mr. McCormick further stated that a Board Order respecting collectability was "absolutely required" and no such order existed at the time the financing had to be done. [459]

Thus, UNCA argued that the appropriate carrying charge rate prior to the consummation of a securitization transaction is the weighted average cost of capital rate assuming on-balance sheet debt and equity financing by UNCA.

In summary, UNCA submitted that, at the time the deferral accounts had to be financed, the only available alternative that did not conflict with the stand-alone, ability to finance and actual cost principles was a combination of debt and common equity. This was the alternative actually implemented by UNCA and 8.47% is the cost rate associated with this alternative.

UNCA argued that Mr. Marcus and Messrs. McCormick and Demcoe encouraged UNCA to pursue an off-balance sheet securitization alternative to financing the deferral accounts. While a securitization *may* be possible, the uncontroverted evidence of Mr. van Yzerloo was that this alternative was not available to UNCA at the time it had to finance its deferral account balances. [460] Moreover, as acknowledged by Mr. Marcus and Messrs. McCormick and Demcoe, changes to regulations and a Board order would have been required to effect a securitization; and neither of these requirements were in place at the time the financing had to be done. [461]

UNCA submitted that it did not take any position on the appropriate rates to be applied to the GENCO Deferral Accounts.

UNCA confirmed that it has calculated appropriate Equity and Debt Costs to be applied to the entire life of the deferral accounts. This eliminates periodic variations in carrying costs, increasing certainty and reducing administrative complexity.

UNCA submitted that the only substantive arguments on carrying costs are those of the Independent Financial Experts (IFE), the FIRM Group and ACC. [462]

To the extent that IPCCAA endorsed the overall recommendations of the IFE, [463] UNCA's reply to IPCCAA's carrying cost argument was subsumed in its discussion respecting the IFE's Argument.

UNCA noted that no party proffered specific cost rates, leaving the Board in a position where it cannot reasonably adopt any of their recommendations. For example, FIRM stated that it has "expressed their position relative to prudent carrying costs and AE's negotiated settlement in other sections of this argument." [464] However, UNCA noted that there were no percentages or dollars of carrying cost set out anywhere else in the FIRM Argument.

UNCA noted that the IFE, with the concurrence of IPCCAA, acknowledged that all-debt financing of UNCA's deferral accounts would not have been possible.

The only substantive suggestions to the contrary were those of FIRM and ACC. However, the UNCA expressed concern that FIRM would have the Board revisit its "no harm" decision and retroactively impose on the parties to that commercial transaction a penalty that is clearly inappropriate. In addition, UNCA confirmed that it would have to breach its banking covenants in order to support ACC's recommendations to use100% short-term debt.

UNCA noted the following IFE statement regarding the stand-alone principle:

> A rote application of the stand-alone principle could involve the determination of a notional WACC, including a notional cost of debt, for the DISCO or the notional deferral account business of the DISCO. Application of the stand-alone principle in this context would amount to a denial of financial reality to the benefit of the shareholders of the parent companies and to the detriment of the customers. The stand-alone principle was developed to shield utility customers from negative impacts of decisions taken by managers of consolidated entities that included the utilities. Where investments in non-utility businesses had a negative impact on the cost of funds for the consolidated entity, including the utility, regulators declined to visit that impact upon the tollpayers. It is one thing to use the stand-alone principle as a shield for utility customers to protect them from bearing the negative impacts of decisions taken in respect to a consolidated entity. It is quite another to allow the utility to use the stand-alone principle as a sword to enhance the position of the shareholder at the expense of the customer. [465]

UNCA responded that the stand-alone principle is just that — a principle. The particular "beneficiary" of its application in a specific context does not vitiate its correctness or the need to apply it as a proper regulatory principle. Thus, UNCA argued that the suggestion that the stand-alone principle *should* be applied in those circumstances where customers benefit and *should not* be applied in those circumstances where shareholders benefit (i.e., the "sword and shield" argument) is both self-serving and contradictory and should be rejected by the Board.

Within the context of NEB precedent, UNCA agreed with the IFE that the *original* application of the stand-alone principle was to the benefit of customers. However, UNCA argued that the IFE is wrong when it claims in respect of the Alberta Board:

> The stand-alone principle was developed to shield utility customers from negative impacts of decisions taken by managers of consolidated entities that included the utilities.

UNCA noted that the genesis of the stand-alone principle in Alberta was the Board's 1978 decision respecting Alberta Gas Trunk Line Company Limited (AGTL), the predecessor of NOVA Gas Transmission Ltd. and NOVA Corporation of Alberta. [466]

In the proceeding that leads to *Decision C78221*, the Producer-Complainants suggested that the Board should commence its capital structure analysis with AGTL's *consolidated* common equity ratio and then make a downward adjustment to reflect the higher risks of the nonpipeline operations. [467] Such an approach, in the opinion of Dr. Waters, would have led to a 22-24% common equity ratio for the pipeline. [468]

UNCA noted that the Board rejected the recommended approach and instead embraced the stand-alone principle, concluding that a 32% deemed common equity ratio for pipeline operations was not unreasonable. [469] UNCA further noted that, had Dr. Waters' approach been applied (i.e., had the stand-alone principle been rejected by commencing the analysis with AGTL's consolidated common equity ratio), AGTL's shareholders would have received a lower rate of return on rate base. Thus, the first application of the stand-alone principle in Alberta was to the benefit of shareholders and not customers.

Notwithstanding the fact that the stand-alone principle was *originally* invoked at the NEB in a context, which provided a benefit to customers, UNCA observed that the NEB has since applied the stand-alone principle in circumstances, which inure to the benefit of shareholders. For example, in its *Decision RH-2-93*, the NEB found that the appropriate stand-alone common equity ratio for Westcoast Energy's pipeline operations was 35% even though:

> The Board is cognizant of the fact that Westcoast's consolidated common equity ratio of 23 percent in 1994 is significantly lower than the deemed common equity ratio prescribed by the Board. [470]

UNCA concluded that the stand-alone principle has been fairly and even-handedly applied by regulators in a variety of circumstances — some of which confer a benefit on customers and some of which confer a benefit on shareholders.

UNCA noted the discussion between Mr. Yates and Dr. Evans and cited by the IFE:

> In the current circumstances, the Board should not apply the stand-alone principle by rote. The Board should deal with reality, utilize independence of thought, question assumptions and think through whether an approach that has been applied in the past in different circumstances should be applied now in new circumstances. Such an approach should lead the Board to deal with reality and to decline to apply the stand-alone principle to the detriment of the customers of the DISCOs. [471]

UNCA responded that the IFE was selective in its use of historical precedents. For example, in its argument, the IFE discussed the need for the Board to pay particular attention to the TOPGAS precedent. The IFE stated:

> There is an experiential basis for the opinion of the IFE that the deferral account balances can be financed wholly with short-term, on balance sheet debt. *Historical precedents are relevant*. [472]

UNCA noted that in assessing the value of the stand-alone principle, which enjoys substantial, consistent precedent, the IFE has recommended that the Board should ignore all of that precedent. However, when considering the weight to be given the TOPGAS experience, the IFE has requested that the Board should underscore the relevance of history.

UNCA noted the following ACC statement regarding the "least cost" argument:

> That infusion (of equity by UNC's shareholder) should be viewed as a choice made by the utility and not govern the Board's decision on the least cost method to finance these balances. [473]

UNCA disagreed with the suggestion that "least cost" is a philosophy that is a proper objective of regulation. UNCA responded that the appropriate standard is reasonable cost or prudent cost. UNCA noted that both the Board and the NEB have rejected the "least cost" proposal being suggested by ACC. [474] As a result, UNCA submitted that the Board should continue to do so.

UNCA confirmed that it agreed with Mr. Edmonson's remarks on behalf of AE on this subject:

> I guess, as I look at what is in front of the Board, and their responsibility is to determine what the prudent cost of financing are, and I took an opportunity to look up the definition of "prudence," and it doesn't talk about the lowest cost. "Prudence" isn't necessarily lowest cost. "Prudence" is using skill and good judgment in the use of the resources, and prudent costs is what the evidence in front of you is, the prudent costs of financing. [475]

UNCA noted the following ACC statement respecting equity redemptions:

> On the other hand, if the proposal to utilize equity is approved, there should be some method to retire that equity once the deferral balance has been fully amortized/recovered. The ACC believes no utility has offered a plan for such a retirement. Absent such an equity retirement plan, the DISCO equity balance will become inflated and customers will later be exposed

> to the risk of paying an inflated DISCO rate of return because the DISCO equity balance is unreasonably thick, and the capital cost would be too expensive. [476]

UNCA responded that ACC's Argument was inconsistent with the policy evidence of UNCA. For example, Mr. van Yzerloo confirmed UNCA's intention to redeem the equity related to its deferral accounts in the following response:

> MR. STOREY: Mr. van Yzerloo, I apologize again. Mr. van Yzerloo, you are going to redeem this equity, I take it, over the period 2001 to 2004?
>
> MR. VAN YZERLOO: Yes, sir. Our intention is to redeem the equity to the level, as if this deferral account did not exist, we would have been to anyways at the end of the collection period. [477]

Thus, UNCA concluded that ACC was incorrect when it stated that no utility plans to redeem unneeded equity as the deferral accounts are drawn down.

UNCA noted the following ACC statement regarding debt financing and breaching banking covenants:

> Further, the Independent Financial Experts concluded that debt would be a prudent financing method for UNC despite its claim that use of debt would put it in default of its borrowing covenants. The experts opined that a temporary exception to the borrowing covenants would likely be approved by UNC's lenders if a regulatory plan is approved that provides full recovery, including, of UNC's deferral balances. Hence, *UNC's representations that a debt financing would violate its borrowing covenants should not override prudent financing options for this unusual non-recurring significant expense*. As the Independent Financial Experts found, as long as recovery is assured, there is no reason why UNC's covenants could not and should not be temporarily waived. [478]

UNCA stated that it was unclear whether ACC is saying that UNCA should have been unconcerned with the potential violation of the banking covenants and should not issue common equity *or* that the Board should now be unconcerned with whether or not UNCA would have violated the banking covenants by failing to issue common equity *or* both.

UNCA disagreed with ACC's suggestion that UNCA should have ignored the covenants and proceeded ahead as if they did not exist, thereby "preserving" what ACC considers to be the "prudent financing option". UNCA responded that the banks would have been in a position to call the loan at any time. UNCA noted that the cash is only on loan to UNCA if the covenants are respected and in addition the banks are the ultimate arbiters of what is required to sustain the loan. Thus, UNCA argued that the Board should reject ACC's recommendation.

UNCA stated that the Board should similarly reject any suggestion by ACC that the Board should award UNCA only the cost of short-term debt, because in ACC's opinion the deferral accounts could be reasonably financed 100% with short-term debt, notwithstanding the fact that all-debt financing would cause a default under UNCA's banking covenants. UNCA argued that such a suggestion would destroy the financial integrity of the utility and would needlessly increase the regulatory risks of all utilities operating in the Province.

UNCA noted ACC final recommendation:

> If debt is utilized, the cost of debt should be limited to not more than 150 basis points above the DISCO commercial paper rate. The amortization period will not extend beyond 2004, and the DISCOs will receive principle payments during the amortization period. A short-term borrowing method will keep the interest rate low and will allow the DISCOs to systematically repay the amount borrowed as customer amortization payments are received. If the Board accedes to the utilities' request to utilize equity, a position to which the ACC is opposed as explained above, it would be our recommendation that a significantly lower return on equity be imputed than is the case for the utility's physical assets. This would be appropriate because of the lower risk involved and also as a means of sharing the burden of these deferral balances between equity owners and customers. [479]

UNCA noted that there was no basis in the evidence for the recommendations of ACC. ACC cited no evidence. In addition, Dr. Rosenberg, ACC's witness on carrying costs, recommended that the cost rate be established at 150 basis points above the Bank of Canada Rate, not 150 basis points above the commercial paper rate. [480]

With respect to the No-Harm issue, UNCA noted that, in approving the sale of TransAlta's distribution assets to UNCA, the Board applied the "no harm" test. Stated simply, if customers are not harmed by the sale, then the sale should be approved.

UNCA submitted that the no harm test has no relevance to these proceedings and second; that in any event, there was no harm occasioned to customers as a result of the sale by TransAlta of the DISCO system to UNCA.

UNCA argued that the no harm test is a test, which the Board applies in deciding whether to approve a sale of utility facilities at the time of the sale. It is a test that looks at all of the circumstances surrounding the sale and decides if, on balance, pluses and minuses considered, the transaction should be approved in the public interest. If, on balance, there is no harm, then the transaction is likely to be approved. If, however, there is foreseeable harm, then the transaction may be rejected or approved, subject to specific terms and conditions designed to mitigate or eliminate the perceived harm. UNCA submitted that once the transaction has been approved, all that remains relevant are normal regulatory principles and specific terms and conditions associated with the approval.

This approach is consistent with the approach taken by the Board in Decision 2000-41 approving the sale of the TransAlta DISCO system to UNCA and consistent with the Board's decision in Decision 2001-65 where the Board noted:

> In Decision 2000-41, the Board was able to attach appropriate conditions to its approval of the transaction to satisfy itself that any potential harm to customers was adequately mitigated [481] .

UNCA noted that in Decision 2000-41 which approved the sale of the TransAlta DISCO operations to UNCA, the Board did not attach conditions to the approval with respect to the balancing pool deferral accounts and none should be attached retroactively, as to do so would be unfair and unreasonable. Thus, commercial arrangements moved forward on the strength of the Board's decision, and the sale was consummated. UNCA stated that for the Board to now determine that it should have made a different finding and then effectively impose that alternative determination on the parties to the commercial transaction would be unfair and unreasonable. Serious questions respecting the propriety of such a finding would be raised; and the perceived regulatory risks and liabilities of operating, buying or selling a regulated utility in Alberta would, in UNCA's submission, increase sharply.

In UNCA's submission not only is the "no harm test" not relevant or applicable, the evidence is that there was no harm. In the current proceeding, the "no harm test" arose in questions from the Board to Messrs. McCormick and Demcoe. Messrs. McCormick and Demcoe had proposed that for DISCOs other than UNCA a "stretching" of the balance sheet by financing the deferral accounts entirely with short-term debt. Nevertheless, the IFE recognized the need for equity in the circumstances faced by UNCA. UNCA however noted that the Board had suggested the possibility that if TransAlta had continued to own the distribution assets, then:

> "...given the larger overall base of TransAlta's regulated businesses, transmission, generation, and distribution, some might argue that no equity infusion would have been required given the size of that business." [482]

UNCA noted that the Board put a similar question to Mr. van Yzerloo:

> So, the question is in applying the no-harm test, how should the Board deal with the fact that under U99, it was the — let's say, TransAlta had the ball, and now you have got the ball, and it is a much heavier ball to carry. How do you think the Board should apply the no-harm test in this situation? [483]

Consistent with this suggestion, parties may argue that the Board should establish UNCA's rate of return on the assumption that UNCA's rate base assets continue to be owned by TransAlta. In UNCA's submission, any such suggestion should be rejected outright for six reasons in addition to those already discussed.

First, UNCA submitted that there was no clear evidentiary basis for the claim that TransAlta DISCO could have financed the deferral accounts totally with debt whereas UNCA required equity. For example, Messrs. McCormick and Demcoe stated: "It is apparent from the above table that 100 debt financing of the deferral account balances would put some strain on the balance sheet of TUC DISCO, particularly with a regulated equity amount based on 40 percent of capital assets". [484] These witnesses concluded:

> The TUC DISCO debt financing of the deferral accounts would not be easy. Strong long-term banking and financing relationships, which could be assumed for TUC DISCO given its parent, would be a compensating factor. This is not without precedent when one considers the A&S and TCPL take-or-pay accounts and the strain placed upon the corporate balance sheets and key indicators. [485]

Second, UNCA submitted that if the sale of the distribution assets had not occurred, then TransAlta would be appearing before the Board in this matter. The same concerns respecting *stand-alone* financing of the deferral accounts would have arisen; and if the Board respected the stand-alone principle, it would have reached similar conclusions respecting the appropriate carrying cost rate as if UNCA were the applicant. Mr. van Yzerloo stated:

> I know that through the last two revenue requirement decisions, the Board took the approach of unbundling the TransAlta organization into its various business components of generation, transmission, distribution and retail consistent with restructuring of the market here in Alberta to create a competitive commodity environment. With that in mind, the stand-alone principle that Mr. Evans has provided in his evidence and spoken to needs to be, in my view, very carefully considered in applying the no-harm test in that the costs — if TransAlta had not sold the business — would be similar on a stand-alone basis as they are today on a stand-alone basis. And the stand-alone principle would say that the distribution operations of TransAlta would not look to the larger size of the organization that is driven by a generation and transmission to support those operations. So, my answer is then that the stand-alone principle does apply in that case in my mind, and the no-harm test should be viewed with the stand-alone principle in front of us. [486]

UNCA noted that Messrs. McCormick and Demcoe had confirmed the proposition that the stand-alone business risks of the deferral accounts are essentially unaffected by TransAlta's sale of its distribution assets to UNCA.

> In addition, the IFE believe the business risk of the DISCO assets was unchanged by the fact of the change of control, and that the business risk of the deferral account amounts was unchanged by their being split between these two corporate entiries. The difficulty in financing these assets was changed in a positive way by splitting the deferral accounts between two balance sheets. [487]

Thus, UNCA stated that unless the Board elected to depart from the stand-alone principle, there is "no harm" arising from the sale of the distribution assets and the financing of the deferral accounts by UNCA rather than by TransAlta.

Third, UNCA submitted that a potential cost rate difference and therefore the concern respecting the "no harm" test would arise *only if* the "stretch the balance sheet" financing option is assumed and *only if* the balance sheets being "stretched" are those of UNCA and TransAlta *on a consolidated basis*. [488]

UNCA submitted that, by definition, "stretching the balance sheet" violates the stand-alone principle. UNCA noted that both BMO Nesbitt Burns and RBC Dominion Securities have stated that equity was required to underpin any debt financing of the deferral account balances on a stand-alone basis. [489] Also, Mr. McCormick and Dr. Rosenberg both acknowledged that on-balance sheet debt cannot be raised without equity support. [490] In addition, UNCA stated that the Board should not abandon the stand-alone principle in order to use the "no harm" test to reduce the carrying costs that would otherwise be collected by UNCA on TransAlta's behalf.

Fourth, UNCA submitted that the ability to finance principle would also be violated, because equity support on the part of both UNCA and TransAlta would be required to permit the financing of the deferral accounts; and yet the requirement for that equity would not be recognized in the "stretch the balance sheet" approach. [491]

Fifth, UNCA submitted that failure to include the cost of the required equity in the calculation of, say, TransAlta's carrying cost rate results in a violation of the actual cost principle. [492] The principle was stated by Dr. Evans in the context of UNCA:

> UNCA cannot finance its deferral account balances entirely with stand-alone debt. Some equity support is required — either at the utility level or through various mechanisms designed to transfer equity support from the parent. If, contrary to what is possible, the Board were to assume that UNCA could finance its deferral account balances entirely with short-term debt, then shareholders of UNCA would effectively be forced to contribute equity financing to UNCA and would, in return, only receive a short-term interest rate on the equity funds. The result would clearly be punitive and would constitute a confiscation of the parent company's equity and borrowing capacity without appropriate compensation. [493]

Sixth, UNCA submitted that the evidence has shown that the stand-alone costs of financing the deferral account operations for UNCA and TransAlta do not differ materially in any event. [494] UNCA noted that Dr. Evans provided the only evidence on possible differences in carrying costs; and he concluded:

> "...the carrying cost rate that should apply in both cases (referring to TransAlta and UNCA) is the stand-alone cost rate." [495]

> "...the 8.47% cost rate is also applicable to the TransAlta deferred costs set out in the UNC Application." [496]

> I did check to see if it is possible that there could be a difference arising, let's say, from a difference in bond ratings that might give rise in the rise to the cost of debt as it does between EDI and UNCA, and that discussion appears on page 20 of my evidence. And the conclusion that I came to was that there would not be a material difference between the cost rates if one looked at TransAlta, sort of, on a stand-alone basis and then UNCA on a stand-alone basis and took into account the difference in debt costs. [497]

In responding to questions from Board staff, Dr. Evans, for sake of argument, put aside his view that the stand-alone costs of TransAlta and UNCA must be the same because the assets being financed are the same and have the same risks. Instead, Dr. Evans quantified the potential difference in cost rates that might arise under a stand-alone financing given the respective credit standings of the two companies.

> The principal reason for that is reliance on the stand-alone concept which is what is set out in the second paragraph on page 20, the second paragraph of that answer. But if you wished to pose the question and put aside that reason for the cost rates being the same, if you wish to pose the question, would you get a different cost rate if you made an adjustment for the slightly higher quality of the debt of TransAlta, then you would come to the — I think I said 3 to 6 basis points that I talked about in my previous answer. [498]

UNCA submitted that in order for the Board to use the "no harm" test in the manner described by the Board, the Board would have to: (1) abandon the stand-alone principle; (2) abandon the ability to finance principle; (3) abandon the actual cost principle; (4) conclude, contrary to the evidence, that TransAlta on a *consolidated basis* could have financed the deferral accounts at a materially lesser cost than UNCA; and (5) conclude that it would be appropriate public policy to penalize UNCA under the "no harm" test, notwithstanding the Board's prior conclusion that the purchase and sale transaction constituted "no harm" to customers.

UNCA noted that FIRM stated the following with regard to the no-harm issue:

> In addressing the question of whether TransAlta Utilities Corporation could stretch its balance sheet to accommodate the deferral account balances incurred by its DISCO function in 2000, they (the financial experts) conclude the "...existing

> financing relationships of TUC are very strong and would facilitate any stretching required." — that is, using 100% debt financing. They conclude by stating that the results of their analysis "...are within the ranges of the other DISCOs that actually stretch their balance sheets to finance the deferral account". Given this ability and the Board's "no harm" directions, the FIRM customers are of the opinion that special financing arrangements and any attendant additional costs should not be recoverable by UNCA DISCO. As a result, a weighted average cost of capital rate should not be used but, rather, UNCA DISCO's current short term borrowing rate. This rate will equate to its "prudent" cost of financing and would be reasonably close to that which TAU would have experienced had it continued in the distribution business. [499]

UNCA noted that FIRM was the only party to take this position respecting the "no harm" test.

UNCA submitted that FIRM's proposal required that the Board abandon the stand-alone principle and embrace the "stretch the balance sheet" notion. [500] UNCA responded that the Board should not abandon the stand-alone principle for reasons set out in its Argument and Reply Argument. [501]

UNCA submitted that in Decision 2000-41, the Board concluded that there was "no harm" arising from the sale of the distribution assets and therefore approved the sale of those assets. Commercial arrangements were entered into on the strength of the Board's decision; and the sale was consummated. UNCA noted that FIRM was suggesting that the Board should now conclude that a "harm" has arisen and should be visited upon the parties to the transaction, given 20/20 hindsight and with the knowledge of Government decisions that could not have been known to any party including the Board at the time of Decision 2000-41. UNCA argued that if the Board were to give any credence to this proposal, it would needlessly increase the risks associated with the ongoing financing, acquisition and sale of utilities in Alberta. As a matter of public policy, the Board should reject FIRM's proposal.

UNCA's Argument cited six other reasons why the Board should decline to apply the "no harm" test in the manner suggested by FIRM. [502] UNCA noted that none of these reasons were adequately dealt with in FIRM's Argument; and they remain compelling reasons why the Board should reject FIRM's "no harm" proposal.

25.4 Views of AE

AE submitted that its 1999/2000 Negotiated Settlement Agreement, in combination with its 2001/2002 TFO Negotiated Settlement Agreement, [503] established the basis upon which carrying costs should be paid on both the DISCO and GENCO 2000 deferral account balances. In AE's 2001/2002 TFO Negotiated Settlement Agreement, Clause 29 provided the authority to recover 2001 carrying costs for both the DISCO and GENCO balances.

AE submitted that the weighted average cost of capital rate to be used for 2001 should be determined in accordance with Sections 4(1) and 4(2) of the *Deferral Accounts Regulation* and with Clause 32 of ATCO Electric's 2001-2002 Distribution Negotiated Settlement. [504] Clause 32 of the AE Distribution Negotiated Settlement states:

> The carrying cost rate for 2001 and 2002 will be determined as follows:
>
> > a) An AEUB approved weighted average cost of capital for UtiliCorp Networks Canada's 2001 Distribution Revenue Requirement, adjusted for ATCO Electric's actual embedded cost of debt and preferred stock.
> >
> > b) In the event that an explicitly AEUB approved weighted average cost of capital for UtiliCorp Networks Canada's 2001 and 2002 Distribution Revenue Requirement is unavailable, then parties agree that they will attempt to negotiate a weighted average cost of capital rate for 2001 and 2002.
> >
> > c) If the attempt at negotiating a weighted average cost of capital rate for 2001 and 2002 fails, then the parties agree that they will request the AEUB to determine that rate for 2001 and 2002. [505]

On the basis that UNCA would attain a negotiated settlement (which was not certain at the time of the AE application), AE submitted that it would attempt to negotiate a rate for 2001 and 2002. If the negotiation failed, AE was requesting that the Board approve the rate for 2001 of 12.44% as outlined in Schedule 10.0 of the AE DISCO Application.

However, during the course of the proceeding, AE submitted new evidence related to the calculation of WACC for purposes of determining the 2001 carrying costs.

As a result, in its argument, AE submitted that it was important to clarify exactly what AE was seeking with respect to carrying charges on the outstanding balances in its GENCO and DISCO deferral accounts. In its original application,[506] AE sought to use a "practical" approach to determining the appropriate carrying cost rate to be applied to these deferred accounts, which entailed using a common equity component and ROE previously approved by the Board for TransAlta in the 1999/2000 GTA. However, based on various Information Requests from the Board, it became clear that the Board was reluctant to adopt this approach. Therefore, AE recommended that the evidence filed on behalf of AE by Ms. McShane in the 2001/2002 General Rate Application for the DISCO operations be used to determine the missing components of the WACC for AE pursuant to clause 29 of the 2001/2002 TFO Negotiated Settlement.[507] AE submitted that Ms. McShane's evidence recommended a common equity component of 45% and an ROE of 11.0-11.25% for AE DISCO.

AE further noted that in response to the specific request from the Board to provide additional evidence in this matter, Ms. McShane filed an additional report on the derivation of a WACC that could be used for AE if its Negotiated Settlement Agreement were to be totally ignored by the Board. Ms. McShane proposed that, if the settlement were to be overturned, a reasonable WACC for the DISCO deferral accounts would comprise 45% common equity and 55% short-term debt. The ROE to be applied to the common equity component should be the same as would be applicable to the DISCO operations, as updated to 11.5%.

In summary, AE submitted that it continued to seek carrying costs as per its original application, as modified to reflect the evidence of Ms. McShane from the 2001/2002 GTAs (i.e., not on the basis of the information which ignores the existence of the Negotiated Settlement Agreement).

AE submitted that while several parties commented on the matter of the appropriate carrying costs to be applied to the outstanding balances of AE's deferral accounts, it is appropriate to comment on the submissions made on behalf of the IFE at the outset of this issue. AE submitted that the evidence of the IFE is irrelevant to the AE situation, as it was not within their mandate to consider AE's Negotiated Settlement Agreement.[508]

However, AE noted further comment was warranted, in case the Board chose to ignore the implications of its approved Negotiated Settlement Agreement. In this regard, AE submitted that the IFE appeared to be confused regarding what AE was actually seeking in these proceedings. AE stated that it believed that any potential confusion should have been removed by the comments that it made in its Final Argument. AE submitted that was not requesting that there be a component of short-term debt in capital structure. Ms. McShane's additional filing, which recommended a component of short-term debt in capital structure, was solely in response to the Board's request (which ignores the Negotiated Settlement Agreement) and was not AE's requested disposition.

AE noted that the IFE maintained that all but one DISCO could finance its deferral account requirements based on short-term debt.[509] However, AE argued that the IFE neglected to mention is that this is only possible because of the existing equity within the DISCOs. AE also noted that the IFE erroneously utilized information regarding CU Inc. and not AE DISCO, or for that matter AE.

AE submitted that the two of the most significant flaws that underpin the IFE's recommendations were exposed during cross-examination. First, the lynch-pin to their conclusion regarding minimal impacts on ATCO Electric DISCO was tied to a review of the assessment conducted by DBRS.[510] First, this report related to CU Inc. and not to ATCO Electric DISCO, and the impacts of the deferral accounts upon CU Inc. were materially different that those that are properly applicable to ATCO Electric DISCO.[511] AE noted that this significant and material fact was not taken into account by the IFE. Additionally, this DBRS report was produced on December 11, 2000 and predated much of what has occurred in these proceedings. Specifically, the report concluded that there is a reasonable certainty of recovery of the outstanding deferral account balances. This is a fundamental component of the DBRS conclusion. However, the witnesses failed to understand and acknowledge that, as events have unfolded, significant doubt is cast on the certainty of recovery of these deferral account balances, and hence the positions set forth by DBRS. As indicated by AE, if the DBRS had known of these subsequent developments, there is significant doubt that they would have reached the same conclusion.[512]

The second fundamental flaw in the evidence of the IFE was that these deferral accounts can, in fact, be financed with 100% short-term debt. Despite resistance to the suggestion that this was simply not doable, the IFE acknowledged that it would not be possible to finance the deferral accounts with 100% short-term debt if not for the existing equity in ATCO Electric DISCO.[513] AE noted that the IFE also changed their evidence, contained in Information Response FIRM-FE-5(a), that no equity was required. The IFE suggested what they meant was they there was no "new" equity layer required.[514] The witnesses indicated that the word "incremental" should be added to this Information Response. In changing their evidence, the IFE was relying on the existing equity in the company and, as confirmed, reliance on the overall financial position of the company to support the deferral accounts.[515] AE also noted that the IFE modified their position and stated that with appropriate regulatory approvals[516] and possibly with certain credit enhancements being available,[517] the company should be able to finance totally with short-term debt.

AE noted that while the IFE acknowledged the "stand-alone principle", they were encouraging the cross-subsidization of the financing of the deferral accounts by the DISCO and the overall corporate entity. AE responded that this is clearly inconsistent with the Board's policy of respecting the stand-alone principle and resisting cross-subsidization, although it is usually alleged to occur in the other direction. AE further noted the IFE's argument that essentially stated that the utilities were wrapping themselves in the cloak of the "stand-alone" principle in an attempt to benefit shareholders at the expense of ratepayers.

AE responded that this allegation is without merit. Specifically, the stand-alone principle is premised on the more basic principle of finance that the cost of capital applied to the operations should reflect the risk of the operations and the opportunity cost of the investment. A symmetric application of that principle to the DISCO operations and the deferral accounts ensures that neither customers nor shareholders have the opportunity to earn a windfall, but rather that utility customers incur, and shareholders receive, a return that incorporates neither positive nor negative subsidies. Finally, as pointed out in AE's Final Argument, the IFE made several fundamental flaws in their analysis which have not been addressed or corrected in their Argument, due to lack of counter evidence.

AE submitted that the evidence of the IFE was irrelevant to ATCO Electric's situation. Furthermore, even if it were to apply, it is fundamentally flawed and therefore the Board should give their evidence no weight in deriving the appropriate carrying costs to be applied to AE's deferral accounts.

AE noted that several parties raised the issue of carrying costs and generally supported the positions advocated by the IFE. However, AE submitted that the positions of the other parties suffered from the same shortcomings as identified above.

25.5 Views of EDI

In addition to applying for a review of the principal amount in its year 2000 Pool Price Deferral Account, EDI also applied for an 8.47% carrying cost rate in respect of the year 2001.[518] EDI submitted that the 8.47% carrying cost is a rate that reflects the stand-alone risks of the deferral account operations and is fully supported in the evidence of Dr. Evans.[519]

EDI submitted that the only substantive contrary evidence was that of Messrs. McCormick and Demcoe representing the IFE.[520] EDI noted that although Mr. Marcus on behalf of FIRM proffered a view on the appropriate carrying cost rate, this view was more in the nature of a brief position statement. [521] EDI confirmed that the reasons why Mr. Marcus' recommendation was untenable were addressed in its Final Argument in the context of the evidence of Messrs. McCormick and Demcoe. [522] EDI further noted that while Dr. Rosenberg offered a similar brief position statement on behalf of ACC in respect of AE's and UNCA's carrying cost rates, Dr. Rosenberg offered no such statement in respect of EDI's carrying cost rate.

With respect to the IFE, EDI submitted that the evidence of Messrs. McCormick and Demcoe did not deal with the core issue — namely, "What are the stand-alone financing possibilities?" [523] Instead, the evidence of Messrs. McCormick and Demcoe focused on "stretching the balance sheet" of EPCOR, the parent of EDI, representing an obvious departure from the stand-alone financing question respecting EDI. [524]

EDI further submitted that, notwithstanding the fact that Messrs. McCormick and Demcoe did not deal with the core issue in this proceeding, EDI's Argument addressed both the principles that should govern the Board's decision and eight alternative financing structures proffered by parties during the proceeding.

In EDI's submission, there are four principles that should guide the Board's determination of the appropriate carrying cost rate. These principles are referred to as the stand-alone principle, the ability to finance principle, the actual cost principle and the reasonable cost principle.

With respect to the first principle, the stand-alone principle, EDI stated:

> Under the stand-alone principle, a utility is regulated as if the provision of the regulated service were the only activity in which the company is engaged. Thus, the cost of providing utility service — and hence rates for service — reflect only the expenses, capital costs, risks and required returns associated with the provision of the regulated service. [525]

EDI submitted that the stand-alone principle is a fundamental tenet of regulation and should be respected for the following reasons:

- The stand-alone principle promotes fairness to customers and investors.
- The stand-alone principle provides for regulatory consistency and therefore reduces regulatory risks.
- The stand-alone principle promotes administrative simplicity.

EDI submitted that Dr. Evans summarized the benefits of the stand-alone principle in the following statement:

> Fairness requires that customers pay rates for service that reflect the costs associated with providing the regulated service. Rates should not be subsidized by the operations of a parent or "sister" company. Neither should the utility customer subsidize the operations of a related company through the payment of rates that reflect more than the expenses, capital costs and required returns associated with the provision of the regulated service.
>
> Second, consistency on matters of regulatory principle is essential if regulatory risks and utility financing costs are to be minimized. The Board has previously invoked the stand-alone principle as a basis for reducing the rates that utility customers pay. [526] If the Board were to now ignore the stand-alone principle in a context where ignoring the stand-alone principle also leads to lower customer rates, the Board's reputation as a fair and impartial regulator would be seriously imperiled.
>
> The perception by potential investors of a "heads you lose — tails I win" form of regulation would unnecessarily increase the regulatory risks facing all utilities under the Board's jurisdiction and would unavoidably lead to an increase in the costs of debt and equity capital. Investor concerns would arise not only because "stand-alone" is a long-standing principle in Alberta but also because it is well accepted elsewhere in Canada.

> Third, the administrative complexity of departing from the stand-alone principle is significant. Consider such an illustrative departure in the circumstances of EDI. A departure from the stand-alone principle would require that the Board consider the ability of EPCOR to provide financing to EDI. But suppose that EPCOR's electricity retailing companies are themselves required to finance large 2001 RRO power purchases that diminish the borrowing capacity of EPCOR on a consolidated basis. Suppose further that EPCOR's unregulated operations require substantial capital. A departure from the stand-alone principle in respect of EDI would require the Board to consider the collective impact of the 2001 retail operations, the unregulated operations and the 2000 distribution wires deferral accounts on the borrowing capacity of EPCOR and each of its subsidiaries. Additional enquiries would be required if there were substantial capital expenditures or financing requirements arising from other parts of the EPCOR organization. In short, the administrative complexity of departing from the stand-alone principle is significant and would ultimately lead to the Board's having to evaluate the circumstances of all companies within the EPCOR family whenever it considered the appropriate financial structure for any individual company. [527] [528]

As also submitted in UNCA's argument, EDI noted that Dr. Evans addressed the potential for increased regulatory risk arising from a departure from the stand-alone principle. [529]

EDI submitted that there is ample regulatory precedent for the stand-alone principle in this and other Canadian jurisdictions. [530]

On the matter of stand-alone, Messrs. McCormick and Demcoe confirmed, "...the decisions of this Board have traditionally reflected the principle that the cost of capital to be applied to regulated utilities should reflect the business risks of those operations, not those of the parent." [531] Messrs. McCormick and Demcoe also stated: "In principle the ownership of a DISCO should have no impact on the appropriate carrying cost to be applied to deferral accounts." [532]

EDI noted that Messrs. McCormick and Demcoe were not aware of any regulatory decisions respecting TransAlta, TransCanada, Westcoast and BC Tel in which the regulators of those companies violated the stand-alone principle by "looking-up" to the financial statements of parent companies or consolidated entities. [533] In addition, during cross-examination, Mr. McCormick confirmed that he did not know whether past decisions of the Board had respected the stand-alone principle. [534]

EDI further noted that based on AE's cross-examination it became clear that Messrs. McCormick and Demcoe attempted to base their recommendations on the risks of the deferral account operations only — i.e., the stand-alone approach. [535] Mr. McCormick confirmed that the analysis of the IFE "looked at the business risks for the deferral accounts in comparison to the normal utility operations." [536] However, in respect of these business risks, Mr. Demcoe then stated: "We did not provide analysis in the evidence. No, we did not." [537]

EDI submitted that the conclusions for the Board are three-fold. First, the stand-alone principle is sound and as a result the Board should continue to adhere to it. Second, Messrs. McCormick and Demcoe confirmed that their studies and recommendations respect the stand-alone principle. Third, notwithstanding their apparent agreement with the stand-alone principle, Messrs. McCormick and Demcoe presented no stand-alone business risk analyses and their studies and recommendations have violated the stand-alone principle. [538]

EDI submitted that the ability to finance principle is that regulation should not impose on the utility financing options that could not have been achieved at the time the financing was required. [539]

EDI noted that the IFE embraced the ability to finance principle:

> MR. WALLACE: Now, turning to UNCA, wouldn't you agree with me that the reasonableness of the cost of capital associated with the deferral account assets has to be judged at the time that the company had to raise the money? In

other words, when Mr. van Yzerloo had to go out and get the money to fund those growing accounts, it is that time that he had to do that that one judges the risks and the costs of the money?

MR. MCCORMICK: Yes. [540]

Having accepted this principle, EDI noted that the recommendations of these witnesses can only be applied on a "going-forward" basis. For example, in their securitization recommendation, Mr. McCormick conceded that "Before the transaction can close, yes, a Board order authorizing collectability, in my mind, is absolutely required." [541] At the time the deferral account financings had to be done, there was no Board order that would have permitted securitization. Therefore, EDI submitted that, in order to respect the ability to finance principle, the Board should not retrospectively apply a carrying cost rate consistent with a securitization transaction until such time as that transaction actually takes place.

EDI also submitted that the Board, as the carrying cost rate, should use the actual cost of financing the deferral accounts unless there are compelling reasons to reject the actual cost. At the same time, in its assessment of the "actual cost", the Board should not ignore the fact that equity is required to underpin any debt financing of the deferral accounts. [542] As evidence, EDI noted the following statement by Dr. Evans:

> EDI could not on its own go out and raise 100 percent debt to finance the deferral account balances. It can't be done. They needed equity behind that. That equity can come from many places and in many forms. But it simply isn't possible to raise 100 cents on the dollar. That is not the actual cost. The actual cost is a blend of debt and equity, both the debt and the equity that was necessary in order to underpin it. And in this case, I think the best estimate of the actual cost of financing is how you would finance the deferral accounts on a stand-alone basis. That is the actual cost of financing. [543]
>
> No. You can't finance the deferral account balances totally with debt. It can't be done...RBC says so and I say so, and I suggest to you that common sense says so. You can't issue debt without equity to back it up. [544]

EDI noted that in their written direct evidence, Messrs. McCormick and Demcoe initially rejected an equity layer in the capital structure. [545] Notwithstanding this position, Mr. McCormick stated in response to a question from the Chairman that "...we are constant in our view that zero to 10 percent is an appropriate equity layer — the zero coming from that group of precedents, the 10 from the securitization — you correctly understand our evidence". [546]

EDI noted that the source of the 10% value is the level of credit enhancement that Messrs. McCormick and Demcoe believe would be required in order to achieve an off-balance sheet securitization of the deferral account balances. [547] They specifically referenced the credit enhancements that are required to securitize credit card trusts and trade receivables trusts. [548]

EDI argued that even if only 10% credit enhancement were required in a securitization trust, that percentage value cannot simply be "transferred" to the world of an operating business and used as an appropriate benchmark for the appropriate stand-alone equity ratio of the deferral accounts. [549]

Dr. Evans also presented the following argument:

> ...let me just add one thing about trade receivables. Those are 60- to 90-day receivables. And so, those are slightly different in terms of a term from what you find as the average term in a credit card trust, and they are certainly different from the term that you would be looking at here. [550]

EDI noted that Mr. McCormick agreed that credit card receivables "constitute a crystallized enforceable legal obligation of the trust against the holder of the credit card". [551] In contrast, the deferral accounts are not "crystallized" in the sense of being currently collectible; and the deferral account balances therefore do not constitute an "enforceable legal obligation". [552]

EDI submitted that it was self-evident that the financing of crystallized, enforceable legal obligations is fundamentally different from the financing of operating assets or "hoped for" receivables that are to be billed and collected through services provided by an operating business.

Thus, EDI submitted that adoption of a common equity ratio of no more than 10% for on-balance sheet financing of the deferral accounts would violate the stand-alone, ability to finance and actual cost principles. Consequently, the Board should reject the suggestion that credit enhancement requirements for securitization trusts can be considered as reasonable benchmarks for those common equity ratios that are required to underpin the financing of deferral accounts on the balance sheets of the utilities.

EDI also argued that the "stretch the balance sheet" alternative violates the stand-alone principle, the ability to finance principle and the actual cost principle.

EDI noted that both RBC Dominion Securities and BMO Nesbitt Burns stated that equity is required to underpin any debt financing of the deferral account balances on a stand-alone basis. [553] Even Mr. McCormick acknowledges that debt cannot be raised without equity support. [554]

EDI submitted that the ability to finance principle is also violated, because equity support is essential to permit the debt financing to take place. Yet, the requirement for that equity is not recognized in the incremental cost of short-term debt. [555]

EDI also stated that failure to include the cost of the required equity results in a violation of the actual cost principle. [556] As stated by Dr. Evans:

> EDI cannot finance its deferral account balances entirely with stand-alone debt. Some equity support is required — either at the utility level or through various mechanisms designed to transfer equity support from the parent. If, contrary to what is possible, the Board were to assume that EDI could finance its deferral account balances entirely with short-term debt, then EPCOR would effectively be forced to contribute equity financing to EDI and would, in return, only receive a short-term interest rate on the equity funds. The result would clearly be punitive and would constitute confiscation of the parent company's equity and borrowing capacity without appropriate compensation. [557]

As a summary, EDI submitted that the Board should reject the All Debt — "Stretch the Balance Sheet" financing alternative.

EDI submitted that the IFE misstated the financing requirements of TOPGAS, which it presented in its evidence.

EDI noted the following IFE statement:

> The IFE reached the opinion that the requisite credit enhancement or equity layer to underpin the securitization of the deferral account balances would be between zero and ten percent. The zero percent equity layer is derived from the TCPL financing of the take-or-pay liability which ultimately became the TOPGAS precedent. [558]

EDI argued that the IFE was disingenuous when it suggested that TCPL's financing took place with zero percent equity. EDI responded that only in the initial years of making take-or-pay payments was TCPL able to incrementally finance its obligations totally with debt and, even then, the existing equity of TCPL provided support for the debt.

EDI further stated that the take-or-pay obligations grew, and TCPL eventually required preferred equity financing as acknowledged by the IFE:

In the case of TransCanada PipeLines Limited (TCPL), significant deferral account balances were financed initially with debt, then with debt and preferred shares, before a securitization option was effected through the TOPGAS companies. [559]

EDI also noted the following exchanges between Mr. Wallace and Mr. Marcus:

> MR. WALLACE: But in principle, you would agree that if a shareholder put up equity, it should be compensated for that equity?
>
> MR. MARCUS: Assuming that the choice to put up equity was a reasonable and prudent choice relative to other choices out there and relative to other options that were available. [560]
>
> MR. WALLACE: Can you tell me how UtiliCorp could have gone out and raised $400 million without some equity support?
>
> MR. MARCUS: I think that something such as a parent company guarantee properly valued and priced into the deal might be cheaper than issuing common equity.
>
> MR. WALLACE: I didn't say "issue common equity." I said equity support. And you have described, I think, a guarantee as a form of equity support, isn't it?
>
> MR. MARCUS: It is a form of equity support. I think you could raise preferred equity as well as common, but I would think that in the position that UtiliCorp finds itself, it may need to do some of those things —
>
> MR. WALLACE: It needs equity support, doesn't it, to raise $400 million. I'm sorry. I think I spoke over your answer.
>
> MR. MARCUS: To some amount.
>
> MR. WALLACE: Thank you. [561]

EDI submitted that the actual cost principle was not respected in the analysis and conclusions of Messrs. McCormick and Demcoe. EDI argued that the IFE failed to recognize the need for equity to underpin any debt financing of the deferral accounts. [562]

With respect to the reasonable cost principle, EDI noted that some parties suggested that the standard by which the Board should fix the carrying charge rate is the lowest cost method of financing the deferral accounts. In response, EDI submitted that the appropriate regulatory standard is "reasonable cost" and not "least cost"

As also submitted in UNCA's argument, EDI referred to the hearing that lead to *Decision U96001*, whereby parties invited the Board to adopt a capital structure for Nova Gas Transmission that lead to what was, in their view, the "least cost" financing. EDI noted that in this case, the Board rejected the "least cost" approach. [563]

> Again, as also submitted in UNCA's argument, EDI further noted that the NEB rejected a similar invitation to apply the "least cost" standard in the context of its multi-pipeline rate of return hearing. [564]

EDI submitted that the only substantive arguments on carrying costs were those of the IFE, FIRM and ACC. [565]

EDI noted that ACC's Argument consisted of a recitation of Dr. Rosenberg's reasons why the carrying cost rate should be established at 1.5% over the Bank of Canada rate and "two further observations" in respect of ATCO and UNCA. [566] In as much as Dr. Rosenberg's evidence was not given in respect of EDI but only in respect of ATCO and UNCA, ACC's Argument was presumably made only in the context of ATCO and UNCA and not in the context of EDI. Notwithstanding ACC's absence of a recommendation in respect of EDI's carrying costs, EDI considered that there were two matters of regulatory principle espoused by ACC that still needed to be addressed.

EDI noted that, "IPCCAA endorses the recommendations of the Independent Financial Experts with the exception that IPCCAA has a strong preference that the Balancing Pool not be used as a vehicle for an 'off balance sheet financing'". [567] As a result, EDI's submitted that its reply to IPCCAA's carrying cost argument was subsumed in the discussion respecting the IFE's Argument.

EDI also noted that no party recommended specific cost rates, leaving the Board in a position where it cannot reasonably adopt any of their recommendations. For example, FIRM stated that it has "expressed their position relative to prudent carrying costs and AE's negotiated settlement in other sections of this argument." [568] However, EDI noted that there were no percentages or dollars of carrying cost set out anywhere in the FIRM Argument.

EDI submitted that there was no reasonable basis for the IFE's views on the stand-alone principle. The Board notes that EDI's argument echoed UNCA's argument with respect to the IFE's views on the stand-alone principle, and was almost virtually the same as UNCA's argument.

EDI submitted that the IFE's views on the stand-alone principle were contradictory and unreasonable, and as a result should be rejected by the Board.

EDI noted the IFE statement regarding the preferred share option:

> The preferred share issue was much ado about not very much. It was precipitated by the statement in the IFE Evidence that they believed that in those limited circumstances where an equity component would be required, if would be appropriate to use a shorter-term equity instrument, such as redeemable preferred shares, to facilitate on balance sheet financing. Dr. Evans responded with evidence about the inability of EDI to make a public issue of preferred shares without losing its tax-exempt status. EDI also filed evidence provided by Mr. Jacques, a tax lawyer. The fact is, however, that the entire discussion of public issues of preferred shares is completely irrelevant. The IFE did not at any time propose a public issue of preferred shares. The evidence is that there is no tax consequence to the issuance of private preferred shares by EDI. As explained by Mr. McCormick, EDI, could use an intercorporate preferred share issue to assist in funding the deferral account balances, without losing tax-exempt status. [569]

EDI submitted three common concerns in respect of preferred share financing alternatives for EDI.

First, EDI noted that the Dominion Bond Rating Service (DBRS) would treat redeemable preferreds matching the term of the deferral accounts as "debt-like"; and therefore preferred would substitute for debt *not* common equity. [570] Thus, EDI argued that the requirement for common equity financing would not be avoided by issuing preferred equity; and the total cost of the preferred shares would likely exceed the cost of debt. [571]

Second, aside from the requirement for common equity to support the preferred share financing, minimum issue sizes would probably require 100% preferred share financing of the EDI deferral accounts *if* the financing could be obtained at all. [572] In this respect, Mr. McCormick agreed that Dr. Evans' $50 million minimum size for a preferred share issue is a "good number". [573]

Third, EDI submitted that there is no market for one-, two- or three-year redeemable preferred shares in any event. [574] EDI noted that during cross-examination, Messrs. McCormick and Demcoe could provide no examples of one-, two- or three-year preferred share issues. [575] Also, EDI noted that Mr. van Yzerloo had considered preferred share financing for UNCA's significantly larger deferral account balances. He explained the results of his investigation into this possibility in the following exchange with Mr. Sisson:

> MR. SISSON: What prevented UNCA from issuing retractable preferred shares as part of the equity injection to cure the breach of covenants under those credit agreements?
>
> MR. VAN YZERLOO: Many issues that we have discussed in this proceeding already through Dr. Evans' evidence. I guess primarily if you realistically look at a preferred share issue of less than $100 million, that is three years and less in duration on a declining balance basis, we have been advised very strongly there is not much of a market for that.
>
> MR. SISSON: So, there is no market for issuing retractable preferred shares under these circumstances?

> MR. VAN YZERLOO: We were advised by our investment advisors not to pursue that option given it was really a nonstarter. [576]

EDI noted that the IFE did not specify whether it was considering a public issue of preferred shares or a private issue. [577] Therefore, Dr. Evans and Mr. Jacques responded in the context of both a public and a private issue.

EDI disagreed with the IFE's statement that "...there is no tax consequence to the issuance of private preferred shares by EDI". [578] EDI responded that whether or not there is a tax consequence ultimately depends on the identity of the purchaser.

For example, if the purchaser were a party other than a member of the EPCOR family, then EDI would lose its tax-exempt status. [579]

In contrast, if the purchaser were a member of the EPCOR family, then the dividend would need to either be "grossed up" for income taxes or the appropriate cost rate would lead to the stand-alone cost of capital for deferral account operations in any event. [580] The precise reasons why an issue of intercorporate preferred shares to another member of the EPCOR family would become uneconomic substantially depend on whether that family member is taxable or non-taxable. [581] Nevertheless, the end result is the same.

EDI submitted that, apart from tax considerations, the IFE ignored the fact that preferred shares would be treated as debt rather than equity by the bond rating agencies, and the pre-tax cost of preferred shares would almost certainly exceed the cost of the debt that it replaces. [582]

EDI noted that the IFE also ignored the absence of any market for one-, two- or three-year term preferred shares. [583] EDI argued that if no market exists, then neither a public nor a private issue could take place, and it would be difficult to contemplate how the cost rate for an intercorporate issue could be established in the absence of a reasonable marketplace benchmark.

Consequently, EDI concluded that preferred shares do not represent an economic alternative in the derivation of carrying costs.

With regard to the actual cost of financing, EDI noted IFE following statement:

> Actual Cost of Debt. The conclusion to be drawn from the evidence is that, throughout the year 2000, the deferral account balances could have been wholly financed by debt. In the case of EDI, the evidence is that the out-of-pocket cost of financing the deferral account balances was a debt cost. EDI borrowed funds on an "emergency basis" from its parent, EPCOR Utilities Inc., to cover pool price costs. EDI does not go to lenders other than its parent for funds. EUI is the primary entity through which the EPCOR companies go to the debt markets. EUI uses Bankers Acceptances and corporate paper to access short-term debt. EUI mirrors its debt costs to EDI, meaning that the short-term blended rate to EUI will be "mirrored through to EDI". On April 1, 2001, EDI issued equity to repay some of the debt to EUI. [584]

Thus, the IFE suggested that the out-of-pocket costs of short-term debt constituted the *actual* cost of borrowing for EDI. EDI disagreed with this assessment referring to the following comments by Dr. Evans:

> No. You can't finance the deferral account balances totally with debt. It can't be done...RBC says so and I say so, and I suggest to you that common sense says so. You can't issue debt without equity to back it up. [585]

EDI noted that Mr. Marcus made similar comments during his cross-examination. [586] In addition, Messrs. McCormick and Demcoe agreed that their recommendation of 100% short-term debt financing could not be implemented without reliance on the existing common equity of the utilities, as demonstrated in the following exchange:

MR. KEOUGH: Sir, I am not putting to you that there is a stand-alone deferral account business. I am saying to you, sir, that your recommendation that these deferral accounts be financed with 100 percent short-term debt could not be implemented if it were not for the existing equity, correct?

MR. MCCORMICK: I agree with that.

MR. DEMCOE: We agree with that. [587]

EDI submitted that if the financing of the deferral accounts requires equity underpinning — and the evidence shows that such an underpinning is required — then any cost rate that reflects only the cost of debt is, by definition, inconsistent with the actual cost of financing the deferral accounts. Thus, EDI's actual cost of financing is not its out-of-pocket cost of short-term debt.

With respect to the "least cost" philosophy, EDI noted ACC's statement:

> That infusion (of equity by UNC's shareholder) should be viewed as a choice made by the utility and not govern the Board's decision on the least cost method to finance these balances. [588]

Although ACC's Argument was cast in terms of UNCA's situation, EDI took exception to the suggestion that "least cost" is a philosophy that is a proper objective of regulation.

EDI submitted that the appropriate standard is reasonable cost or prudent cost. As indicated in EDI's Argument, both the Board and the National Energy Board have rejected the "least cost" proposal now being suggested by ACC. [589] As a result, EDI submitted that the Board should continue to do so.

EDI concluded that it agreed with Mr. Edmondson's remarks on this subject:

> I guess, as I look at what is in front of the Board, and their responsibility is to determine what the prudent cost of financing are, and I took an opportunity to look up the definition of "prudence," and it doesn't talk about the lowest cost. "Prudence" isn't necessarily lowest cost. "Prudence" is using skill and good judgment in the use of the resources, and prudent costs is what the evidence in front of you is, the prudent costs of financing. [590]

EDI noted that ACC asserted that if the utilization of equity is approved, there should be a plan to retire that equity once the deferral account balance has been fully amortized/recovered. In the absence of such a plan, ACC claimed that the DISCO equity balance would become inflated and consequently customers would be exposed to the risk of paying an inflated rate of return. [591]

In response, EDI submitted that the evidence was clear that EDI will not retain unneeded equity. Instead, EDI will recognize the potential need for additional equity to finance its growing business in any decision to redeem all or any part of its April 2001 equity issue. EDI submitted that both Mr. Cowburn and Dr. Evans addressed this matter from a policy and finance perspective in response to Board questions:

MR. COWBURN: I was saying that our redemption of equity would depend on the business situation in which we found ourselves, and a component of that business situation would be the ongoing need to finance capital investments as the deferral account balances dropped. [592]

DR. EVANS: The financing of a company in its totality is an ongoing proposition, and so companies may be using equity or debt today to finance one set of assets. And as they move through time, they may draw down those assets through depreciation or other charges and find that they are financing other assets. Certainly what one can say is that if the equity now residing in EDI is not needed as they progress through 2002 to 2004, and if their capital structure were to suddenly find that the equity ratio is creeping up, I would expect that management and EUI would take steps to redeploy that equity somewhere else in the organization. Because it would make no sense to have a capital structure that was out of line in respect of the business risks. But these things are not a moving target, and the company will

> have other needs for financing as it grows and develops, and it would scarcely make sense to simply redeem equity in the short-term only to put it back again in a year or so when that need was there. So I am sure it will all be based on the forecasts of what the company's needs are as they move through time. [593]

With respect to the issue of applying consistent carrying cost rates between the DISCOs and the GENCOs, EDI noted the following statement by Dr. Evans:

> It is not even so much that we are dealing with two separate companies. It is that the nature of the deferrals are quite different. In the case of EGI, there is a surplus position rather than a deficit, and that surplus is expected to be given back in the very short term.
>
> So, EGI can't go out and invest in longer-term obligations. It can only keep the money in a fairly short-term facility because it is going to have to give that money back in the very short term.
>
> That is not the case here. Here we have got deferral accounts that are going to stretch out from 2000 out to 2004. And so, you can't simply expect to finance those as if they were short term in nature. They are also of substantially different size, in this case, 25 percent of EDI's property plant equipment. In the case of EGI, the balance to be refunded represents a fairly clearly more modest proportion of the generating assets of EGI, and so that is a difference.
>
> And finally, I believe that we are dealing with a specific regulation in the case of EDI that does not apply to EGI, and EGI is operating under the Board's information letter. And so, the whole context is slightly different as well, the framework in which this is taking place.
>
> So, I would put it this way: Irrespective of whether EDI and EGI are separate companies or whether all of these operations happen to be conducted within the same company, for regulatory purposes, they should not have the same carrying cost rate for the reasons I just gave you. [594]

EDI noted that the recovery of 2001 carrying costs from the Balancing Pool is specifically provided for in the *Deferral Accounts Regulation*. However, EDI noted that the scope of the Board's jurisdiction under the Deferral Accounts Regulation in respect of EDI does not extend to the period beyond 2001. Also, EDI submitted that the Board should not engage in cross-subsidization among different distribution service areas and should therefore only flow carrying costs through the Balancing Pool if those costs are recovered in the service area in which they are incurred.

25.6 Views of the Cities (Red Deer and Lethbridge)

The Cities submitted that there were some general matters respecting carrying costs that pertain to all applicants, and the Cities shared the views of other applicants with respect to some of those matters.

Firstly, the Cities submitted that the owner's prudent cost of financing is not the lowest cost that can be achieved for this particular deferral account. The Cities stated that any assessment of the prudence of the cost must have regard not just to the circumstances of the deferral account but the overall operation of the utility. Certainly a municipal DISCO could potentially finance this deferral account entirely with short-term debt, subject to some restraints on municipalities contained in the Municipal Government Act. However, the ability to do so does not make it a prudent decision. In that regard, the Cities shared the view of AE that:

> Prudence isn't necessarily the lowest cost. Prudence is using skill and good judgment in the use of resources... [595]

The Cities submitted that what appeared to be lacking in the IFE's analysis was a realistic view of the issue of prudence. What was proposed is a one size fits all formula, without regard to real and specific differences between the utilities and any sense of fairness to the owners of those utilities. In particular, the IFE was of the view that the deferral accounts "can be prudently financed with short term debt to the breaking point if you like" and only then is some equity layer "desirable". [596] The Cities noted that while the IFE accepted that the uncertainty and timing of recovery can increase the risk, [597] and that borrowing has to be supported by equity, [598] these factors were given short shrift. Instead, the utilities are to stretch their equity to finance on a short-term basis and essentially provide their equity for free. The Cities submitted that this is particularly inappropriate when it is in effect a forced investment. In that regard, the Cities shared the views expressed by AE:

> We don't see this as an investment, as an opportunity to earn; we just feel it is important that we get fair compensation for those monies we have put forward." [599]

Secondly, the Cities submitted that the IFE did not acknowledge the concept of a stand alone utility for the purpose of determining the costs of financing. Instead, the IFE in its assessment looked to the consolidated entity and its balance sheet to reach its conclusions with respect to short-term borrowing. [600] This, in the submission of the Cities, is contrary to regulatory precedent and practice.

In regard to these two matters, the Cities supported the evidence of Dr. Evans, stating that:

> The actual cost is a blend of debt and equity, both the debt and the equity required to underpin it. [601]

The Cities noted Dr. Evans' statement that the issue is:

> How would you finance the deferral account on a stand-alone basis. [602]

The Cities submitted some specific observations with respect to their applications:

- The Cities have applied for financing cost based on a weighted average cost of capital consisting of a short term debt rate and an equity return

- The Cities submitted that the deferral accounts were not a risk free activity and in particular where they more aggressively managed those accounts through hedging activity, such risk should be compensated for through some return on equity.

The position of the Cities with regard to risk, return and hedging was set forth before the Board as follows:

Mr. Sawada on behalf of Lethbridge stated:

> ...because we took that risk (of hedging) we feel it does justify a higher return (than) simple debt financing and the inclusion of an equity portion in or final structure, we feel is appropriate." [603]

Mr. Roth on behalf of Red Deer commented that:

> ...there is always an upside and downside to it (hedging). This could have been a totally different market as it turned out. There could have been risk put on our consumers which they would have had to bear, but that was a risk we took." [604]

The Cities submitted that it would be imprudent to finance the deferral accounts solely on the basis of short-term debt when there is a risk, and when such short term financing is dependent on equity in any event. Further, exposing equity to risk without return is imprudent.

With respect to the components of the weighted average cost of capital, the Cities have:

- utilized an approved capital structure

- utilized a rate of equity return based upon some previous board analysis but submit that it is appropriate to provide to the Cities the same rate of return given to the investor owned DISCOS

• utilized the Cities' short term borrowing rate with a 25 point uplift; such uplift was confirmed as appropriate by the independent financial expert, [605] Red Deer's consultant [606] and Lethbridge's banking advisors. [607]

In addition to these observations, the Cities noted that, in fact, their deferral accounts were financed entirely by equity by drawing on the Cities' reserves. The Cities further submitted that while the they were not seeking a recovery based on 100% equity, as that would result in inequities between customers in Alberta, they did note that restrictions on municipalities' financing and budgeting activities were contained in the *Municipal Government Act*; creating some barriers with respect to actual financing activities by the municipality which affect the Cities' DISCOs as they are departments of the Cities and not stand-alone corporations. The provisions governing financial administration are set out in Part 8 of the Act and include the following:

• Operating budgets must be established annually of revenues and expenditures and revenues must be sufficient to pay the estimated expenditures (s. 243)

• Deficiencies must be rectified after three years (s. 244)

• A separate capital budget must be prepared

• Borrowing is subject to restrictions and debt limits(s. 251, 252)

• Generally borrowing is for capital purposes

The Cities noted that while none of these provisions would specifically in and of themselves prohibit the borrowing contemplated for financing the deferral accounts, any such borrowing for operating expenditures reduces the municipality's' flexibility and therefore creates similar impediments to those referred to by the investor owned utilities with respect to covenants in their debt instruments. Consequently, the "self sustaining utilities" would normally cover shorter-term non capital expenditures through reserves rather than borrowing. That was what the Cities did in this case.

The Cities submitted that their prudent financing costs are a blend of debt and equity, and that a weighted average cost of capital method should be utilized in calculating the financing costs to be recovered from the balancing pool in 2001.

The Cities noted that the IFE suggested that the evidence supports the conclusion that the deferral accounts could have been financed with short term debt in part on the ground that the DISCOS did in fact finance with debt. [608] Without commenting on the inference that the appropriate test is whether the DISCOS "could have" (as opposed to "should have") financed with 100% short term debt, the Cities submitted that the IFE's conclusion as to the actual manner of financing the Cities' deferral accounts was incorrect.

The Cities submitted that while Lethbridge's witnesses may have used the term "borrowing" in a non-technical sense to describe the internal movement of funds from the general municipal operations to the distribution utility operation, it is clear from a reading of the whole of the evidence that the City of Lethbridge financed the utility's shortfall with respect to power purchase costs through equity, namely, the City's reserve accounts. [609] With respect to Red Deer, it is clear that the funding came from an electric utility reserve account. [610]

In effect, the Cities used the equivalent of retained earnings to finance the deferral accounts. In the Cities' submission, that is equity. The Cities noted however, that in their applications they are not seeking financing costs on the basis of 100% equity, although that is how the accounts were actually financed.

With respect to the stand-alone principle, the Cities noted that the IFE urged the Board to reject arguments based on the stand-alone principle, which would exclude the use of the entirety of the "corporate entity's" financial resources and balance sheets for the purpose of determining the prudent costs of financing. [611] The Cities further noted that the IFE concluded that the stand-alone principle was only developed and applied to protect the customers from any costs and burdens arising from the consolidated operations of utility parents. With regard to the stand-alone principle, the Cities submitted that they support the position taken by UNCA in its argument [612] and by EDI in its argument. [613]

Specifically however, with respect to the IFE's interpretation of the stand-alone principle as reflected in their argument, the Cities submitted that this is too narrow an interpretation of the principle. The Cities noted that the principle evolved to ensure that customers paid the costs necessary to provide utility service to them, and did not receive either the burdens or benefits of consolidated operations.

To accept the asymmetrical application of the principle as suggested by the IFE would lead to a situation where the true costs of utility service would be understated because of consolidated operations to which the Utility customer made no contribution. The Board should, in the Cities' submission, reject any such lack of even handedness in the application of a principle designed to determine what the true costs of utility service is, unencumbered by any subsidization flowing to or from customers through consolidated operations.

The Cities submitted that the IFE's suggestion that because one or more of the DISCOS do not in fact operate as stand alone entities, this is evidence that the principle should not be applied, is without merit. The stand-alone principle as applied to a greater or lesser extent is a notional concept and not an actual state of affairs for one or more of the DISCOs and it is this notional concept that the Board has utilized to determine the appropriate level of cost necessary to provide utility service to customers without cross-subsidization.

The Cities further submitted that by taking the position that they have with respect to the stand-alone principle, the IFE has in the result addressed the wrong question. Instead of determining what the utility's prudent financing cost is, as required by the Regulation, they deal with the question of what the parent is capable of achieving by way of financing. What the parent can do is not the question that the Board has to deal with. What the regulation requires the Board to do is to determine the utility's prudent cost of financing.

With respect to the issue of the prudent cost of financing, the IFE concluded that the DISCOs could wholly finance the deferral account balances with short-term debt. [614] The Cities argued that analysis was flawed for the reasons set out above. The Cities submitted that the evidence should be rejected and supported the argument of EDI. [615]

In addition, the Cities noted that the IFE did not conclude that the deferral account is a risk free activity, and on that basis alone, the Cities submitted that at least some equity return should be permitted. This should be particularly true in the case of the Cities who aggressively attempted to manage the accounts.

Finally, the Cities submitted that the IFE's opinion was based on analysis, which was driven by what could be done. No attention was paid to the words contained in the regulation. The Cities noted that the IFE stated that "it was not within the mandate of the IFE to determine or discuss the relevance and application of Alberta Regulation 240/2000". [616] The Cities submitted that in failing to have regard to the regulation, the IFE failed to consider the meaning of prudent. "Prudent" is defined in Black's Law dictionary as "sagacious in adapting means to end; circumspect in action, or in determining any line of conduct. Practically wise, judicious, careful, discreet, circumspect, sensible (citation omitted). In defining negligence, practically synonymous with cautious". The Cities submitted that that it is difficult to understand how stretching one's balance sheet to the breaking point, or undertaking risk without return could from any perspective whatsoever be deemed to be cautious or careful on the part of a utility.

The Cities noted that FIRM argued that to avoid inequities between municipal and regulated DISCOs arising from the impact of hedging the appropriate course of action is to have all DISCOs repay the interim financing costs paid out of the Balancing Pool and then such benefits, by implication would accrue only to the customers of the DISCOs who hedged. [617]

While the Cities agreed that there is a potential for inequity to occur, as addressed in their written argument, they submitted that the solution suggested by FIRM was not in compliance with the legislation. Payment from the balancing Pool was effectively a quid pro quo for depriving the DISCOs of the opportunity to collect the monies in a timely fashion. It is mandatory in nature, and the Board has not been given the jurisdiction to make the direction suggested.

The Cities noted that FIRM did not explicitly address the prudent cost of financing of the Cities' DISCOs. However, implicit in the discussion with respect to other DISCOs there appeared to be the conclusion that the financing rate for 2001, prior to securitization, is the short-term cost of debt on the basis that this is the least cost alternative. While this would be the least cost for customers, the Cities submitted that the FIRM proposal was not in accord with the Regulation, which uses the term "prudent" and not "least cost".

The Cities noted that ACC's recommendation with respect to the prudent costs of financing was that short-term debt financing "was the best vehicle for financing these deferral balances", based on the evidence of all of the non-utility experts.[618] The Cities submitted, firstly, to the extent that that evidence includes the IFE perspective, such evidence is flawed as it is not in accord with the requirements of the regulation or consistent with regulatory precedent and principle. With respect to the other non-utility "financial" experts, the Cities shared the reservations about that evidence expressed by other applicants in the course of their arguments.

With respect to Dr. Rosenberg's carrying cost argument,[619] the Cities made several observations. With regard to ACC's view that debt financing is far less expensive than equity financing, the Cities argued that while that may be true, it is not the basis upon which the cost of financing is to be determined. With respect to ACC's argument that it was inappropriate for the investor owned utilities to earn a profit on the misfortune of the customers, the Cities noted that the circumstances giving rise to this problem was an unanticipated rise in the cost of providing utility service, which costs the customers are required to bear, and for which the utilities had to commit capital.

Finally, the Cities noted ACC's view that it was is necessary to match the financing to the asset and as this is short-term obligation, there should be some method of retiring the equity. While this view was not specifically directed at the municipal DISCOs, the Cities submitted its views that this "asset" will be retired as the accounts are recovered from customers and on an accounting basis the amortization contemplated would be no different than the application of depreciation to rate base.

The Cities further commented that the focus of ACC's argument was on least cost and no attention was paid to the concept of prudence.

25.7 Views of FIRM

FIRM submitted the following carrying cost position regarding DISCO deferral accounts for the years indicated:

- 2000 — no carrying costs/interest
- 2001 — cost of financing in accordance with *Deferral Accounts Regulation* 240/2000
- 2002 and beyond — no authority provided and, it is submitted, carrying costs should be based on the prudent cost of financing except for those deferral accounts referred to in AE's TFO 2001-2002 Negotiated Settlement

FIRM supported the securitization option, which would remove all risk from the utilities by taking these deferral accounts off-balance sheet. The Utilities obligations would relate only to billing, collection and remittance. FIRM submitted that it is anticipated that a securitization option could be in place by the end of 2001. This being the case, the issue of carrying costs need only be dealt with for 2001. FIRM further submitted that the deferral account balances can only be determined at December 31, 2000 and no carrying costs should be computed for the year 2000. In 2001, FIRM confirmed that it had expressed its position relative to prudent carrying costs and AE's Negotiated Settlement in other sections of its argument.

FIRM submitted that there is an obligation on the Utilities to prudently finance these costs and the Board should order the use of the least cost alternatives for each utility in its decision. In addition, once the deferral account balances have been determined as at December 31, 2000, the calculation of carrying costs should be determined monthly.

FIRM submitted that the Applicants have taken a very liberal interpretation of the *Deferral Accounts Regulation Alberta Regulation 240/2000* which authorizes the Board to provide for recovery of "the prudent cost of financing the amounts in [the owner's] deferral accounts ...." FIRM noted that the Applicants were generally consistent in employing a notional calculation that is not reflective of the costs, which they have incurred or expect to incur regarding these deferral accounts.

With regard to the DISCO deferral accounts, FIRM noted that the following rates have been requested based, for the most part, on some form of weighted cost of capital where both the ratio and the rates are not cost based. The following table summarizes the composite rates requested:

Table 17: Applied for Composite Rates (per FIRM)

DISCO ENTITY	RATE
ENMAX	Bank of Canada Bank Rate + 1.5%
AE	12.44% [620] (8.43% after tax)
EDI	8.47%
UNCA	8.47%
Lethbridge	8.44%
Red Deer	8.31%

FIRM submitted that the Applicants did not borrow at these rates to finance their respective deferral accounts.

FIRM noted that AE took the position that because carrying costs were addressed in the Board approved Negotiated Settlement Agreement, the agreed-upon rate was, by definition, the "prudent" cost of financing [621] and there is, therefore, no conflict between the Agreement and the *Deferral Accounts Regulation*. However, FIRM argued that the Board is bound by the *Deferral Accounts Regulation* and it must take precedence over the terms of the Negotiated Settlement, whether approved by the Board or not.

FIRM noted that the Applications also differed as to the years to which carrying costs should apply. In this regard, FIRM agreed with the comments of ENMAX that the *Deferral Accounts Regulation* "... refers to 2000 deferral accounts and 2001 carrying costs only." [622] FIRM noted that two points emerge from this position. First, the Board should delete the claims for capitalized carrying costs for 2000 claimed by ENMAX and EDI. Second, it would be inconsistent to allow AE to recover 2000 carrying costs, as requested without the express agreement of customers.

With regard to the latter point, AE took the position that the 2001/2002 TFO Negotiated Settlement entitled it to recovery of carrying costs for the year 2000. FIRM stated that even a cursory review of Section 43(a) confirms that the parties did not intend this and in addition, a method of determining carrying costs is only provided for the years 2001 and 2002. This should not be surprising given that the settlement is specifically directed to the test years 2001 and 2002.

FIRM noted that AE quoted from Decision 2001-8 [*ATCO Electric Ltd., Re* (2001), 2001 CarswellAlta 2094 (Alta. E.U.B.)] and stated, "... no party initiated any action to challenge, review or appeal the position advanced by the Board." [623] FIRM responded that it should be noted that this decision constituted an interim approval subject to further consideration and final determination in this proceeding. For the reasons stated, it would be inequitable and without legal justification to allow AE to recover 2000 carrying costs when other applicants are prevented from doing so and the agreement upon which AE relies (2001/2002 TFO Negotiated Settlement) does not substantiate this position.

FIRM also noted AE's suggestion that the level of carrying costs referred to in the Board's Information Letter IL2000-1 should be used as a floor since "... it would be entirely unreasonable to expect ATCO Electric to carry the significant balances for an extended period with no compensation." [624] FIRM responded that no one, including the IFE, is suggesting that there should be no compensation but, rather, that the compensation should be based on the "prudent cost of financing."

FIRM noted AE's argument against the position of the IFE:

> It is simply not possible to finance these deferral accounts with short-term debt, without the cross subsidization being provided by the existing equity layer and ATCO Electric's overall financial position. [625]

Based on this argument, AE submitted that:

> To rely upon this cross subsidization is entirely inappropriate, and inconsistent with the Board's precedent, which has continuously shown respect for the stand alone principle. [626]

FIRM commented that no specific reference was made to this "precedent" and that it could see no reason why customer-financed equity should not be used for this particular utility purpose. FIRM noted that the position of AE should be compared to that of ENMAX, which has stated that:

> ... debt financing is appropriate with respect to its own 2000 Pool Price Reconciliation Account, as it represents the least cost to customers, and promotes regulatory efficiency. [627]

FIRM noted that many of the DISCOs attempted to justify their requested carrying costs based on the "stand-alone principle". This concept, which was embraced by many of the applicants, was described by EDI as a situation in which the "... utility is regulated as if the provision of the regulated service were the only activity in which the company is engaged." [628] FIRM submitted that no reason was given as to why this particular activity should be accorded "stand-alone" status as opposed to any other function or activity of the utility. Thus, this gives rise to a hypothetical discussion regarding Company X. As stated by the IFE, this "... could involve the determination of a notional WACC, including a notional cost of debt, for the DISCO or the notional deferral account business of the DISCO." [629] FIRM submitted that this would "... amount to a denial of financial reality to the benefit of the shareholders of the parent companies and to the detriment of the customers." [630]

FIRM concluded that the Applicants have promoted the use of the stand-alone principle but have provided few reasons as to why it should apply to the deferral accounts, for which recovery is assured through the Board process. It should not be seen as an investment opportunity.

FIRM noted that UNCA appeared to agree, at least in principle, that the utility's carrying costs should be based on actual costs. UNCA stated:

> The actual cost of financing the deferral accounts should be used by the Board as the carrying cost rate unless there are compelling reasons to reject the actual cost. [631]

FIRM acknowledged that, with regard to UNCA, the cost of financing may require "some amount" of equity, as indicated by Mr. Marcus. [632] In this regard, UNCA had made an effort to justify its application based on actual costs rather than a notional calculation.

However, FIRM submitted that the Board must also take into account the "no harm" directions made by it in Decision 2000-41 and the necessity of determining what would have been TransAlta's prudent cost of financing the UNCA deferral accounts. In summary, irrespective of the cost to UNCA, the amount allowed by the Board as the "prudent cost of financing" should not exceed the cost that TransAlta would have experienced.

FIRM noted that both the Cities of Lethbridge and Red Deer used a notional calculation based on a weighted average cost of capital calculation of 8.44% and 8.31%, respectively. However, as stated by the IFE:

> Lethbridge DISCO borrowed money from the City of Lethbridge to cover the pool price costs. The City of Lethbridge did not access its revolving line of credit, but provided funds from reserve accounts. [633]

> The City of Red Deer DISCO also covered deferral account costs by transferring funds from a city reserve account, but referred to the action as the use of equity. [634]

In summary, FIRM agreed with the evidence of Mr. Marcus who stated that securitization "should be the main option that is pursued". [635] Absent securitization, customers should not be responsible for any amount that exceeds the prudent cost of financing the Applicant's deferral accounts.

With regard to the No-Harm issue, FIRM noted that in Decision 2000-41 (TransAlta Utilities Corporation Sale of Distribution Business), the Board approved a sale to UNCA DISCO of TransAlta's distribution and retail business, based on the "no harm" standard. As a result, it made special provisions to exclude the premium paid on sale and to ensure the ongoing benefits of the full amount of UCC. In this regard, the Board stated:

> Therefore, it is manifest that customers are facing a real and substantial risk of higher rates that they would not face absent the transaction. The Board considers this risk to represent a harm to customers that, in accordance with the general principles set out in Section 4.1 of this decision, must either be offset or mitigated for the Board to approve the transaction. [636]

FIRM submitted that in order to determine whether this principle would be violated, the Board must reach some conclusion as to the quantum of carrying costs that TransAlta would have incurred and compare the resulting costs to that which is now being requested by UNCA DISCO.

FIRM noted that The IFE addressed this issue [637] and responded to Board questions requesting an analysis of the hypothetical case of TransAlta Utilities Corporation continuing to own the DISCO until the end of the year 2000 and to, in effect, compare its balance sheet borrowing capacity to that of UNCA DISCO. As a starting point, the IFE noted that the unsecured debt of TransAlta Corporation and UtiliCorp Networks Canada (Alberta) Ltd. are both rated by DBRS as "A", and that other DISCOs (ENMAX, EDI and AE) were able to "stretch" their balance sheets to finance deferral accounts.

FIRM further noted that, in addressing the question of whether TransAlta Utilities Corporation could stretch its balance sheet to accommodate the deferral account balances incurred by its DISCO function in 2000, the IFE concluded the "... existing financing relationships of TUC are very strong and would facilitate any stretching required." — that is, using 100% debt financing. The IFE concluded by stating that the results of their analysis "... are within the ranges of the other DISCOs that actually stretch their balance sheets to finance the deferral account." [638]

Given this ability and the Board's "no harm" directions, FIRM submitted that special financing arrangements and any attendant additional costs should not be recoverable by UNCA DISCO. As a result, FIRM submitted that a weighted average cost of capital rate should not be used but, rather, UNCA DISCO's current short term borrowing rate. FIRM noted that this rate would equate to UNCA's "prudent" cost of financing and would be reasonably close to that which TransAlta would have experienced had it continued in the distribution business.

FIRM submitted that it recognized that, with regard to UNCA, the cost of financing may require "some amount" of equity, as indicated by Mr. Marcus. [639] In this regard, FIRM noted that UNCA had made an effort to justify its application based on actual costs, rather than a notional calculation.

However, FIRM submitted that the Board needed to also take into account the "no harm" directions made by it in Decision 2000-41 and the necessity of determining what would have been TransAlta's prudent cost of financing the UNCA deferral accounts. In summary, FIRM submitted that, irrespective of the cost to UNCA, the amount allowed by the Board to be UNCA's "prudent cost of financing" should not exceed the cost that TransAlta would have experienced.

25.8 Views of ACC

ACC noted that all non-utility expert witnesses in this proceeding, including the IFE, strongly advocated the use of short to intermediate term debt as the best vehicle for financing these deferral balances. The ACC's witness, Dr. Rosenberg, testified at length on the advantages of utilizing debt financing. First, debt financing is far less expensive than equity financing. Second, Dr. Rosenberg expressed that it was inappropriate for the investor owned utilities to earn a profit on the misfortune of the customers, especially if that misfortune was partly of the utilities' own making. Third, Dr. Rosenberg explained that financing should be synchronized to the longevity of the asset that is being financed.

It was noted that these balances will be completely amortized by year-end 2004, under any proposal. If short to intermediate debt financing is utilized, the debt can be repaid from customer amortization payments systematically over the amortization period. At the end of the amortization period, the debt should be completely paid off. Alternatively, ACC submitted that if the proposal to utilize equity is approved, there should be some method to retire that equity once the deferral balance has been fully amortized/recovered. The ACC believed no utility has offered a plan for such a retirement. Thus, ACC was concerned that, absent such an equity retirement plan, the DISCO equity balance will become inflated and customers will later be exposed to the risk of paying an inflated DISCO rate of return, since the DISCO equity balance is unreasonably thick and capital cost would be too expensive.

The ACC offered two further observations on the carrying cost issue. With regards to AE, the ACC notes that AE's financial statements issued in this proceeding didn't demonstrate any no evidence that AE needed to issue additional equity in order to finance its deferral balances. With regard to UNCA, while it may be true that UNCA did get an infusion of equity from its parent company, ACC argued that the equity financing should not influence the Board's approved financing method. That equity infusion should be viewed as a choice made by the utility and should not govern the Board's decision on the least cost method to finance these balances.

Further, ACC noted that the IFE concluded that debt would be a prudent financing method for

UNCA, despite its claim that use of debt would put it in default of its borrowing covenants. ACC also noted that the IFE opined that a temporary exception to the borrowing covenants would likely be approved by UNCA's lenders if a regulatory plan is approved that provides full recovery, including the return, of UNCA's deferral balances. Moreover, ACC submitted that UNCA's representations that a debt financing would violate its borrowing covenants should also not override other prudent financing options for this unusual non-recurring significant expense considerations.

ACC submitted that if debt is utilized, the cost of debt should be limited to not more than 150 basis points above the DISCO commercial paper rate. ACC noted that the amortization period will not extend beyond 2004, and the DISCOs will receive principle payments during the amortization period. Further, a short-term borrowing method will keep the interest rate low and will allow the DISCOs to systematically repay the amount borrowed as customer amortization payments are received.

Alternatively, if the Board accedes to the utilities' request to utilize equity, it would be ACC's recommendation that a significantly lower return on equity be imputed than is the case for the utility's physical assets. ACC submitted that this would be appropriate as a result of the lower risk involved and could also be viewed as a method of sharing the burden of the deferral balances between equity owners and customers.

ACC noted AE's argument against the IFE recommendation:

> While professing to understand the "stand-alone principle" it is submitted that the recommendations of these witnesses do not respect this principle and in fact fly directly in its face. It is simply not possible to finance these deferral accounts with short-term debt, without the cross subsidization being provided by the existing equity layer and ATCO Electric's overall financial position. [640]

ACC responded that the issue is not whether AE could or could not finance these costs with their current capital structure or with some hypothetical capital structure. Instead, the issue is much simpler and more direct. The issue is given that a regulatory asset that will be on the utility's books for three or four years at the most, what is the most reasonable and economic way to finance these costs. For the reasons laid out in the testimony of numerous witnesses and explained in the ACC's Final Argument, the answer is short to intermediate term debt.

25.9 Views of IFE

IFE submitted that its primary mandate was to "present and review the prudent financing options available to the DISCOs." [641] The IFE was also asked to "address the relevancy of including an equity component in the cost of financing of the deferral accounts." [642]

At the same time, the IFE submitted that it was not within their mandate to determine or discuss the relevance and application of *Deferral Accounts Regulation* Alberta Regulation 240/2000, Board Information Letter IL 2000-1, Decision U99099 and Decision U99046. Nor was it within their mandate to opine on the precedence of a Negotiated Settlement, whether there is a duty to utilize or develop least-cost alternatives, the issue of fairness to customers and utility, or the ability of the Board to require the Balancing Pool to pay DISCOs with future recovery from customers.

Through their written and oral evidence, the IFE discharged their mandate under paragraph (b) of the Retainer Agreement, which states:

(b) In preparing the submission, the Independent [Financial] Experts shall:

• Review and analyze the applications that have been filed by the DISCOs in the Proceedings,

• Review applicable decisions of the Board, legislation and regulations,

• Discuss with banks, investment bankers, investment analysts and credit rating agencies regarding the impacts and costs of debt financing of Deferral Accounts for generic DISCOs,

• Prepare a comparative analysis and summary of the filings by the DISCOs as they pertain to financing options, costs of financing, financial and business risks and equity components,

• Review and analyze alternate financing options available for the DISCOs and the Balancing Pool,

• Assess the relevance of including any equity component, and

• Consider any other pertinent issues.

In their assessment of carrying costs, the IFE concluded that the DISCOs, with the exception of UNCA, could wholly finance the deferral account balances with short-term, on balance sheet debt. [643] After responding to information requests, reviewing rebuttal evidence from the DISCOs, and considering the evidence given by DISCO witnesses under cross-examination, the IFE submitted that they continue to believe that the deferral account balances in most cases can be, as they have been, appropriately and competitively financed with short-term debt at rates more competitive than the application of WACC.

The IFE noted that the examination of the out-of-pocket costs of financing the deferral account balances inspired a discussion of the tracking of funds and the "stand-alone principle". Some, though not all, [644] DISCOs suggested that funds should not be tracked, and that the appropriate rate to be utilized for the notional financing of deferral account balances should be the WACC, either of the DISCO or of a notional "deferral account business" subset of the DISCO. The IFE noted that the DISCOs also argued that the stand-alone principle requires that the Board consider the WACC of the DISCO (or the deferral account operations of the DISCO) rather than the WACC of the entity that actually finances the deferral account balances. The position of the IFE with respect to this issue was stated in its response to information request of ATCO.FE-10 (c):

> We understand that the stand alone principle requires that the costs that may be recovered by a utility should be those that would be incurred by the utility on a stand alone basis. We do not understand that the principle requires the rejection of corporate reality in accessing financial markets. [645]

The IFE submitted that while the DISCOs have requested that the Board apply the stand-alone principle, their evidence includes a number of examples of facts, which do not support the image of vigorously independent stand-alone operations. For example, in spite of strong verbal commitment to the stand-alone principle, the evidence demonstrated that in the case of EDI, the deferral accounts were not recorded on its balance sheet for the year 2000. They appeared on the balance sheet of an affiliated company, [646] which were not produced on grounds of confidentiality. In the case of Lethbridge DISCO, the deferral account balance "would tend to be mixed up with the whole capital structure of the City". [647]

The IFE noted that, while supporting the concept of the stand-alone principle, some of the applicants expressed concern that a higher debt level at the DISCO level would diminish the borrowing capacity at the parent level. [648] Some applicants, in their tax planning, determined to defer the deduction of the electricity costs represented by the DISCO deferral accounts so as to enhance the manufacturing and processing tax credit arising from other operations within the corporate entity. [649]

It was noted that, as indicated by Mr. Cowburn of EDI, financing within a corporate group could achieve economies of scale by having a larger organization go to the market. [650] The financial reality is that borrowing is not done by the DISCOs, or by a notional deferral account business subset. It is the parent organization or a special-purpose financing subsidiary that goes to the market for funds. Sometimes, the cost of those funds is mirrored to the subsidiary. Sometimes, it is not.

The IFE submitted that a rote application of the stand-alone principle could involve the determination of a notional WACC, including a notional cost of debt, for the DISCO or the notional deferral account business of the DISCO. Application of the stand-alone principle in this context would amount to a denial of financial reality to the benefit of the shareholders of the parent companies and to the detriment of the customers.

The IFE also submitted that the stand-alone principle was developed to shield utility customers from negative impacts of decisions taken by managers of consolidated entities that included the utilities. Where investments in non-utility businesses had a negative impact on the cost of funds for the consolidated entity, including the utility, regulators declined to visit that impact upon the toll payers. [651]

It was further submitted that it is one thing to use the stand-alone principle as a shield for utility customers to protect them from bearing the negative impacts of decisions taken in respect to a consolidated entity. It is quite another to allow the utility to use the stand-alone principle as a sword to enhance the position of the shareholder at the expense of the customer.

Where the parent corporation is the one that incurs out-of-pocket costs of financing, at a rate that is less than the rate that would be achievable by the DISCO (or by a notional deferral account business subset of the DISCO) on a stand-alone basis, adoption of the stand-alone principle would result in the organization achieving for its shareholders a profit represented by the difference between the actual cost of financing and the notional cost of financing by the DISCO. [652] It would also fail to account for the financing capacity that is provided to the financing entity by the DISCO that is part of the corporate structure. In this regard, the IFE submitted that it believed that the size of the enterprise is an important factor in the determination of the credit quality or rating of an organization. [653] Each of the financing entities in the organizational families of which the DISCOs are a part is relying in part on the DISCO to enhance the size of the consolidated enterprise. [654] The credit quality of the DISCOs contributes to the overall credit quality of the organization.

The IFE concluded that, in the current circumstances, the Board should not apply the stand-alone principle by rote. Instead, the Board should deal with reality, utilize independence of thought, question assumptions and think through whether an approach that has been applied in the past in different circumstances should be applied now in new circumstances. [655] Such an approach should lead the Board to deal with reality and to decline to apply the stand-alone principle to the detriment of the customers of the DISCOs.

With respect to historical precedent, the IFE submitted that there was an experiential basis for the opinion of the IFE that the deferral account balances can be financed wholly with short-term, on balance sheet debt. Thus, historical precedents are relevant. For example, in the case of TransCanada PipeLines Limited (TCPL), significant deferral account balances were financed initially with debt, then with debt and preferred shares, before a securitization option was effected through the TOPGAS companies. [656]

By the end of 1981, TCPL had paid to gas producers $1.013 billion financed on its balance sheet with $733 million of term loans and $280 million of preferred shares. [657] On its balance sheet, Alberta & Southern Gas Co. Ltd. (A&S) financed take-or-pay liabilities of $176 million through a commercial paper program when its rate base assets totaled approximately $10 million. [658]

The IFE noted that during cross-examination the DISCOs declined to engage the IFE on the relevance of the TOPGAS precedent or the take-or-pay liabilities of TCPL or A&S. [659] For example, while Dr. Evans attempted to distinguish TOPGAS in some ways, the IFE suggested that cross-examination revealed him to be unsuccessful. [660]

The IFE submitted that the conclusion to be drawn from the evidence is that the TCPL and A&S experiences are irrefutable. Significant deferral account balances were funded on balance sheet with debt and preferred shares. This experience has lead the IFE to the entirely defensible opinion that deferral account balances in the current circumstances could also be funded with on balance sheet debt.

With regard to the preferred share issue, the IFE submitted that there was not much that could be concluded based on the evidence and argument. It was precipitated by the statement in the IFE Evidence that they believed that in those limited circumstances where an equity component would be required it would be appropriate to use a shorter-term equity instrument, such as redeemable preferred shares, to facilitate on balance sheet financing. [661] The IFE noted that Dr. Evans responded with evidence about the inability of EDI to make a public issue of preferred shares without losing its tax-exempt status. EDI also filed evidence provided by Mr. Jacques, a tax lawyer. [662] However, the IFE argued that the entire discussion of public issues of preferred shares was completely irrelevant. The IFE did not at any time propose a public issue of preferred shares. The evidence was that there is no tax consequence to the issuance of private preferred shares by EDI. As explained by Mr. McCormick, [663] EDI could use an inter-corporate preferred share issue to assist in funding the deferral account balances, without losing tax-exempt status.

The IFE also noted that a loss of tax-exempt status to EDI would occur as a result from a public issue of common shares. [664]

The IFE submitted that the shorter-term nature of the recovery of the deferral amounts and the anticipated repurchase of shares issued by UNCA is much more akin to a preferred instrument than common equity. Similar to EDI, UNCA would not suffer negative tax consequences as a result of a preferred share issue to a related party with a substantial interest. [665]

The IFE noted that elements of its evidence that have been overlooked or ignored include:

• the evidence that the short-term debt rate of the relevant DISCO, rather than the cost of its long-term debt, is the most appropriate rate for the calculation of carrying costs;

• the evidence that the credit card and trade receivable securitization precedents are practical, real world examples of the level of equity required to finance assets similar to the deferral accounts; and

• the uncontroverted evidence of the TCPL and A&S experience with on balance sheet financing of take-or-pay liabilities, which clearly establishes that stretching the balance sheet is a prudent method to finance assets similar to the deferral accounts.

The IFE noted that several applicants took the position that they should receive a carrying cost based on WACC, and that the cost of debt component of the calculation should be calculated with respect to their respective long-term debt rates. The IFE expressed the view that the appropriate debt rates are short-term rates. The IFE noted that the evidence was that the deferral account balances were initially financed with debt at short-term rates. [666] It was also noteworthy that the evidence of Ms. McShane for AE recognized that a short-term debt rate of 5.75 percent would be appropriate, in contrast to the longer-term rates sought by AE. [667]

The IFE noted EDI assertion that:

> The Board should reject the suggestion that credit enhancement requirements for securitization trusts can be considered as reasonable benchmarks for those common equity ratios that are required to underpin the financing of deferral accounts on the balance sheets of the utilities. [668]

The IFE responded that the evidence shows that credit enhancements for securitization trusts are real world stand-alone evidence of the equity layer required to support the financing of a host of small accounts from a large base of debtors. For example, the TCPL and A&S experiences speak for themselves. The IFE submitted that they are incontrovertible evidence that stretching the balance sheet is a prudent method to finance assets similar to the deferral account balances.

The IFE responded to the EDI argument that the concept of stretching the balance sheet, as discussed by the IFE, is a departure from the stand-alone financing question respecting EDI. [669] First, as discussed in the IFE Argument, [670] the IFE stated that the stand-alone principle does not require the rejection of corporate reality in accessing financial markets. Second, the IFE evidence was consistent with the fact that there is no "stand-alone deferral account business". It is also consistent with the historical realities of TCPL and A&S on balance sheet financings of take-or-pay obligations. Finally, the IFE noted that the deferral account balance did not appear on the EDI balance sheet as at December 31, 2000. [671]

The IFE noted that EDI devoted some of its argument to preferred shares. [672] The IFE noted that EDI remained focused on a public issue of preferred shares and ignored the fact that the IFE did not at any time propose a public issue. The IFE further submitted that the evidence remains that it is within the power of the parent of the DISCO to use preferred shares, issued to a member of its corporate family having a substantial interest, to fund a portion of any equity component required to finance the deferral account balances. [673] Thus, the IFE argued that the real question related to any equity component that may be determined to be required in a DISCO capital structure is whether the nominal common equity really behaves like preferred shares and should therefore earn a return as a preferred share. The IFE noted that this was the situation in the later years of the TCPL on balance sheet financing of its take-or-pay obligations. [674]

The IFE also noted that EDI included an assumption of "mirroring" of a preferred share financing from a related company to EDI. This appeared to be inconsistent with Dr. Evans' position that dollars could not be traced into a regulated subsidiary company as either debt or equity. [675]

The IFE submitted that given the shorter-term risk of the deferral account balances, the WACC for the distribution business of the DISCOs should not be determinative of the prudent cost of financing the deferral amounts. The WACC for the distribution business of the DISCOs depends on the risk of the wires business. In contrast, the IFE argued that deferral account balances have a different risk level than the assets of the wires business. Deferral account balances are not long term. The risk of recovery is significantly less than the assets of the wires business.

> The IFE noted that with respect to the temporal risk of recovery, it was instructive to look at the TOPGAS precedent. The take-or-pay obligations began to arise in 1977 and were ultimately collected by 1993. These deferral amounts began to accrue in 2000 and will be collected by the end of 2004. In summary, the IFE submitted that the risk of recovery of the deferral account balances is significantly less than the TOPGAS obligations.

> In response to AE's assertion that the appearance of the IFE was irrelevant to a determination of what carrying charges should be applied to its deferral accounts, [676] the IFE noted that it was the IFE's recommendation to investigate the concept of securitization, with the resultant broad discussion on the record and the consequent consideration of the viability of the securitization option.

> The IFE also noted AE's argument that a: fundamental flaw in the evidence of the financial experts is that these deferral accounts can, in fact, be financed with 100% short-term debt. [677]

The IFE argued that this assertion ignored the fact that the conclusion of the IFE was driven by empirical evidence of such financings by A&S and TCPL. For example, the evidence of Mr. Demcoe was that A&S financed its take-or-pay obligations on balance sheet with 100 percent short-term debt. [678] In addition, TCPL financed its initial take-or-pay obligations with 100 percent debt at rates based on prime or lenders' cost of funds in identifiable financings approved by the Alberta Petroleum Marketing Commission. [679]

The IFE also noted AE's suggestion that the IFE:

> were also quick to change their evidence, contained in Information Response FIRM-FE-5(a) that no equity was required. [680]

The IFE responded that a review of the record reveals that the IFE did not change their evidence. The IFE were consistent in their view that an on balance sheet short-term debt solution was a prudent financing alternative, given existing equity. The IFE presented the following statement as evidence:

> It is our conclusion that new material tangible equity support is not necessary for the financing of most utilities deferral accounts. It is more likely that with the appropriate regulatory authorities and in some cases credit enhancement mechanisms the deferral accounts can be prudently financed with all short-term on balance sheet debt. [681]

In citing the on balance sheet financings of take-or-pay obligations by A&S and TCPL, the IFE confirmed that they could not and did not deny that there was equity on those balance sheets. The IFE further stated that one of the essential concepts of the IFE evidence was that in the past a number of entities facing amounts similar to the deferral account balances in this proceeding have financed those amounts with on balance sheet short-term debt. [682]

The IFE also submitted that AE misstated its position in the following comments:

> The witnesses also modified their position and are now saying that with appropriate regulatory approvals (26T6260) and possibly with certain credit enhancements being available (26T6263) the company should be able to finance totally with short-term debt. [683]

The IFE submitted that a review of the record shows that the IFE have always viewed a Board order as necessary for the collection of the deferral account balances. [684] The IFE noted that it was clear from page 16 of the IFE evidence, as well as from page 14 of that evidence:

> We believe that the utilities, with appropriate regulatory authorities and assurances, could prudently finance the deferral accounts predominantly with short-term on balance sheet debt. Each utility has different credit characteristics and financing capacity that would vary the costs of financing and other factors involved in each case. [685]

The IFE submitted that it was their belief that, in advance of a Board order and as the accounts were accreting during 2000, short-term debt financing was appropriate owing to uncertainty as to the total amount and term over which it may be recovered. [686] Further, the IFE submitted that an examination of the evidence as a whole will show that the IFE anticipated a broad range of credit enhancements, ranging from an increase in interest rates [687] to comfort letters [688] or guarantees [689] and additional security. [690]

Appendix 7

26 Views of the Parties - DISCO Hedging Issues

26.1 Views of TransAlta

TransAlta indicated that it disagreed with suggestions that it that it ought reasonably to have been expected to acquire DISCO hedges in respect of the year 2000.

As part of its application in the U99099 proceeding, TransAlta sought to take on the pool price risk. By contrast, the Board noted in respect of intervenors at p. 200 of Decision U99099:

> IPCAA recommended instituting a pool price deferral account for TransAlta-DISCO, similar to that used in the Utilities' 1998 negotiated settlements. Mr. Drazen considered that **removing the significant forecast risk related to pool price** would reduce the DISCO and GENCO cost of capital and benefit customers. Other Intervenors supported IPCAA's proposals for deferral accounts.
>
> (Emphasis added)

The Board's decision on this issue was as follows, at page 202 of Decision U99099:

> The Board considers it appropriate to establish pool price deferral accounts for both GENCOs and DISCOs for each of 1999 and 2000. Deferral accounts will **ensure that 100% of the difference between the actual hourly and forecast hourly pool price is accumulated and borne by the customers** of the respective GENCO or DISCO.
>
> (Emphasis added)

TransAlta stated that Decision U99099 was clear. TransAlta stated that its request to let it manage the pool price risk was denied, and the deferral account was established for the express purpose of ensuring that customers, not shareholders, bore 100% of the pool price risk. TransAlta indicated that nowhere in Decision U99099 was hedging beyond the statutory hedges, or funding for the costs and risk of such an exercise, contemplated.

Decision U99099 was delivered in late November of 1999. Decision 2000-31[*TransAlta Utilities Corp., Re* (May 30, 2000), Doc. 2000-31 (Alta. E.U.B.)], delivered in late May of 2000, dealt with, *inter alia*, resolution of the TransAlta 1999 DISCO Distribution Price Deferral Account amount of $13.9 million (see p. 7 of that Decision). That the DISCO deferral account was a matter to "*pass any cost/benefit arising to the DISCO from the GENCO deferral accounts to TransAlta's DISCO's customers*" was reiterated, at page 8 of that Decision (emphasis added). TransAlta stated that in the U99099 proceeding or the 2000-31 proceeding that no party had suggested that TransAlta should have undercut the '100% to customers' nature of the deferral account by having hedged in 1999, or that that TransAlta should be hedging in 2000.

When the 2000 DISCO deferral account began to accumulate a significant balance during the year, TransAlta brought that matter forward for consideration of an interim rider to deal with the growing balance, and Decision 2000-52 [*TransAlta Utilities Corp., Re* (July 27, 2000), Doc. 2000-52 (Alta. E.U.B.)] was delivered in late July of 2000. In that Decision, the Board yet again noted that: *"The impact of the distribution deferral account is that differences between forecast and actual pool prices are to be charged or refunded to the account of the customer*." (Decision 2000-52, page 1, emphasis added)

TransAlta stated that in the 2000-52 proceeding that no intervenor had disputed that fact, nor did any suggest that TransAlta should have been or should then be engaging in DISCO hedging activities in respect of 2000. Indeed, Intervenors noted that given the volatility of pool prices, the need for interim collection was debatable (FIRM, IPCCAA and IPPSA/SPPA, respectively, at pages 4, 5 and 6 of Decision 2000-52). Volatility of pool prices led intervenors to question even an interim rider at the time.

TransAlta argued that to suggest in hindsight that TransAlta should have been undertaking hedging on behalf of and at the risk of customers, despite those intervenor positions and despite the clear declarations in a series of Decisions between late 1999 and mid 2000, is simply not credible.

Interim rider matters were further considered in Decision 2000-60, released on August 31, 2001. Again in that Decision (page 19), the Board noted that: "*... customers strongly requested the implementation of deferral accounts in the proceedings leading to Decision U99099."* It was also noted (page 20) that, "*... the Board agrees with IPCCAA that the impact of pool price on unhedged load represents the main source of the deficiency in the present balance of the TransAlta DISCO deferral account*." Despite discussion of the unhedged portion of the DISCO load, no suggestion is noted in that Decision as being made by IPCCAA, by any other Intervenor or by the Board, that hedging of that portion by TransAlta ought to have been or be in contemplation.

The overt, consistent and clear allocation by the Board, at the behest of customer representatives, of 100% of the pool price risk to customers runs from Decision U99099 in late 2000 through proceedings to the eve of the sale to UtiliCorp. That clear assignment and acceptance of risk, together with the customer anticipation that Pool prices might moderate in the remaining months of 2000, explain why no hedging suggestions arose. It is only after the year 2000 is over that intervenors now seek to reinvent history, to avoid the consequences of a risk they sought to bear during 2000. The history is clear, and that history could not in fairness be reinvented.

TransAlta stated that history applies with equal force as the background for UtiliCorp's course of action after it purchased the Distribution & Retail business from TransAlta. That history renders academic, in TransAlta's submission, discussions of whether hedges were available in sufficient volumes, in reasonable shapes, and at acceptable costs in respect of the year 2000, although the evidence in this proceeding indicates that such hedges were not, in fact, available.

TransAlta said the history of their DISCO deferral account also renders moot comparisons with the positions and actions of municipal DISCO's, who were not under the same regime, and who did not have in place throughout 2000 the type of mandated deferral account that TransAlta did. TransAlta stated that had TransAlta's U99099 request to bear the pool price risk been accepted, rather than rejected, history and TransAlta's actions in 2000 might have been different — but again, TransAlta stated, "history is not to be reinvented".

TransAlta noted that ACC submits (p. 2) that 'by not even asking its customers whether they were interested in hedging ... the DISCO's were derelict in their duty'. TransAlta asked in the U99099 proceedings to take on the risk of Pool price variances, thereby providing a hedge to customers. TransAlta met strong and successful opposition to that request, and heard no change of view from customer representatives throughout 2000. TransAlta indicated they couldn't fairly be suggested to have been under any 'duty' to hedge.

TransAlta views that IPCCAA's argument (p. 24) consisted only of "unsupported superficialities and inaccurate assertions". TransAlta stated that the evidence in the proceeding demonstrates in each case the contrary of IPCCAA's assertions, to wit:

• IPCCAA asserted insufficient codes of conduct were in place: TransAlta's Principles of Operating Conduct and intended practices were before the Board in the U99099 proceeding, and led to proper relationships in 2000, as detailed elsewhere in this Reply,

• IPCCAA asserted that GENCO's took actions that increased Pool prices: TransAlta's offering minimized overall costs to customers, as fully discussed in this Reply, and

• The DISCO's were not being responsible by not hedging: The evidence in this proceeding does not demonstrate that DISCO's could have hedged in any material manner. Moreover, the clearly articulated regime for 2000 was that customers sought to take the Pool price risk, operated throughout 2000 under a regime where the Pool Price risk had explicitly been assigned to them, had opposed TransAlta's proposal that it bear and deal with the Pool price risk, and never raised during 2000 the question of TransAlta or UNCA hedging.

TransAlta stated that SPPA makes the intriguing assertion (p. 21) that: 'Intervenors were not prepared to assume the risk of high pool prices and were equally not prepared to compensate TransAlta or any other applicant for doing so.' In SPPA's perspective, TransAlta stated that intervenors simply wanted the Board to wish away Pool price risk. What the Board did instead, in recognition that risk can't be wished away but is to be allocated, was establish deferral accounts that provided expressly for variations from Pool price forecasts to be to the account of customers.

TransAlta stated that SPPA (p. 55) asserts that when a DISCO is buying energy at prices above $500/MWh and selling for under $50/MWh, the analysis to determine that their customers were adequately protected should have been performed. In so asserting, TransAlta stated that SPPA chooses to ignore that TransAlta had sought to protect customers from Pool price risk, had been opposed by customers, and had had deferral accounts imposed on it that expressly assigned the Pool price risk to customers as customers had requested. TransAlta suggests there is no indication whatsoever that any customer had raised a contrary concern throughout 2000, despite several regulatory events that presented opportunities for customer representatives to evidence any change of heart.

TransAlta noted that SPPA comments (p. 56) that if TransAlta had elected to increase Pool prices through its offer strategy, it ought to have considered the effect on customers and thereby considered hedging. In addition to the above comments on SPPA's perspective, TransAlta indicated it must also be remembered, in its view, that TransAlta's hydro offering strategy had the effect of minimizing overall costs to customers. TransAlta engaged in proper hydro system management, not Pool price management. TransAlta stated that SPPA's penchant for choosing any given hour and saying 'why wasn't hydro being run cheaply in this hour' is a myopic perspective, which if followed by TransAlta, would have seen customers bear increased overall costs in 2000.

TransAlta stated that SPPA's argument (p. 56, footnote 135) also confirms the flaws in calculations it filed regarding IPP energy, by noting the pre-sold nature of non-regulated MWh that removed them from benefiting from increased Pool prices.

TransAlta stated that SPPA asserts (p. 59) that there is no evidence that customers accepted residual pool price exposure beyond the legislated hedges. To make such an assertion, TransAlta stated that SPPA must ask that the Board ignore the clear customer positions that carried the day in the U99099 proceeding, and that were never recanted by customers over 2000.

26.2 Views of UNCA

26.2.1 UNCA Perspectives on the Regulatory Context

UNCA suggested it is absolutely essential to consider the regulatory context in making a determination whether TransAlta/UNCA should have hedged the pool price deferral account. It is UNCA's submission that when the regulatory context faced by UNCA is examined the only fair conclusion is that no one contemplated TransAlta/UNCA would hedge against variations in the Pool Price. Furthermore, it is unfair and unreasonable to suggest at this time that TransAlta/UNCA should be penalized for failing to do so.

In the proceedings leading to Decision U99099, UNCA stated that the issue of who should bear the pool price risk was thoroughly debated. The issue was clearly recognized by the Board in its Decision at page 199, where the Board states in the section headed Distribution-Deferral Account:

> The Board, in this section must determine whether it is appropriate for pool price, reservation price and sales volume risk to rest with the DISCO or whether deferral accounts should be set up to pass variations from forecast to the DISCO's customers. [691]

UNCA stated that there were alternatives presented as indicated in the Decision:

> TransAlta and EPGI opposed the use of deferral accounts on the grounds that such deferral accounts blunt incentives to manage risk effectively, and may actually result in inefficient choices in system operation. [692]

UNCA stated that the issue was vigorously debated with all Interveners that presented argument on this issue supporting the creation of a pool price deferral account, suggesting among other things, that removing the significant forecast price risk would reduce the DISCO cost of capital and benefit customers. [693]

UNCA noted that the Board rejected the TransAlta proposal and found that:

> ...the generation/sales forecast is an important part of both GENCO and DISCO revenues/costs. The Board considers it appropriate to establish pool price deferral accounts for both GENCOs and DISCOs for each of 1999 and 2000. Deferral accounts will ensure that 100% of the difference between the actual hourly and forecast hourly pool price is accumulated and borne by the customers of the respective GENCO or DISCO. [694]
>
> (Emphasis added)

UNCA believed this statement in their submission makes it absolutely clear that the entire pool price risk rests with the customers of UNCA. UNCA stated that the U99099 Decision was published on November 25 th , 1999 and none of the parties requested a review or reconsideration of this decision at any time during 1999 or 2000, when theoretically at least, some steps might have been taken to hedge the deferral accounts.

UNCA stated that having decided that the risk should rest with the customers, the Board went on to reduce the return to the TransAlta/UNCA DISCO on the basis of the reduced risk the utility faced. In discussing business risk and capital structure the Board stated, after a general discussion of trends in risk faced by the GENCOs and DISCOS:

> ...the Board notes that it has mitigated a substantial amount of the modest increase in business risk of the integrated utility by shielding the utility from the volatility of hourly pool price changes through the implementation of pool price deferral accounts for both the GENCO and DISCO functions in the current proceeding. This shield was not available to the GENCO and DISCO functions in 1996. In comparison to the 1996 GTA period, volatility and hence risk of hourly pool prices has grown substantially. As a result, the Board is in agreement with the need for deferral accounts. [695]

UNCA noted that the Board then set the appropriate capital structure based on the reduced risk resulting from the deferral accounts. In UNCA's submission, it would be totally wrong and unfair to tell investors that they were being protected by a deferral account, to reduce the return because of the existence of that protection and to then, having lowered the return, remove the protection and retroactively make the shareholders responsible for costs they had never anticipated would be their responsibility. UNCA stated that it would be doubly wrong to do this at the behest of parties, which urged the creation of the deferral accounts seeking the benefits of the associated reductions in risk and return.

UNCA stated that the regulatory context for consideration of the distribution deferral accounts does not end with Decision U99099.

On June 30, 2000, TransAlta filed an application with the Board for an interim rate rider of 25% for consumption from August 1, 2000 onward and continuing into the year 2001. The application was driven by a large deficit due to the fact that "actual pool prices for the first 5 months of the year average $63/MW.h compared to a forecast pool pricing of 2000 re-filing of approximately $27/MW.h for the first 5 months of 2000." [696] TransAlta calculated that the distribution deferral account could go to approximately $170 million by December 31, 2000. UNCA stated that this application brought the seriousness of the rapid increases in the pool price and the associated pool price deferral account directly and clearly before the Interveners.

UNCA indicated there could be no question that as of June 30, 2000, if not well before that, the Interveners were all aware of the impacts of the pool price spikes and the ramifications for the pool price deferral account. In spite of this information, not one of them applied to the Board for a review and reconsideration of Decision U99099's Pool Price Deferral Account provisions nor did any of them approach TransAlta or UNCA suggesting that hedging would be a good idea.

UNCA stated that the Interveners instead opposed the increase citing forecast uncertainty. IPPSA/SPPA elaborated on the impact of the uncertainty:

> Other reasons cited to delay the disposition of the deferral accounts is the considerable forecast uncertainty for the remainder of 2000. IPPSA/SPPA commented that similar to the unforeseen large increase in natural gas prices during the first half of 2000, a significant reduction in natural gas prices and/or power pool prices for the remainder of 2000 is potentially possible. [697]
>
> (Emphasis added)

Further on Decision 2000-52, UNCA noted that the Board indicates:

> In terms of a summary of its submission, IPPSA/SPPA argued that the original intent of Decision U99099 with respect to deferral accounts should be adhered to, and should not be altered. Otherwise, a number of other decisions could potentially be re-opened and debated. As a result, IPPSA/SPPA recommended that the Board not approve the Application. [698]

In UNCA's submission, throughout December 1999 and all of 2000, the Interveners clearly had the knowledge and the opportunity to revisit the use of the deferral account, or to consider other alternatives. They did not take action and we submit to you that the reason they did not, is the reason attributed to IPPSA/SPPA by the Board, a belief that prices could come down and that they would benefit from the fall in prices. This was not an unreasonable view given the unprecedented highs they had reached by June 2000.

UNCA stated that these Interveners are extremely sophisticated and have knowledge available to them that is every bit the equal of the market knowledge available to UNCA. This is particularly clear in the case of SPPA, who has been represented throughout its existence in regulatory matters by Mr. Hildebrand, who indicated, without much prompting, that his company is "the only company that provides third party independent comprehensive, fundamental pool price forecast in this market". [699] He also indicated that his relationship with SPPA is a close one and that when his company sees a problem, it is pro-active and takes it to their client. [700] UNCA stated that TransAlta argued that the market information available to the Interveners in 2000 was every bit as good as the market information available to TransAlta/UNCA.

The Board's interim decision in 2000-52 was followed by a final decision 2000-60 on August 31, 2000. In the latter decision, the Board stated:

> The Board notes that it approved the implementation of GENCO and DISCO deferral accounts and Decision U99099 and approved the specific GENCO and DISCO deferral account formulae in refiling Decision 2000-3.

The Board notes that customers strongly requested the implementation of deferral accounts in the proceedings leading to Decision U99099.

The Board also notes TransAlta's view that 'the recent rise in natural gas prices was clearly unforeseen and even in the absence of deferral accounts would likely constitute materially changed circumstances'.

Accordingly, had the Board not established deferral accounts and had TransAlta then applied for increases to its rates due to materially changed circumstances, the Board considers that this alternative scenario would have constituted a review and variance application." [701]

UNCA suggested this passage confirms that the significance of the deferral accounts was well known and the clear fact that the burden rested with the customers. If the Interveners wished to change the rules, UNCA stated that they had numerous opportunities from November 25, 1999 to August 31, 2000 to come forward and to seek changes while something could be done. But they did nothing.

26.2.2 UNCA Perspectives on the City of Lethbridge Evidence

UNCA noted that the municipal DISCOs did hedge some of the exposure above and beyond the legislated hedges. However, UNCA noted that it was neither a simple nor risk-free decision. Mr. Sawada on behalf of the City of Lethbridge noted there was risk associated with hedging activities and that his customers could have ended up paying more rather than less. [702] The level of hedges undertaken by the City of Lethbridge is not clear, ranging from 0 to 47%, [703] but UNCA noted that it is clear that Lethbridge was not fully hedged. [704] UNCA noted that it is also clear from the discussion in the transcript that the amounts involved in the hedge were very small in comparison to those that would have had to be undertaken by the AE or UNCA DISCOs. [705]

UNCA noted that Lethbridge also made it clear that getting hedges was not a simple matter. The Cities' evidence was that it was not easy to put in place a hedge arrangement in September 2000 even for the limited requirements of Lethbridge. [706] Furthermore, UNCA noted that the decision to hedge was not self-evident as reflected in the slim vote in favour of hedging of 5 to 4. [707] .

26.2.3 UNCA Perspectives on The City of Red Deer Evidence

UNCA noted that the City of Red Deer also hedged, securing a benefit of approximately $7.3 million.

Further, UNCA noted that Mr. Roth also confirmed the practical difficulties in hedging in the following excerpt from the transcript:

> Q. At a very high level can you tell me whether it is your experience that hedges are commercially available in the market?
>
> A. Mr. Roth: As of today, I am not sure because we are not in the retail business anymore, so we are not directly involved in this anymore but during the year 2000.
>
> Q. Yes Sir
>
> A. And particularly in probably the latter three quarters of that year hedges were very, very difficult to come by. The prices were extremely high if you could, in fact, find one. It was almost impossible to find a hedge that was tailored to your actual load profile. You had to, sort of, take what was on the market. It was a seller's market. [708] "
>
> (Emphasis added)

UNCA noted that the difficulty was further emphasized in a later exchange:

> Q. But despite that I guess what I'm seeing here in the schedule is that you were able to hedge throughout the year, and quite successfully as the year progressed in this schedule.
>
> A. Mr. Roth: That's correct, but I don't want to give the impression that that was easy to come by. That came with the result of the many sleepless nights, I might add, because of the high cost. And as well there is always an upside and a down side to it. This could have been a totally different market as it turned out. There could have been risk put on our consumers which they would have had to bear but that was risk we took. [709]

UNCA noted that Mr. Roth also testified as to the nature of the market, the need for rapid decisions and the deterioration of available hedges within a matter of hours. [710] Mr. Roth acknowledged that the decision was not a "no brainer" and recognized that others might have made a different decision. [711]

UNCA noted that it is notable that Mr. Roth, who was in the market, was not prepared to indicate that if UNCA had decided to hedge, whether there would have been enough hedging product available to allow Red Deer to hedge. [712]

Finally, UNCA submitted that it should be recognized that the municipalities exist in a very different regulatory environment. UNCA stated that Red Deer had no "inkling" of any kind of a deferral account to accommodate this type of thing. [713] By way of contrast, UNCA stated that the investor-owned DISCOs had been through a contested hearing and had been ordered to set up deferral accounts passing through variations in the Pool Price to Customers.

26.2.4 UNCA Perspectives on ACC

In UNCA's submission, Dr. Rosenberg simply has no credibility on this issue; and his evidence amounts to little more than self-serving hindsight.

UNCA stated that, in UNCA's opinion, Dr. Rosenberg was not familiar with the availability of hedges in the Alberta market in 1998 [714] , 1999 [715] or 2000 [716] . UNCA stated that Dr. Rosenberg acknowledged that prudence would require any hedge to have customer approval [717] .

Furthermore, UNCA noted that importantly Dr. Rosenberg agreed that:

> If you were to reverse that, having the lowered the rate of return or lowered the equity component afterwards and imposed the risk on the shareholders that would not be a fair action. [718]

UNCA noted that Dr. Rosenberg conceded, that at no time during the year 2000, did ACC ever suggest hedging, but rather it is only after the fact that ACC suggested that the Pool Price exposure should have been hedged [719] .

UNCA noted that Dr. Rosenberg's original evidence suggested that if a cap of $70.00 had been purchased for the year 2000, the deferral account could have been eliminated [720] . As pointed out in cross-examination, the evidence upon which he based that projection contemplated an average pool price that was already $70.00 per MW.h. UNCA noted that common sense suggests that with an upward trend and average price already at the $70.00 level a cap for $70, if available at all, would only be available for a significant premium. Furthermore, UNCA stated that the ease of obtaining the hedge suggested by Dr. Rosenberg does not accord with the evidence of the municipalities who were in the market and must be discounted totally.

In spite of this factual understanding, UNCA stated that Dr. Rosenberg concluded it was imprudent not to hedge and that such hedges were readily available. In UNCA's submission, such a conclusion is untenable in the face of the admitted facts.

26.2.5 UNCA Perspectives on the Simard Hedging Evidence

UNCA views that the only qualified expert who testified on hedging and the prudence of the DISCOs was Mr. Tim Simard, whose evidence is found in Exhibit 349. Mr. Simard is a founding principal of Risk Advisory, a Calgary firm that has provided risk management advisory services and system support to more than 130 companies in Canada, in the US and in New Zealand since its inception in 1995. Mr. Simard himself has been at the forefront of the energy risk management industry in Canada since its genesis in 1985.[721] Mr. Simard is clearly qualified to comment on the prudence of TransAlta/UNCA in not entering into hedged transactions on behalf of the ratepayers in excess of the legislated entitlement positions.

UNCA stated that Mr. Simard responded directly to the evidence of ACC and SPPA bringing into question the prudence of TransAlta and UNCA and concluded that the actions of the DISCOs were not imprudent.

UNCA noted that Mr. Simard properly noted that the "establishment of an appropriate hedging program is entirely a function of the risk appetite of the individual organization or organization for whom the hedge is established."[722] This fundamental requirement seemed to be recognized by the Interveners in theory; however, UNCA noted that they do not seemed to give any weight to the difficulties of creating a hedge program that is satisfactory to all customer groups. UNCA stated that, in their opinion, recent experience in trying to hedge the RRO exposure has shown that getting Intervener consensus on a hedging program is extremely difficult.

Mr. Simard, in UNCA's submission, summarized the intervener position quite appropriately when he stated:

> "...they have opted for a scenario where they prefer to leave all responsibility for the hedge with the DISCO (who once again is not in as good a position to assess the risk appetite of its ratepayers) and then subject the DISCOs to a negative hindsight review. If prices fall and the DISCO does hedge, the interveners can claim their constituents desired full exposure to market prices. If market prices rise and the DISCO does not hedge, the interveners can claim after the fact (as they are doing), that their constituents did not want exposure to pool price movements."[723]

Mr. Simard also brought the discussion back to the true economic nature of a hedge:

> ... One should note that in an efficient market, the premium one pays for price protection will be equal to the expected payout from that insurance policy. For example, if one acquires protection against prices rising from above $70 for $3.00 per MWh in an efficient market, it is because the probability-weighted expectation of the payout on this option will be $3.00. If a premium is low, it is because the expectation of any payout on the option is low. One will not be able to acquire price protection for a cost that is below the expected payout. In fact, in an embryonic market like the Alberta pool price forward and options market in 1999 and 2000 (and today), there would have been a liquidity premium attached to these types of structures so that the required premium would have exceeded the expected payout from the option.[724]
>
> (Emphasis added)

While it may now appear that options to protect against increases in the pool price were cheap at some time in the past, UNCA stated that it must be remembered that at the time they were entered into, they reflected the value of the benefit likely to be received. Accordingly, while today, with hindsight, UNCA stated that interveners may say they would not have objected to the cost of a particular hedge because the protection it would have given is so great, it must be remembered that at the time they were entered into, the cost/value equation was very different. UNCA stated that there was no expectation of the high prices that occurred, and accordingly had the market turned out differently and prices fallen as many anticipated, it is entirely conceivable that there would have been a proceeding at which Interveners would have argued that the costs of the hedges were excessively high for the benefit received and that they should not be recovered in UNCA's cost of service.

UNCA stated that Mr. Simard also pointed out that on a practical basis, an 85-90% hedge is very prudent and in fact consistent with customer interests.[725] Mr. Simard, like the representatives of the Municipalities, also spoke to the difficulty of matching hedges to load shape.[726]

26.2.6 UNCA Perspectives on SPPA Evidence

UNCA remarked that after the completion of the oral evidence, SPPA filed Exhibit 1209, in response to a question from the Board. UNCA interprets that it goes far beyond the question posed by the Board and serves to mislead rather than to inform. Exhibit 1209 is an exhibit SPPA relies heavily upon in its argument to demonstrate that the DISCOs could have hedged, potentially saving hundreds of millions of dollars. In UNCA's submission, this Exhibit is a self-serving, theoretical, after-the-fact calculation that does not in any way reflect the market as described on the record of these proceedings by those who were active in the market.

UNCA stated that Exhibit 1209 does little more that take actual volumes and look at what might have been gained had TransAlta/ UNCA been able to hedge at very advantageous prices at the very best time, i.e. December 1999 and January 2000. UNCA stated that Exhibit 1209 is not based on the market for hedges. It is based on numerous assumptions by the authors. It describes types of arrangements that "were likely available [727] " in their opinion for virtually all-available power in spite of contrary market evidence.

UNCA stated that SPPA suggested a hedge of 270 MW at low cost was possible. UNCA stated that this simply does not accord with the evidence of those who were active in the market. UNCA has already reviewed the evidence of the municipalities with respect to the scarcity of hedges and the cost of such hedges in its Argument. [728] The TMP producers also testified to the scarcity of hedges in the following passage from the transcript:

> Q. ...During the year 2000, did you consider using hedges as an alternative?
>
> MR. JOYS: Yes. I will answer that, since we probably did more hedging than my esteemed colleague. We hedged in the financial marketplace virtually every year since the Option 21 agreement was put in place, so 1996 through 2000. I would offer that in the year 2000, we didn't do as much hedging as we had in years past, not because we didn't attempt to but because the players and the offers were not as forthcoming in the year 2000 as they were in previous years.

So, we did do some hedging in 2000, but there wasn't as much to offer, and the pricing, based on our risk management portfolio, was not very aggressive. The premiums on the hedges in 2000 were quite different than they were in years previous.

> MR. FELL: In Alberta Newsprint's case, we did hedge to a small degree in some years, and we were offered hedges in the year 2000, but we worked harder to gain more flexibility on our operation side. And we gained more by going down than we would have by paying the extreme premiums that we saw on hedges in the year 2000.
>
> Q. And those premiums that you are referring to, was that right from the beginning of the year 2000 or even in 1999 for year 2000 hedges?
>
> MR. JOYS: Sir, I believe that premiums were there all along. In our comprehension, we don't believe even today there is a liquid market for going out and doing financial hedges. In the period prior to getting to 2001, and I can't comment on 2001, but all years previous to that, it appeared as though most of the hedges were not really financial, but they had to have a physical backup. And as things got tighter and tighter through the B.C. boarder, it appeared there was less and less volume available, and any kind of decent pricing access into the Pacific Northwest or wherever was somewhat restricted because of practices as, I think, primarily on the other side of the border, but I am not expert enough to comment upon that.

So, there appeared to be less and less volume available and less and less players available to offer volume, which appeared to give us a premium of much greater than what you seen in previous years, 1999, 1998, et cetera. Although in those years, I would comment there was a significant premium because there was not player, not enough volume, and it was proven out, I guess, after the fact that the numbers were quite a bit higher than what the market supported. [729] "

(Emphasis added)

UNCA concluded that this evidence and the evidence of the Municipalities demonstrate very clearly the lack of any connection between Exhibit 1209 and the real market for hedges. UNCA stated that even if there were evidence of a small amount of power available at a low price it does not mean a large amount of power would be available at the same price. UNCA stated that the prices for additional blocks of power could increase rapidly. UNCA stated that Exhibit 1209 lacks any market credibility and should be discounted totally.

The fact that some Interveners also don't accept Exhibit 1209 is evident in the Argument of FIRM, which states:

> The FIRM customers are of the view that the Board should consider hedging in their analysis but recognize the difficulties in evaluating the impact, if any, hedging may have had on the final outcome. [730]
>
> (Emphasis added)

UNCA stated that the other Interveners ignored Exhibit 1209.

UNCA suggested that even SPPA doesn't fully accept this exhibit as demonstrated in its own argument when, after discussing Exhibit 1209, SPPA states, "the quantum of harm suffered by consumers will undoubtedly be difficult to determine" [731] and further on in its argument when it contemplates the possibility of the Board ordering a "more comprehensive review upon which the Board can place greater reliance. [732]

26.2.7 UNCA Perspectives on GENCO Behavior

UNCA recommended that one issue raised by IPCCAA that should not be dealt with, as a hedging issue, is the behaviour of the GENCOs in selling into the Power Pool [733] .

UNCA noted that IPCCAA stated, "The regulated utilities, operating without rigorous Codes of Conduct, operated as integrated utilities in 2000. The GENCOs undertook actions that increased the Pool Price and the DISCOs were not being responsible to the customers by doing nothing." [734] UNCA noted that this statement does nothing to advance the debates on the DISCO's duty to hedge or the allegations against the GENCOs.

UNCA stated that the allegations against the GENCOs are the subject of a different phase of these proceedings and if the GENCOs did indeed misbehave, the Board will deal with the appropriate remedies in that phase. The DISCOs varied in their levels of independence, but all deserve to have the hedging issue dealt with on its merits, uncoloured by irrelevant and debatable innuendo.

26.2.8 UNCA Summary on Hedging Availability, Prudence and Penalties

In summary, UNCA submitted that it acted in good faith and in accordance with Board Decisions in precisely the manner contemplated by all parties participating in those proceedings and should not now be retroactively penalized for doing so.

Furthermore, UNCA submitted there is strong evidence that the action of UNCA in not hedging the unhedged balances was prudent, given the level of the legislated hedges and the lack of clarity concerning the customers' tolerance for risk.

UNCA summarizes that based on the evidence on the record, it is clear that TransAlta/UNCA acted prudently throughout. UNCA stated that another process is not needed as suggested by SPPA. If there were any evidence of imprudence, or of a significant market for hedges, UNCA stated that it would have come out in this proceeding.

26.3 Views of AE

AE considered that the main issue associated with ATCO Electric's DISCO Deferral Account Application relates to the decision not to engage in any hedging activity, beyond the scope of its legislative hedges, in 2000. As indicated, these legislated hedges covered approximately 90% of ATCO Electric DISCO's requirements.

AE stated that the record is very clear regarding the availability, or lack thereof, of hedging products in the Alberta market during the year 2000. AE stated that numerous witnesses readily agreed that such products were "thinly available", difficult to come by and that the market for hedges was illiquid (14T2562; 15T2903; 22T4907; 23T5053; 24T5485-6). AE contends the issue is — should ATCO Electric have attempted to acquire additional hedges and in this one case attempt to outguess the market? ATCO Electric submits that its Negotiated Settlement Agreement definitively disposes of all matters related to its Distribution deferral account, including fully addressing the hedging issue.

ATCO Electric views that their witnesses demonstrated the Negotiated Settlement Agreement shifts 100% of the risk and responsibility for variances between actual and forecast prices to customers [735] . AE stated that this was what the customers wanted, and in fact demanded in the context of the other distribution utilities during the 1999/2000 general rate applications (14T2625-6; 23T5057-9). In this regard, AE observes that at the time of ATCO Electric's 1999/2000 Negotiated Settlement Agreement IPPSA (a party jointly represented with SPPA and a co-filer of final argument in the 1999/2000 GTA proceedings) filed a "side letter" as part of signing ATCO Electric's Negotiated Settlement Agreement. This letter stated, in part:

> IPPSA is concerned about the issue of deferral accounts. Specifically, we believe that yearly deferral accounts relating to generation surplus shortfall and pool price will distort market signals. Customers who are interested in taking the risk of exposure to pool price and the risk of hedging their power requirements ought to feel (sic) receive the benefit or feel the pain of their decisions as soon as possible, which in our view would be monthly as opposed to yearly.

It is interesting to observe how a current, retroactive "look-back" by SPPA can attempt to distort what was happening at the time.

With the risk having been fully shifted to customers, AE suggested it was incumbent upon such customers to take any action they may have wanted to, in order to mitigate this risk as they saw fit. If ATCO Electric were expected to engage in any hedging activity, AE stated its Negotiated Settlement Agreement would have been very different. Specifically, the formula contained in the Negotiated Settlement Agreement would not have been in the form that currently exists (23T5056). Rather, AE stated it would have to be adjusted to reflect for variances between forecasts and proposed hedged prices, and not solely relate to differences between forecasts and actual prices. AE stated that no such adjustments are contemplated by the deferral account formula, and it is completely unfair to suggest that ATCO Electric should somehow have imagined that, notwithstanding the clarity of this formula, it was somehow expected to act in a manner inconsistent with the Negotiated Settlement Agreement. AE stated that one can only imagine the position Intervenors would take if ATCO Electric came before the Board seeking to recover costs incurred to put in place hedges that were not authorized or contemplated by the Negotiated Settlement Agreement. AE stated that one need only look to the approach adopted regarding EPCOR's hedges to see that Intervenors will seek disallowances wherever they have even the slimmest of arguments to support their position.

While a limited number of hedges may have been available early in 2000, AE remarked it is impossible to speculate on a retroactive basis that sufficient hedging products were available to satisfy the complete DISCO load in the Province and, if so, at what cost. In addition, ATCO Electric was cognizant of the environment in which TransAlta and EGI had sought to assume pool price risk in the context of the 1999/2000 GRAs, only to have Intervenors unanimously oppose these parties assuming this risk (which was an offer to assume a hedge at the forecast price) and insist that customers take this risk (23T5057-59). AE suggested that the only parties to engage in hedging activities were municipal DISCOs, which could be assured of cost recovery for these efforts. AE stated that recovery was assured because their municipal owners regulate those DISCOs. AE stated that even SPPA acknowledged that this was a significant difference (25T5697). Not surprisingly, distribution utilities regulated by this Board (which would have to have such costs approved after the fact) were not willing to assume the risks of attempting to outguess the market in this one particular circumstance. AE commented this is exactly what certain Intervenors, on a retroactive "look-back", would have you believe was reasonable and suggests this is not appropriate.

As noted by ATCO Electric, the unhedged portion of its load had a very awkward load shape, for which a product was not readily available in the hedging market (23T5050-5052; 5090). It was not a 7x24 or 6x16 load product (23T5091). It was just random (23T5092). Any attempt to speculate regarding what was potentially available (and at what price) is a hopeless effort that is simply not productive. AE suggests an entity with 90% of its load hedged via the legislative hedges could not and should not have reasonably been expected to look for additional hedges to cover the balance of its load requirements in these circumstances. In this regard, ATCO Electric supports the positions put forth by Mr. Simard of Risk Advisory on behalf of UNCA (Ex. 348). ATCO Electric endorses the comments made by Mr. Simard as they are generic in nature and confirm that parties could not reasonably have been expected to take the actions now expected by certain Intervenors on a retroactive basis. This position also puts aside totally the speculation that these efforts would have been successful in reducing costs.

AE stated that it is also important to understand that ATCO Electric DISCO had gross entitlement of 9974 GWh and actual called entitlements of 9480 in 2000 (Ex. 404, I.R. BRATCODISCO-PP-2). Based on its forecast load of 9888 GWh and its gross entitlements of 9974 GWh, ATCO Electric was adequately hedged for its forecast requirements. In these circumstances, ATCO Electric stated that it could not have been expected to obtain additional hedges. In this regard ATCO Electric would point out that the logic adopted by SPPA in Ex. 1209 is fundamentally flawed and ignores the data for ATCO Electric DISCO, as well as, forecast AIS generation.

AE suggested that the ACC expert witness demonstrated a complete lack of knowledge of the Alberta market and that he knew little of substance about the matters upon which he was opining, and was unfamiliar with anything to do with hedging in the Alberta market (14T2622, 2631-35). Once again, AE stated that this evidence must likewise be totally disregarded by the Board.

AE comments that in argument SPPA also raises the issue of hedging and the extent to which ATCO Electric DISCO should have hedged during 2000 (p. 56-62). In this regard, SPPA includes the irrelevant observation that unregulated generating affiliates of the DISCOs did hedge some of their output in 2000. ATCO Electric is unsure why this observation is made. While ATCO Electric does not know the extent to which its unregulated generating affiliate may have sold production to either a host or under long-term contract, this has little to do with anything that is currently before the Board. As noted by ATCO Electric in its Final Argument, the only parties to take the risk of hedging were those assured of cost recovery without further regulatory proceedings or approvals. If ATCO Electric has been assured of full cost recovery, regardless of the outcome of its actions (for example if this had been covered in the Negotiated Settlement Agreement), it may have been prepared to engage in this risk free activity. However, this was not the case.

In this regard, AE claims it is somewhat ironic that SPPA opposes the recovery by EPCOR of the losses it incurred when attempting to hedge, while at the same time opposing the recovery of costs actually incurred to purchase power by the those parties who did not hedge, including ATCO Electric. AE stated that SPPA emphasizes the need for stakeholder involvement and regulatory approval prior to entering into a hedging arrangement as a basis for its position. AE recommends that unless the framework is established in advance, with the agreement of all parties and approval of the Board (such as for the RROT) there is no possible way that the type of process contemplated by SPPA could be implemented on a timely basis for someone to actually acquire a hedge in the market. Had such a process been contemplated as part of the Negotiated Settlement Agreement clearly, AE stated that it would have been included in that document (similar to the situation surrounding the RROT). AE stated that the absence of any such provisions speaks volumes to the obligation, or lack thereof, placed on ATCO Electric DISCO to actually hedge. AE stated that this is particularly true given the fact that customers had assumed the *full* pool price risk under the deferral accounts contained in the Negotiated Settlement Agreement. AE contends this was known, understood and accepted by all.

AE views that any suggestion that ATCO Electric should be subjected to a penalty due to its failure to hedge is totally unsupportable. To begin with, there is no evidence to support the speculation that a product that would fit the uneven load profile of the portion of ATCO Electric's requirement not covered by legislative hedges was even available, when it was available and at what cost. AE suggests there were no such products and ATCO Electric cannot be faulted for failing to acquire these non-existent products.

As well, in 2000 ATCO Electric had gross entitlements of 9974 GW hours and actual called entitlements of 9480 GW hours, to serve an aggregate load of 9888 GW hours. AE determines this information demonstrates that ATCO Electric's load was hedged by its legislated entitlements at a level greater than 100% of its forecast requirements. Given that ATCO Electric DISCO deferral accounts were based on forecast load, a change in the DISCO load from forecast did not change the hedge coverage available to customers.

As such, AE believes there is no basis for suggesting that ATCO Electric behaved imprudently, or that it should suffer the consequences of any penalty associated with a failure to hedge. ATCO Electric says it did not attempt to "out-guess" the market in this particular case, and it cannot be faulted for this course of action. AE stated that all parties knew that ATCO Electric was seeking deferral accounts to avoid this very risk.

As pointed out previously, ATCO Electric contends it has suffered a significant shareholder hit because of the structure of its DISCO deferral account when compared to that imposed on TransAlta and EGI by the Board.

26.4 Views of EDI

EDI views that the evidence in this proceeding overwhelmingly demonstrates the limited availability of appropriate hedging opportunities for DISCOs during 2000. For example, when asked for his views on the extent to which hedges were available in Alberta in 2000, Mr. de Palezieux on behalf of EDI gave the following response:

> At the high level, I would have to say that Alberta is a very illiquid market. There are very few buyers; there are very few sellers; there are very few transactions period that occurred in 2000 and in years earlier.
>
> And I would relate that, I guess with the types of transactions you could expect in the Pacific Northwest at a hub such as the mid-Columbia or the California Oregon border COB, which would be quite liquid compared to the Alberta market. [736]

Even though there were a number of counter-parties who were long on power, EDI suggests the hedging market in Alberta during 2000 was illiquid, as discussed in the following exchange:

> > MR. MANNING: Hence my follow-up question, which is, Can you just explain to me in the context of Alberta market in 2000 what you mean by "illiquid market"?
> >
> > MR. de PALEZIEUX: Sir, typically if — I will give a "for instance." In August of last year, when the Wabamun unit went down, EDI became or the customers of EDI became more exposed to pool price because the entitlements were no longer available to that unit, and EDI became concerned about Pool prices because obviously with that unit being off there was a higher probability of higher prices.
>
> A search was done in the market at that time by members of EDI or ESI on behalf of EDI to go into the marketplace and look for various counter parties that might be able to sell some energy. And numerous phone calls were made to known counter parties in the province. One offer was finally obtained, and that offer was well above the forecasted price that EDI had obtained at that time. And so, my definition of "liquidity" — in a liquid market, you can be fairly trusted — you can trust that when you phone a certain number of counter parties — and normally these transactions are conducted over the phone — that you will receive an offer, and for various terms, and perhaps various products. There may be call options available. There could be bilateral transactions available. There could be contract for differences, and such, you know, was not the case in 2000 in Alberta. [737]

When asked to comment on the availability of hedges in 2000, Mr. Roth stated on behalf of Red Deer:

> And particularly in, probably, the latter three-quarters of that year, hedges were very, very difficult to come by. The prices were extremely high if you could, in fact, find one. It was almost impossible to find a hedge that was tailored to your actual load profile. You had to, sort of, take what was on the market. It was a seller's market. [738]

Mr. Willis confirmed on behalf of ENMAX that hedges were not readily available during 2000. [739]

EDI concludes this evidence is clear and was left unchallenged in any substantive way and that appropriate hedging opportunities were extremely scarce in 2000, particularly during the latter months of the year.

EDI suggests it is critical for the Board to recognize that the question of whether or not a DISCO took prudent and timely steps to obtain hedges is a question that must be answered in the context of the specific facts that existed at the time that hedges were, or could potentially have been, obtained in respect of the 2000 Test Year, and not on the basis of perfect 20/20 hindsight. It would be extremely unfair for the Board to play the role of "Monday morning quarterback".

EDI is of the view that the only information that is relevant to the determination of whether or not a DISCO was prudent in obtaining, or choosing not to obtain, hedges is the information that was available to the DISCO at the time that the decision was made. Information that has subsequently become available through the passage of time is entirely irrelevant to this determination.

In Decision U99099, the Board stated:

The Board considers that pool prices will be difficult to forecast with confidence throughout 1999 and 2000 due to the following:

• the tight supply demand situation

• the timing of new sources of supply

• the pricing of imports

• natural gas prices

• the potential for the exercise of market power [740]

In fact, EDI stated that it was the difficulty in accurately forecasting pool prices, which led the Board to establish pool price deferral accounts for 1999 and 2000. EDI views that DISCOs faced these same circumstances in considering their hedging alternatives.

EDI concludes that the evidence demonstrates that EDI acted prudently and in a timely manner with respect to obtaining hedges by, among other things:

• Giving appropriate consideration to all relevant factors and information available, such as the extent of pool price volatility, forecast load and entitlements, customers' net load exposure, weather impacts, availability of hedges, pricing of hedges, liquidity of hedges and outage information [741] .

• Ensuring that the forecasts EDI was relying on were updated monthly and that its hedging transactions were based on the most current forecast available at the time of the transaction [742] .

EDI suggests the record demonstrates that EDI's exposure in 2000 was adequately covered with respect to variations (such as weather variations), which could be reasonably anticipated given the difficulties inherent in forecasting pool prices. In fact, EDI's forecast exposure net of gross entitlements was only 3%, with the result that EDI's load was completely hedged. [743] The extraordinary events, which occurred in 2000 (e.g., the Keephills and Wabamun 4 forced outages) could not have been reasonably foreseen with respect to either their time of occurrence or the lost generation associated with each outage. Given the tight supply conditions in the province at the time of these outages, the cost of power escalated disproportionately higher than the generation capacity lost by the system. In these circumstances, EDI is of the perspective it would be entirely unreasonable to suggest that EDI could have obtained economically viable hedges in respect of these outages.

EDI submits that the record clearly demonstrates that it acted in a prudent and timely manner with respect to obtaining hedges for the 2000 Test Year.

Different DISCOs have different exposure levels and operational circumstances. EDI believed it was not clear by what standard DISCOs should be judged for any imprudence for failure to hedge.

However, the evidence shows that EDI did undertake hedging on behalf of its customers during 2000. As described above, EDI indicates it gave due consideration to all relevant factors and incorporated the most up to date forecasts in the formulation and execution of its hedging strategies. As Mr. de Palezieux pointed out, EDI diligently and prudently managed its hedged position on an ongoing basis during 2000. [744] Consequently, any discussion respecting penalties for imprudence for failure to hedge is not relevant to EDI.

In reply, EDI suggests there is no reasonable basis for SPPA's assertions respecting the availability of hedges in 2000.

In section 2.1.1 of its Final Argument, EDI summarizes the extensive evidence on the record demonstrating that the availability of appropriate hedging opportunities for DISCOs during 2000 was extremely limited.

EDI remarks that in making this claim, SPPA fails to show on any reliable basis that non-regulated supply would in fact have been available to the DISCOs. The clear evidence of EDI's witnesses was that a search was done in the market for hedging opportunities among known counter parties, and only one offer was obtained. [745] That offer was well above EDI's forecast price.

EDI submits that the only reasonable conclusion based on the evidence before the Board is that hedging opportunities were extremely scarce in 2000, particularly during the latter months of the year.

26.5 Views of Lethbridge and Red Deer

The Cities engaged in hedging in 2000 resulting in net benefits to their customers. Both Cities undertook such activities to attempt to protect their consumer interests, and regarded it as equivalent to an insurance policy to protect their customers from catastrophic price increases.

Mr. Roth on behalf of the Red Deer explained the reasoning that he applied in initiating and continuing those activities:

> It is something that we did in order to avoid a catastrophe. It is like putting insurance on a building. (Transcript 2585)
>
> Well, I think the primary factor that we considered was the fact that the GENCOs would conduct business on a whatever-the-market-will-bear basis. Whatever you call that, I think some people were talking about shadow pricing or whatever, whatever terms you want to put to that, and whether that is right or wrong, I am not going to say; but our position was that if you can get 5 cents more, that is what we are going to have to pay. (Transcript 2594)
>
> But as I said earlier, as a utility manager, I think that we knew there was a market out there for generation in 2000 than there was before, and we anticipated some different behaviour, and we took steps to make some provision, Plan B, to accommodate some of that stuff and that type of behaviour. (Transcript 2600-2601)

Mr. Lentz on behalf of Lethbridge stated as follows:

> We did engage in hedging which tends to serve to protect the customer's interest. ...The hedging we undertook, in its simplest terms would be considered similar to an insurance policy." (Transcript 2422)
>
> We were trying to limit our exposure to extremely high prices. And we recognize that there was a risk and a cost associated with doing that and we were prepared to take that risk. (Transcript, 2423)

Having said that however, the Cities are not making any comments or submissions on the prudence or lack thereof by any other DISCO in failing to engage in any or any significant hedging activities. The circumstances of each DISCO must be examined independently. The Cities do note that hedging was by no means a simple or easy activity and the availability of hedges particularly towards the latter part of 2000 was limited and costs were high. In that regard Mr. Roth advised the Board as follows:

> And particularly in, probably, the latter three-quarters of that year, hedges were very, very difficult to come by. The prices were extremely high if you could, in fact, find one. It was almost impossible to find a hedge that was tailored to your actual load profile. You had to, sort of, take what was on the market. It was a seller's market. (Transcript 2562)
>
> You know, we were hedged all year long, and there were hedges available out there. There weren't a lot of them. They were hard to come by, but... (Transcript 2566)

As it turned out the hedging activity did go some distance to protecting the customers' interests. But whether much larger loads could have been hedged to the same extent is not within the knowledge of the Cities.

26.6 Views of IPCCAA

IPCAA stated that the regulated DISCOs undertook no hedging in 2000. The municipal DISCOs all hedged, although to varying degrees.

IPCAA stated that the regulated utilities, operating without rigorous Codes of Conduct, operated as integrated utilities in 2000. Further, IPCAA stated that the GENCOs undertook actions that increased the Pool Price and the DISCOs were not being responsible to customers by doing nothing.

IPCAA stated that there is sufficient evidence in this proceeding as to the means available to the DISCOs to hedge some of their exposure.

26.7 Views of FIRM

FIRM stated that it is clear that the Municipal DISCOs did undertake hedging programs, to varying degrees and with varying success, to try and mitigate the rapidly rising pool prices in 2000. FIRM stated that there appears to have been adequate supply for the other DISCOs to consider such hedging alternatives. (See SPPA argument on this issue).

The FIRM customers took the position that the GENCOs owed an obligation to consumers to act in their best interests under the regulatory compact. (See section 1.1.2 of this argument) If the GENCO's had fulfilled this obligation, the DISCOs may not have required hedging to try and mitigate the pool price run up.

FIRM stated that hedging is another alternative that could have been considered and was available to those DISCOs who were interested in managing the pool price risk in 2000 for consumers. FIRM stated that it is difficult to quantify exactly what impact hedging may have had on the final balances in the deferral accounts. The FIRM customers are of the view that the Board should consider hedging in their analysis but recognize the difficulties in evaluating the impact, if any, hedging may have had on the final outcome.

26.8 Views of ACC

ACC stated that the resolution of the above issues (with the exception of the penalty for any imprudence for failure to hedge, which is addressed in Section 2.3 of this Argument) revolves around the answers to two questions:

> a) Did the DISCOs have the responsibility to hedge a portion of their load?
>
> b) Did the DISCOs have the opportunity to hedge a portion of their load?

Turning to question a) above, the ACC believes that the answer is yes, the DISCO did have the responsibility to hedge to protect its customers from the volatility of a dysfunctional market. In general, ACC stated that the greater the exposure left unprotected by the legislated hedges, the more pressing is that responsibility. The very size of the increases being sought (61 % of 2000 generation costs for UNC (without Wabamun 4) and 38% of 2000 generation costs for AE) as a result of these deferral balances, demonstrates that, despite the legislated hedges, the risk was not inconsequential. Moreover, ACC stated that the DISCOs, knowing firsthand the abuses and gaming to which this immature market were susceptible, and having access to models that explicitly calculated the impact of high pool prices, were in the best position to evaluate the price protections that could be obtained by a hedge. Indeed, ACC noted that in its September 1, 2000 RROT Application, ATCO Electric said:

> Procuring power on the wholesale market to hedge the retail risk will create value for the customers, despite the premiums required. AE submits that this type of volatility reduction and management is a valuable service to the customers.[746]

The ACC submits that by not even asking its customers whether they were interested in hedging, by not even inquiring or exploring what hedges were available and what they would cost, the DISCOs were derelict in their duty.

There is one aspect of question a) that is particularly relevant to ATCO DISCO. ACC noted that ATCO witness Mr. Beckett claims that the existence of the negotiated settlement somehow relieved ATCO DISCO of its responsibility to explore hedges as a means of more fully protecting its customers. ACC suggests Mr. Beckett is wrong and that the Negotiated Settlement no more relieves the AE DISCO of its obligation to take any reasonable step to protect its customers than it relieves the ATCO GENCO of acting to keep the costs of its customers down. ACC noted that the Negotiated Settlement is not a magic wand that transformed ATCO Electric from a Regulated utility to a Non-Regulated utility. ACC noted that the Negotiated Settlement was merely a means for avoiding a litigated resolution of the DISCO's revenue requirement and established deferral mechanisms for handling unforeseen deviations from market forecast.

As regards question b), it is clear that the answer is yes to that as well. Several DISCOs in fact did hedge. As Mr. Roth of the City of Red Deer testified:

> Q. You have mentioned that you have been hedging since 1996, or you have been implemented hedging strategy since that period.
>
> A. MR. ROTH: That's correct.
>
> Q. Then you also mention that during the course of year 2000, that hedging became more and more difficult, and that it was hard to find a hedge that was tailored to your load profile.
>
> A. MR. ROTH: That's correct.
>
> Q. But despite that, I guess what I am seeing here in the schedule is that you were able to hedge throughout the year, and quite successfully as the year progressed in this schedule.
>
> A. MR. ROTH: That's correct, but I don't want to give the impression that that was easy to come by. (14T2576-2577)

The ACC is not saying that the acquisition of hedges in 2000 to protect consumers would have been simple. Dr. Rosenberg testified that it would have been a prudent "insurance policy" in view of the potential hundreds of million-dollar exposure.

ACC stated that ATCO Electric did not inquire whether any of its customers would be interested in being protected by a hedge in the year 2000. ACC stated that AE did not even make any inquiries, even its sister company ATCO Power, what the cost of a call or a collar might be for a portion of ATCO DISCO's load. (22T4907, 9 — 13)

By this inaction, the ACC holds that ATCO Electric must be found imprudent. It is ATCO Electric's position that "as long as it did not explicitly violate the negotiated settlement agreement, then the Board cannot find that it acted imprudently". ACC stated that that position couldn't be accepted. If ATCO's interpretation were true, ACC stated that then any utility that was not under a Negotiated Settlement could never be found to have acted imprudently because, vacuously, it would not have violated a Negotiated Settlement. Clearly, ACC stated that this couldn't be allowed.

26.9 Views of SPPA

Introductory Views of SPPA

SPPA suggests the onus to prove the EUB regulated DISCOs' (the "DISCOs'") rates were just and reasonable has not been met. In particular, the DISCOs failed to consider customer exposure. In SPPA's view, the DISCOs clearly knew they were significantly unhedged and that they had a regulatory obligation to ensure that costs incurred on behalf of their customers were prudent. When a DISCO is buying energy at prices above $500/MWh and selling for under $50/MWh, the analysis to determine that their customers were adequately protected should have been performed.

SPPA views that the EUA provides clear direction to the Board and the DISCOs regarding the present applications for the approval of the deferral account balances. Section 51(3) of the EUA clearly provides that the burden of proof in this case to show that the approval of the DISCO deferral account balances will result in a just and reasonable tariff lies with the DISCO. In SPPA's submission, the DISCOs have failed to provide adequate evidence to establish the justness and reasonableness of their failure:

> a) to consider the nature and level of customer risk,
>
> b) to consider appropriate risk mitigation strategies, and
>
> c) to communicate to the Board and consumers the financial risk they were imposing due to their unhedged positions.

In SPPA's submission DISCO's have not provided adequate evidence that hedges were not available and were not cost effective in 2000. In fact, the ability of the municipal DISCOs to hedge suggests the contrary. Even if adequate hedges were not available by mid to late 2000, it is clear that senior management with AE DISCO was aware even before 2000 that AE GENCO intended to shadow price and that this offering strategy would cause increases in pool prices. Moreover, although it is clear TransAlta/ UNC and EGI were aware of AE GENCO's shadow pricing activities, it appears (to SPPA) they similarly failed to act on this knowledge.

SPPA stated that Section 52(1)(b) of the EUA states that the DISCOs will have a reasonable opportunity to recover prudent costs associated with generation. In SPPA's submission, purchasing energy from the Power Pool at prices well in excess of tariff rates, without a reasonable hedged position, and without reasonable regard for customers' interests, cannot be found to be prudent.

SPPA stated that Section 58(3) of the EUA requires the DISCOs not to act in an unjust or unreasonable manner. Failure of the DISCOs to fully consider the impact of the DISCO deferral account balances, especially in light of the GENCO offer practices, has resulted in proposed rate increases to consumers that are, in SPPA's submission, manifestly unjust and unreasonable. As stated in SPPA's direct evidence:

> To the extent the utilities non-regulated generation affiliates can profit from an offer strategy employed for regulated generation, the onus on the utility to exercise prudent judgement and act in the interest of customers should be even greater. [747]

SPPA stated that it is interesting that the municipal DISCOs did engage in hedging activities. These smaller, and arguably less sophisticated DISCOs, saw their way clear to protecting their customers. SPPA stated that Lethbridge states that it viewed hedging as "insurance against catastrophic losses" to its customers. [748] Yet, SPPA stated that the DISCOs did nothing to protect customer interests. SPPA submits again:

> If ATCO and TAU to increase pool prices though their offer strategies, it would have been appropriate to protect consumers from price increases before implementing these offer strategies. In our view neither can be said to have acted prudently in procuring electric energy in the absence of prudent risk management, i.e., hedging. [749]

SPPA stated that AE and TransAlta DISCOs together represented about 70% [750] of the energy sold through to consumers in 2000. SPPA suggests that if these two DISCOs had properly hedged, losses to the customers from the significant increases in pool price would have been significantly reduced. As noted in Ex. 1209, SPPA stated that it was the non-regulated generation supply owned and or managed by AE and TransAlta's affiliates that provided the best opportunity for the DISCOs to procure hedges.

SPPA notes that both AE and TransAlta's affiliates did hedge some of their non-regulated generation output in 2000. [751] What makes the DISCOs' behavior even more questionable is that their affiliates were willing to hedge their non-regulated generation output, but not for the direct benefit of the DISCOs, who allowed these companies to grow and spin off the non-regulated entities in the first place.

Despite the reasons why the DISCOs elected not to protect their customers from higher prices brought about by their own and others actions, SPPA stated that they had an obligation first to advise their customers of the risk they were imposing on them, and second, to do something about it.

Clearly, SPPA stated that the DISCOs knew they were significantly unhedged and that customers would suffer from the mounting size of the deferral accounts. SPPA stated that the following key observations were made in Exhibit 1209:

> 1. In November of 1999, after the issuance of U99099, it should have been obvious to the DISCOs that they would have been significantly unhedged given their own forecasts.
>
> 2. The price protection afforded from the generation built under regulation would extend to the actual regulated generation output through the various GENCO deferral accounts.
>
> 3. A forecast of the regulated generation compared to the DISCOs' forecast sales would have shown the potential shortfall. For AE, the expected shortfall was about 90 MW, for TransAlta, 520 MW.
>
> 4. Variability in the unhedged position would have been expected, since the regulated generation output amounts would be expected to be a function of plant availability, hydro resources and pool prices (for marginal gas units). Therefore, the DISCOs could not have hedged 100%.
>
> 5. Reducing the DISCOs forecast unhedged position by 30% to 50% would have been appropriate, which would have left their total forecast unhedged positions approximately 5% and 10%, for AE and TransAlta, respectively.

In its direct evidence SPPA suggested that a market study be performed once additional data was made available. If the Board finds that the evidence in Exhibit 1209 is not sufficient, SPPA encourages the Board to order a review of the potential hedges that were available in 2001 and their expected cost.

SPPA comments that Exhibit 1209 outlines six possible hedge scenarios where the DISCOs could have used non-regulated supply from imports, IPPs and their generation affiliates.

SPPA stated that the major sources of non-regulated supply, IPPs and imports, were 4,722 GWh and 1,383 GWh, respectively, for a total of 6,105 GWh, or about 11.3% of the total supply in 2001. [752] SPPA stated that AE and TransAlta were forecast to be unhedged by 797 GWh and 4,568 GWh, respectively, for a total of 5,365 GWh.

Converted to a capacity term, SPPA stated that the 6,105 GWh of IPP and import energy equates to about 695 MW. It was suggested in Exhibit 1209 that adequate hedges from these sources would have amounted to about 270 MW (39% of total).

In a perfect world, SPPA stated that these two DISCOs could have been fully hedged from these two supply sources. SPPA is not suggesting that the DISCOs should have tried to fully hedge themselves. SPPA stated that there was, however, ample supply available to hedge to the levels suggested in Exhibit 1209.

SPPA stated that additional 2000 supply sources were also available. There was 767 GWh imported from Saskatchewan and 616 GWh from B.C. [753] Both AE and TransAlta have historically bought and sold electricity with their utility neighbors. SPPA stated that the amount of energy that was available for hedging in late 1999 might have been more or less than what was actually delivered. Obviously, the actual prices in 2000 had an impact on the amount of imports into Alberta in 2000. However, SPPA contends imports have long been a source of supply to Alberta and it is likely that imports could have been used to hedge a portion of the DISCO's load.

SPPA stated that the larger and more predictable source of supply was generation output from IPPs. Page 5 of Exhibit 1212 shows the generation output of the main IPPs in 2000. Of the 4,722 GWh produced, 1,940 GWh was from IPPs that AE's affiliate has an equity interest in and 2,006 GWh is from IPPs that TransAlta's affiliate has an equity interest in. [754] Output from these plants alone (84% of the total), assuming it was available, would have provided more than enough capacity (455 MW) to support adequate additional hedges (270 MW) for AE and TransAlta DISCO, as suggested in Exhibit 1212.

SPPA stated that there are many permutations and combinations of hedges that the DISCOs could have prepared and presented to consumers in late 1999 and early 2000. Undoubtedly the process would not have been without its difficulties, but it could have been attempted. Section 56 of the EUA contemplates such a process. As the RRO hedging hearings in December 2000 showed, regulatory approvals can be expedited when required. [755]

UNC filed rebuttal evidence prepared by Mr. Simard, which suggested that "any hedging transaction for 2000 would be a function of the risk appetite of its (TransAlta/UNC) ratepayers." [756] With respect, SPPA submits that Mr. Simard does not seem to understand the regulatory obligation of a regulated utility. SPPA stated that it is not the obligation or the requirement of consumers, or their representatives, to tell DISCOs how to act prudently. SPPA stated that the DISCOs had the obligation to incur costs in a prudent manner. The onus was not for intervenors to discharge.

During the 1999/2000 GTA, TransAlta sought to assume the risk associated with forecasting pool price. SPPA stated that consumers opposed TransAlta and EPCOR's applications because they were concerned that these applicants had market power and could manipulate the pool price to their advantage. [757] AE offered deferral accounts as a mechanism to remove the incentive for the abuse of market power; or so consumers thought. It was not until U99099 was issued in November 1999 that consumers and the applicants knew that deferral accounts would be in place for 2000.

SPPA notes that Mr. Simard takes the position that consumers, through their intervenors, should have advised the Board of their risk tolerance during the 1999/2000 GTA proceeding. [758] SPPA notes that he goes on to suggest that "it can be argued that the adoption of the deferral account mechanism and the Board's explicit support for the deferral account on the basis that the pool price exposure is accumulated and borne by the consumers provided TransAlta and UNCA with an indication is that there was a desire to maintain the residual pool price exposure." (Emphasis added) While this could be argued, SPPA believes the argument would be incorrect. There is no evidence to suggest that consumers were willing to take on the "residual pool price exposure". SPPA noted that consumers asked for pool price deferral accounts in order to provide protection against the abuse of market power. The trade off was that if market power was implemented by non-regulated entities, like importers, consumers were taking on increased risk. [759]

SPPA noted that the "residual pool price exposure" referred to by Mr. Simard is presumably the volume of energy sold to consumers that was not provided by regulated generation at a fixed price under the deferral account mechanisms. This "unhedged" energy was bought by the DISCOs at pool price and sold to consumers at fixed tariff rates. The resulting revenue shortfall has given rise to the large DISCO deferral account balances.

There is no evidence to suggest that consumers accepted this "residual pool price exposure". SPPA suggests that Mr. Simard's suggestion that the Board's determinations somehow gave an "indication" on the part of consumers is simply wrong and unsupported by the evidence and arguments in the 1999/2000 GTA.

It was the DISCOs' regulatory obligation to determine the impact their purchase of electricity at high pool prices would have on their customers. If a DISCO felt it needed to know the risk appetite of its customers before it entered into any additional hedging, as suggested by Mr. Simard, [760] then SPPA believes it had the regulatory obligation to find it out. The EUA provides a hedging approval mechanism in s. 56 of the EUA. SPPA stated that it is the Board that must determine the appropriate risk appetite and public interest considerations on behalf of consumers in any section 56 applications brought before it.

Mr. Simard also suggests that SPPA members, who sell their products into commodity markets, do not always fully hedge. [761] With respect, the selling strategies of SPPA members who are interfacing with un-regulated workably competitive oil and gas commodity markets are of no relevance to a regulated, non-competitive market where a regulated DISCO is purchasing energy on behalf of its consumers pursuant to its regulatory obligations.

SPPA stated that the fact that some SPPA members may have benefited from higher commodity price in 2000 is a function of the risk profile each individual SPPA member elected to take with respect to the revenue it receives. SPPA suggests that to suggest that the same risk profile should be applied to the cost of electricity is not correct. If SPPA members knew in advance that the DISCOs did not intend to uphold their regulatory obligations in 2000, then SPPA members may have had the opportunity to put in place whatever risk management strategies they deemed appropriate.

SPPA contends that AE is also confused as to why consumers recommended that the Board adopt deferral accounts for 2000. In rebuttal evidence, AE quotes liberally from the 1999/2000 GTA as to the difficulties in forecasting pool price, including the exercise of market power. [762] On this aspect they are correct; consumers were concerned over the exercise of market power. So was the Alberta Government, which in fact enacted the EUA Amendment to try and prevent the exercise of market power by the applicants. AE does suggest, however, that consumer's rejection of TransAlta DISCO's application proposal to take on the pool price and sales volume risk somehow suggests that consumers wanted to take on this risk. [763]

> By proposing to set the TransAlta DISCO cost of energy based on a forecast of Pool Prices, TransAlta offered customers a hedge on energy costs. The basis for the hedge was to be a Board-approved hourly pool price forecast, and the cost to customers for the hedge was proposed to be recognition of the risk assumed by TransAlta in the DISCO with a premium rate of return over system average return on equity. Customers opposed this approach, and argued that they should assume this risk, rather than compensate TransAlta for taking this risk.
>
> (Emphasis added)

In their opening statement, AE uses even stronger words: [764]

> At the time the Negotiated Settlement was completed and approved, and Decision U99099 was issued in the TransAlta DISCO application, it was clear to all parties that no one in the industry other than TransAlta was prepared to fix the forecast price at which DISCOs purchased electricity in 1999 and 2000. In fact, intervenors were clear and unanimous — ratepayers insisted on assuming this risk!
>
> (Emphasis added)

SPPA believes that consumers did not want to take on the risk of TransAlta DISCO being short in the market - rather they saw DISCO deferral accounts as the lesser evil to providing the GENCOs with free reign in the absence of GENCO deferral accounts. In their 1999/2000 GTA argument, IPPSA and SPPA stated: [765]

> It should be noted that DISCOs are typically in a "short" position with respect to supply — their supply needs are not fully met by the legislated hedges and they are forced to buy energy at Pool Price. GENCOs, on the other hand, are typically in a "long" position — they have "loose juice" which for which they receive the Pool Price The flip side of Mr. Way's pocket change incentive for a DISCO to do the wrong thing when deferral accounts are in place is the GENCO's incentive to do the wrong thing in the absence of deferral accounts.

SPPA suggests consumers realized that there was a trade-off between having the DISCOs take on pool price volume risk and giving the GENCOs the incentive to use their dominant market positions. [766] SPPA says that simply because consumers advocated for deferral accounts does not mean that they wanted to take on the DISCO's pool price risk. Consumers continue to have faith in the regulatory compact, which, in SPPA's submission, was not undermined in anyway by the Board directive to institute DISCO deferral accounts.

SPPA stated that AE goes on the defensive and makes the following comments that SPPA views as unsupported:

> It is quite clear that ACC and SPPA would have been content to claim the benefits of "in-the-money hedges" for customers, and would have been intent on challenging the prudency of the ATCO Electric DISCO if any such hedges had ended up "out-of-the-money" (probably to the extent of pointing out that the Negotiated Settlement specifically precluded acquiring such hedges). [767]
>
> (Emphasis added)

It is not "quite clear" what position SPPA would have taken. SPPA has been clear that the applicants' regulatory obligations need to be properly considered and that their inaction needs to be assessed in light of the unprecedented rate increases the applicants are seeking.

Finally, SPPA noted that AE claims that speculation by AE "would not have been in the public interest, and was not the prudent course of action." [768] As noted in SPPA Argument Section 1.3.1, SPPA believes that the negotiated settlement that was filed with the Board does not in any way limit either the Board's ability to review the prudence of AE's actions or diminish AE's regulatory obligations. SPPA views that if AE DISCO was minding its regulatory obligations, it would have considered its customers' risk exposure; considered an appropriate risk mitigation strategy (such as hedging); and sought approval from the Board, under s. 56 of the EUA, hopefully with prior customer consultations. SPPA noted that acquiring hedges may very well have been in the public interest and the prudent course of action, and obviously would have been carefully considered by the Board and intervenors in any s. 56 application.

SPPA suggests that as demonstrated in Exhibit 1209, the actual benefits to consumers from DISCO hedging activities, should they have put them in place to the level suggested, could have reduced the cost to consumers in 2000 by as much as $220 million.

The quantum of harm suffered by consumers will undoubtedly be difficult to determine. In SPPA's view, that is no excuse for not performing the exercise, based on the best evidence available. SPPA has provided evidence in Exhibit 1209 that suggests a reasonable level of hedging that should have been put in place in late 1999 and early 2000, given the actual circumstances that were in place at the time.

Based on the analysis described in Exhibit 1209, the following harm to consumers was calculated by SPPA: [769]

Table 18: SPPA Calculated Hedging Costs and Benefits

DISCO	Hedge	Hedge Size Gross (MW)	Hedge Size Net (MW)	Natural Gas Price Hedge ($/GJ)	Hedge Cost (000)	Hedge Benefit (000)

With fixed price natural gas hedges

ATCO	1. ATCO Gas units	20.0	17.0	3.00	$ 8,049	**$ 13,690**
	2. Co-gens	10.0	10.0	3.00	$ 3,649	**$ 8,053**
		30.0	27.0		$ 11,698	**$ 21,744**
TAU	3. TEM B.C. imports	75%	11.8	N/A	$ 13,900	**$ 10,145**
	4. TEM Sask imports	75%	21.1	N/A	$ 11,467	**$ 22,049**
	5. IPPs	300.0	137.1	3.50	$ 67,500	**$ 108,018**
	6. Co-Gens	100.0	100.0	3.00	36,486	**$ 80,533**
			270.0		$ 129,353	**$ 220,744**

Without fixed price natural gas hedges

ATCO	1. ATCO Gas units	30.0	17.0	variable	$ 12,415	**$ 9,324**
	2. Co-gens	10.0	10.0	variable	$ 4,911	**$ 6,791**
		40.0	27.0		$ 17,327	**$ 16,115**
TAU	3. TEM B.C. imports	75%	11.8	N/A	$ 13,900	**$ 10,145**
	4. TEM Sask imports	75%	21.1	N/A	$ 11,467	**$ 22,049**
	5. IPPs	300.0	137.1	variable	$ 96,476	**$ 79,042**
	6. Co-Gens	100.0	100.0	variable	49,113	**$ 67,905**
			270.0		$ 170,956	**$ 179,141**

SPPA stated that if the Board finds that a more comprehensive review of the potential for hedging instruments and their expected cost is warranted, then SPPA encourages the Board to order that a process be implemented to allow for a more comprehensive review upon which the Board can place greater reliance.

SPPA stated that if the Board is persuaded that adjustments to the GENCOs pool price deferral accounts are warranted then the estimates provided in the above table should also be adjusted. Using the approach suggested in BR.SPPA-1(a) of determining a deemed hourly pool price, adjustments could be made by replacing the actual pool price with the deemed pool price in the spreadsheet attachments to Ex. 1209. SPPA stated that this exercise would ensure there is no double counting between the GENCO and DISCO deferral account adjustments.

In reply, SPPA contends it is interesting to note that when arguing against the magnitude of the benefits its generation affiliates enjoyed in 2000 TransAlta claims that no IPP would be built without a "sales contract to support financing". The applicant claims that their affiliate sold forward, or hedged, some of their IPP output at fixed prices, which they imply could have been at prices below the actual Power Pool price in 2000. [770]

> Speculations by intervenors such as SPPA of supposed effects on affiliated generators and importers are in any event unreasonably made. By assuming receipt of marginal Pool price for all IPP output, they assume that no part of IPP outputs were pre-hedged and pre-committed — an heroic assumption that effectively assumes that all IPPs in Alberta have been built without energy sales contracts to support financing.

SPPA remarks that if there are any "heroic assumptions" to be made by consumers it would be that the regulated DISCOs were looking after their interests. Is this the type of "heroic assumption" that TransAlta expected its customers to make? If we are to believe that the applicants' affiliates did hedge their IPP output, then who was the counter party to these hedges? If these hedges were made available, then why was the market for hedges "thin"? This appears to be a case of the applicants expecting the Board to believe there was some fictitious competitive market in 2000 that their affiliates participated in, but was not available to the regulated DISCOs.

SPPA stated that hedges were available in 2000 from SPPA's perspective. SPPA stated that there is a process outlined in the EUA for the DISCOs to achieve regulatory approval for hedges. SPPA stated that clearly the DISCOs continued to have an obligation in 2000 to procure costs in a prudent manner and to ensure rates to consumers were as low as possible. SPPA stated that the DISCO's reliance on the deferral accounts to provide adequate protection to consumers was seriously inadequate.

SPPA is of the opinion that at the beginning of 2000 it should have been crystal clear to every DISCO that Power Pool prices in 2000 were likely to be higher than forecast. They had to look no further than the cost of imports. With Powerex's static import offer price just below $500/MWh and the 1999/2000 GTA import modeling assumption a maximum of $45/MWh,[771] the likelihood of average Power Pool prices being significantly higher than forecast was very close to 100%. Similarly the DISCOs should have known that their customers were going to be significantly exposed to these high prices based on their 1999/2000 GTA forecasts.[772] There is no evidence to suggest that actual results from 1999 would have pointed to lower unhedged volume exposure to DISCO customers.

AE suggests that it should not have tried to "out-guess the market".[773] SPPA suggests that in 2000 there was no competitive market and to add insult to injury, AE deliberately and methodically increased Power Pool prices to further acerbate the harm imposed on consumers. SPPA further notes that if in fact hedges were "thinly available" it was likely that the unavailability was largely a result of the applicant's affiliates' unwillingness to make hedges available.

SPPA is not suggesting that AE should have speculated on behalf of consumers nor is it suggesting that approval should have been sought after the fact. SPPA submits that reasonably priced hedges could have been obtained in the last year of regulation from the applicant's affiliates. Further, SPPA stated that the applicant had a duty under the regulatory compact to continue to protect customers and provide service at the lowest possible cost throughout 2000.[774] A mechanism existed, that is s. 56 of the EUA, to mitigate all the risk to the DISCO for procuring a hedge on behalf of consumers. The DISCOs had a regulatory obligation, which they clearly did not fulfill.

SPPA stated that AE suggests at page 19 of their Argument that intervenors may have opposed AE seeking cost recovery if it had obtained hedges on behalf of its customers. SPPA suggests that AE is forgetting that a EUA section 56 application would have been required in order for AE to receive approval to pass the cost of the hedge through to customers and that AE's comparison to the position taken by SPPA with respect to EPCOR's internal hedge is irrelevant.

(End of Appendix 7)

Footnotes

1 Formerly, Edmonton Power Generation Inc.

2 AR 240/2000, as amended by AR 6/2001 (*Deferral Accounts Regulation*)

3 Riders approved in Decision 2001-55 [*ATCO Electric Ltd., Re* (June 22, 2001), Doc. 2001-55 (Alta. E.U.B.)](AE) and 2001-56 [*Utilicorp Networks Canada (Alberta) Ltd., Re* (2001), 2001 CarswellAlta 2126 (Alta. E.U.B.)] (UNCA) dated June 22, 2001.

4 Deferral Accounts Deficiency Correction Amendment Regulation, AR 6/2001

5 *Deferral Accounts Regulation*, section 5(2)(a)

6 *Deferral Accounts Regulation*, section 2

7 *Deferral Accounts Regulation*, section 5(1)

8 Exhibit 341, Section 9.0, page 21

9 Exhibit 326, BR.UNCA DISCO-5

10 Transcript, page 4636-4637

11 Transcript, page 4637-4638

12 Transcript, page 3927

13 Transcript, page 3927-3928

14 Exhibit 349, page 1

15 Transcript, page 4639

16 Exhibit 403-01, page 15 and Schedule 12.0

17 Exhibit 435-2

18 Exhibit 436-2

19 EDI Opening Statement

20 Transcript, page 4888

21 Transcript, page 2663-2665

22 AE Argument, page 24.

23 Transcript, page 5906 — 5907

24 Exhibit 349, page 1

25 Riders approved in Decision 2001-55 (AE) and 2001-56 (UNCA) dated June 22, 2001.

26 *Deferral Accounts Regulation*, sections 5(1) and 5(2)(a).

27 *Deferral Accounts Regulation*, sections 5(1) and 5(2)(c).

28 UNCA Argument, page 21 and Exhibit 353, page 7.

29 Exhibit 353, page 11-12

30 UNCA Reply Argument, page 10

31 EDI Argument, page 11

32 Transcript 6388-6392

33 Transcript 6245-6246; Transcript 6388-6392; Transcript 6752

34 AE Reply Argument, page 31

35 AE Reply Argument, page 31.

36 TransAlta Argument, page 60

37 Lethbridge and Red Deer Reply Argument, page 2

38 See, e.g. 15T2821; 15T2929-2930; 18T3592

39 IFE Argument, page 6.

40 IFE Argument, page 6.

41 Decision U99099, page 230

42 Decision U99099 page 214

43 Decision U99099, page 214.

44 Decision U99099, pp. 213-214.

45 Decision U99099, page 237

46 Decision 2000-41, *TransAlta Utilities Corporation, Sale of Distribution Business* (July 5, 2000)

47 Exhibit 353, page 26-27

48 Transcript page 4801-4803

49 UNCA Exhibit 373 Schedule 1.0

50 UNCA Application Ex 341 Pg 16

51 U99099 Volume 2 Appendix 3, page 1 of 4

52 BR-TAU-3 (Prior to September 2000 interim credit of $49 million)

53 AE DISCO Application Schedule 1.0

54 Exhibit 131, Schedule 8.0.

55 Exhibit 131, Schedule 8.0.

56 AE GENCO Application Schedule 1.0

57 Decision 2000-41, page 20 (NB: Omission of the word "not" is a clerical error in Decision 2000-41)

58 UNCA Argument, page 28.

59 Decision 2001-65, *ATCO Gas — North, a Division of ATCO Gas and Pipelines Ltd., Sale of Certain Petroleum and Natural Gas Rights, Production and Gathering Assets, Storage Assets and Inventory: Reasons for Decision 2001-46* (July 31, 2001), page 10.

60 Decision 2001-65, Appendix 1 (Ruling on Issues List, April 14, 2000), pp. 36-37.

61 Decision 2000-41, page 20

62 UNCA Argument, page 32. Transcript page 2698

63 EDI Argument, page 9. Transcript page 4281

64 UNCA Argument, page 23. *Decision U96001*, page 92.

65 UNCA Argument, page 24. National Energy Board, *Decision RH-2-94*, page 25.

66 Lethbridge and Red Deer Argument, page 10.

67 Section 52 of the EU Act requires the Board, in approving a tariff, to provide the electric utility with a reasonable opportunity to recover its prudent costs.

68 Transcript, page 4281

69 Page 13.

70 IFE Argument, page 5. IFE Evidence, Exhibit 1301, page 24.

71 IFE Argument, page 5.

72 Exhibit 1306, page 1

73 Exhibit 1306, page 2

74 IPCCAA Argument, page 24.

75 UNCA Argument, page 22. Exhibit 353, page 26-27; Transcript page 2802-2804

76 UNCA Argument, page 22-23. Exhibit 353, page 26-27

77 UNCA Argument, page 34-35. Exhibit 1304, Response to Information Request FIRM.FE-5(b); Transcript page 6262-6263; Transcript page 6424; Transcript page 6429-6430; Transcript page 6649-6651; Transcript page 6696; Transcript page 6702; Transcript page 6756-6757.

78 EDI Argument page 15. Transcript page 2803

79 Transcript, page 4329

80 Lethbridge and Red Deer Argument, page 10.

81 Lethbridge and Red Deer Reply Argument, page 3

82 Decision U97065, page229

83 Decision U99099, page 215

84 Decision U99099, page 230, 254, 264, 282

85 Transcript 4339

86 Exhibit 404-2-21, BR.ATCODISCO-PP-17(a) (Revised), page 3; Exhibit 404-2-22, BR.ATCODISCOPP-17 (Revised), Appendix A, page 2

87 Exhibit 1306, page 1

88 Transcript, p. 6651.

89 Exhibit 1304, IFE IR Responses to AE, ATCO.FE-10 (h)

90 Exhibit 341, Appendix A

91 Exhibit 503 05, Schedule C-1

92 Where a municipality (e.g. ENMAX, Lethbridge and Red Deer) does not have GENCO operations, the appropriate standard would be total city electric operations (i.e. TRANSCO and DISCO). The Board was not provided with any evidence respecting total city electric operations or breakdown by business function in these proceedings.

93 Exhibit 341, App. A, page 7

94 Exhibit 341, App. A, page 7

95 Exhibit 341, Appendix A, page 8.

96 Exhibit 341, App. A, p. 8; Exhibit 503 05, Schedule C-1, page 9

97 Exhibit 341, App. A, p. 8.; Exhibit 503 05, Schedule C-1, page 9

98 Pages 1 and 2

99 Exhibit 341, Appendix A, page 2.

100 Exhibit 341, App A, page 2. Exhibit 503 05, Schedule 1, page 3.

101 Exhibit 341, App. A, page 2

102 Exhibit 503 05, Schedule C-1, page 3.

103 Transcript, page 3077

104 Transcript, page 3859

105 Transcript, page 3860

106 Dominion Bond Rating Service, *Credit Card Programs in Canada*, February 1999, page 2.

107 Dominion Bond Rating Service, *Credit Card Programs in Canada*, February 1999, page 2.

108 Exhibit 506, page 21

109 Exhibit 102.

110 AE Argument, page 25. Exhibit 421, page 27

111 AE Argument, page 25.

112 Exhibit 701, page 3

113 Resolution of the City of Lethbridge City Council at the regular meeting of City Council held April 17, 2000.

114 Exhibit 805, page 3

115 Transcript, page 6648-6649

116 Transcript, page 6751-6752

117 Decision U99099, page 215.

118 Decision U97065, page 229.

119 Exhibit 351, BR.UNCA DISCO-32 (b), page 2-3.

120 Exhibit 354, page 4-5

121 Transcript, page 6244 (emphasis added)

122 Exhibit 351, BR.UNCADISCO 32, page 3

123 Exhibit 351, page 3

124 Transcript 4194 and Exhibit 406

125 Exhibit 412-2, page 25

126 Includes common equity ratios determined in Decision U99099, page 230, 254, 264, 282

127 ACC Argument, page 6

128 Exhibit 1105, page 13

129 Exhibit 403 15, Schedule 10.0

130 Exhibit 404-2-21, page 3-4.

131 In her Evidence, Ms. McShane stated the purpose of her evidence as "I have been requested by ATCO Electric Limited to provide an expert opinion on the appropriate capital structure and cost of capital to be applied to the 2000 Distribution Pool Price and Related Deferral Account Balances. The request for the opinion arises from a letter to ATCO Electric from the AEUB, dated April 24, 2001. The letter seeks responses to a number of information requests related to the cost of financing 2000 pool price deferral accounts on the premise that the Company had not entered into a settlement agreement which specified how the carrying costs on the deferral accounts were to be determined."

132 Exhibit 404-2-22, BR.ATCODISCO-PP-17 (Revised), Appendix A

133 Exhibit 404-2-22, BR.ATCODISCO-PP-17 (Revised), Appendix A, page 3.

134 Exhibit 404-2-21(d), BR.ATCODISCO-PP-17 (Revised), page 4 and Schedule 5.

135 Exhibit 341, Appendix A, page 16-18; Exhibit 503 05, Schedule C-1, page 16-18.

136 Exhibit 341, Appendix A, page 16.

137 Exhibit 404-2-22, BR.ATCODISCO-PP-17 (Revised), Appendix A, page 5

138 Exhibit 503 05, Schedule C-1, page 17

139 Exhibit 404-2-22, BR.ATCODISCO-PP-17 (Revised), Appendix A, page 4.

140 Exhibit 341, Appendix A, page 16-17; Exhibit 503 05, Schedule A, page 16-18

141 Exhibit 403-01, page 4; Exhibit 403-15, Schedule 10.0

142 Exhibit 421, page 3

143 Exhibit 404, -2-22, BR.ATCODISCO-PP-17 (Revised), Appendix A. page 3-4

144 Exhibit 805, page 3; Exhibit 704, page 3

145 Exhibit 341, Appendix A, page 3; Exhibit 503 05, Schedule C-1, page 4.

146 Exhibit 341, Appendix A, page 3; Exhibit 503 05, page 3-4

147 Decision U99099 page 226-227

148 Exhibit 373 Schedule 1.0

149 Exhibit 341, page 16

150 UNCA Argument, page 34. Exhibit 1301, pages 13 and 15 See also Exhibit 1304, Response to Information Request BR.FE-8, page 1.

151 Exhibit 354, page 1

152 Exhibit 341, page 13

153 Exhibit 341, page 14

154 Exhibit 341, page 14

155 Exhibit 354, page 4

156 Exhibit 354, page 4-5

157 UNCA Argument, page 23. Transcript page 4801-4803

158 UNCA Argument, page 23. Transcript page 2700-2701

159 UNCA Argument, page 23. Transcript page 4131

160 Decision 2001-47, page 3

161 Exhibit 351, BR.UNCA DISCO-32(b), page 2-3

162 Exhibit 363

163 Transcript, page 3937

164 Exhibit 351, page 3

165 Exhibit 341, page 14

166 Exhibit 341, page 3

167 Exhibit 403-01, Schedule 1.0.

168 Exhibit 131, Schedule 8.0.

169 Exhibit 403-01, page 5.

170 Exhibit 403-01, page 6 [emphasis added]

171 Emphasis added.

172 Decision 2001-83, page 19

173 Decision 2001-4, *TransAlta Utilities Corporation, 2001 Transmission Facility Owner Tariff and Negotiated Settlement* (January 12, 2001)

174 Decision 2001-14, *ATCO Electric Ltd., 2001 - 2002 Distribution Tariff Application, Part B: Phase I Distribution Tariff Revenue Requirement* (February 27, 2001)

175 Exhibit 404-2-21, page 4.

176 Exhibit 403-01, page 6.

177 Exhibit 421.

178 Exhibit 421.

179 Exhibit 421, page 27

180 Exhibit 421, page 26; Exhibit 403-01, Schedule 10

181 AE Argument, page 25.

182 Exhibit 404-2-21, BR.ATCODISCO-PP-17(a) (Revised), page 3; Exhibit 404-2-22, BR.ATCODISCO-PP-17 (Revised), Appendix A, page 2.

183 Exhibit 404-2-27, BR.ATCODISCO-PP-17 (Revised), Schedule 5.

184 AE Reply Argument, page 31.

185 Exhibit 404-2-21, page 3.

186 Exhibit 505, Schedule A.

187 Exhibit 513; Transcript, page 3146-3147

188 Per Board Decisions

189 Decision U99099, Appendix 5, page 1 of 2

190 Decision U99099, Appendix 5, page 2 of 2

191 Transcript, page 2804, 2817 and 3096

192 Transcript, page 2817-2818

193 Transcript, page 2815

194 Transcript, page 3145

195 Transcript, pages 2812 and 3146

196 EDI Reply Argument, page 9

197 Transcript 3181-3182.

198 Exhibit 503 05, Schedule C-1, page 9

199 Exhibit 503 05, Schedule C-1, page 10

200 Exhibit 503 05, Schedule C-1, page 3-4

201 EDI Opening Statement

202 Transcript page 3401

203 Section 10(3)(f) of the *Alberta Energy and Utilities Board Act* authorizes the Board, where it considers it just and proper to do so, to award "further or other relief in addition to, or in substitution for, that applied for as fully and in all respects as if the application or matter had been for that partial, further or other relief." In this respect, the Board is no longer constrained by section 87 of the PUB Act, which does not apply to electric utilities by virtue of section 106.1 of the PUB Act.

204 Exhibit 704, page 2

205 Red Deer (the Cities) Argument, page 12

206 Red Deer (the Cities) Reply Argument, page 1-2

207 Red Deer (the Cities) Argument, page 12

208 Red Deer Argument, page 12

209 Exhibit 704, page 3

210 Exhibit 704, page 3

211 Exhibit 805, page 2

212 Lethbridge (the Cities) Argument, page 12

213 Lethbridge (the Cities) Reply Argument, page 1-2

214 Lethbridge (the Cities) Argument, page 12

215 Lethbridge (the Cities) Argument, page 12

216 Exhibit 805, page 3

217 Resolution of the City of Lethbridge City Council - regular meeting of City Council held April 17, 2000.

218 Exhibit 805, page 3

219 As directed in Decision 2000-60, Schedule B

220 Exhibit 2, page 4

221 Exhibit 4, page 25

222 IPPSA/SPPA.TAU-5.

223 Transcript, page 383

224 Exhibit 103-GENCO and Ex. 403-DISCO

225 Exhibit 102.

226 Page 13.

227 Page 9.

228 ACC GENCO Argument, section 8 — GENCO Carry Costs, page 32

229 Transcript, page 1849

230 ACC GENCO Argument, page 34.

231 ACC DISCO Argument, page 7

232 FIRM Argument, page 30
233 FIRM Argument, page 30-31
234 FIRM Argument, page 30-31
235 ACC DISCO Argument, page 7
236 Exhibit 1103, page 11
237 FIRM Argument, page 30
238 Transcript, page 1845-1846
239 ACC GENCO Argument, page 34.
240 FIRM Argument, page 33
241 Response to Information Request BR.EGI-6.
242 Exhibit 02, page 4
243 Exhibit 103-01, page 3 of 12
244 Exhibit 201, page 9
245 Decision U99099, page 13.
246 Exhibit 1306, Opening Statement, page 1
247 Exhibit 1306, Opening Statement, page 1
248 Exhibit 1306, Opening Statement, page 3
249 Decision U99099; Outstanding Matters.
250 TransAlta Rebuttal Evidence
251 Using a tax rate of 41%
252 Using a tax rate of 38.5%
253 FIRM Argument, page 47; ACC Argument, page 5; IFE Argument, page 11.
254 IPCCAA Argument, page 24.
255 Transcript 3629-3630.
256 FIRM Argument, page 47
257 IFE Argument, page 11.
258 IPCCAA Argument, page 24.
259 UNCA Argument, page 22.
260 Transcript 6413-6414.
261 Exhibit 1301, pages 23-24; Exhibit 1304, Response to Information Request BR.FE-11
262 Transcript 4782.
263 Transcript 4816
264 Exhibit 1304, Responses to Information Requests BR.FE-11, EDI.FE-9, EDI.FE-12 and EDI.FE-13
265 Exhibit 1304, Responses to Information Requests BR.FE-11, EDI.FE-9, EDI.FE-12 and EDI.FE-13; Transcript 2853; Transcript 3192
266 Transcript 2894-2895; Transcript 6688
267 Exhibit 1301, page 1
268 Transcript 3629-3630; Transcript 3190
269 Transcript 2853-2854.
270 Exhibit 506, page 23 See also Transcript 3194-3195 and Transcript 3862-3864.
271 Transcript 4839-4840.
272 Transcript 4829
273 Exhibit 370, Response to Undertaking by UNCA at Transcript 4004, page 5
274 Transcript 4837
275 Transcript 4838.
276 Transcript 4830.
277 Transcript 3158-3159; Transcript 3192
278 Exhibit 1304, Response to Information Request FIRM.FE-11 (b).

279 Transcript 6442-6443.

280 Transcript 6445-6446.

281 Exhibit 1304, Information Request FIRM.FE-11 (a)

282 Exhibit 1304, Response to Information Request FIRM.FE-11 (a)

283 Transcript 6436-6437.

284 Transcript 6437.

285 Transcript 6449.

286 Transcript 2856; Transcript 2895; Transcript 3899

287 Transcript 2855-2856; Transcript 3899

288 Exhibit 1414, page 2

289 Exhibit 504, Response to Information Request BR.EDI-16 (a, b, c); Transcript 3031-3032.

290 Transcript 3031-3032.

291 Transcript 6494.

292 Exhibit 383, page 1

293 Transcript 4787.

294 Exhibit 504, Response to Information Request BR.EDI-16 (d,e)

295 Exhibit 1411, page 3

296 Exhibit 506, page 38; Exhibit 1301, page 21

297 Exhibit 506, pages 4-5.

298 Exhibit 1301, page 21

299 Exhibit 1301, page 21; Exhibit 1304, Response to Information Request ATCO.FE-27(b)

300 Exhibit 1414, page 3

301 Exhibit 1414, page 3; Transcript 4789-4791; Transcript 4856-4857

302 Transcript 4789-4790.

303 Transcript 4838.

304 Exhibit 1410.

305 Exhibit 1411.

306 Transcript 3988-3990.

307 Exhibit 383, pages 5-7.

308 Transcript 3901-3902.

309 Transcript 3908. A similar discussion took place with Mr. Edmondson at Transcript 4303.

310 EDI Argument Section 4.3.1.5

311 Exhibit 1411, page 2

312 See 27T6494-5; IFE Opening Statement, Exhibit 1306

313 IFE Opening Statement, Exhibit 1306, page 3; IFE Evidence, Exhibit 1301, page 21.

314 IFE Evidence, Exhibit 1301, pages 19-20.

315 See ATCO.FE-17; ATCO-FE.18; ATCO-FE.19; UNCA.FE-1; Exhibit 1307 referring to ATCO-FE-18.

316 See Exhibit 1307, updated response of the IFE to ATCO-FE-23.

317 See 16T3077; 19T3859-62; 28T6397ff

318 See e.g. 27T6430; 28T6708; 28T6752; the IFE model in Exhibit 1303 uses 10 percent as its base and shows higher borrowing costs until that level is achieved.

319 See IFE Evidence, pages 5, 15 and 24; ATCO-FE.10 (h); IFE Opening Statement, Exhibit 1306.

320 See Exhibit 1307 update to ATCO-FE.29(c); 28T6641ff

321 EDI-FE.09; EDI-FE.13; 28T6641; 27T6501; 28T6626

322 IFE Evidence, Exhibit 1301, page 20.

323 28T6673.

324 IFE Evidence, Exhibit 1301, page 19.

325 See IFE Opening Statement, Exhibit 1306.

326 See 28T6628.

327 28T6715.

328 EDI Argument, page 15.

329 EDI Argument, page 20.

330 Transcript, pages 6861-6863.

331 Transcript 3629-3630

332 Transcript 4838

333 Transcript 4830

334 See section 5.5 of UNCA's Argument.

335 See section 5.1 of UNCA's Argument

336 Transcript page 4744 line 18

337 Transcript page 4657, line 19

338 Section 8

339 ACC.UNCA DISCO #2 — 9

340 Transcript page 4739

341 Transcript page 4740

342 AE Rebuttal Evidence (Exhibit 405, p. 30)

343 AE DISCO Rebuttal Evidence, Exhibit 405, page 30

344 Transcript page 5125

345 Transcript page 5126

346 Transcript page 4945

347 UNCA Argument, page 42 (emphasis added by IPCCAA).

348 Transcript, page 4745

349 Exhibit 106, page 30

350 ATCO Argument, page 24 (emphasis added by IPCCAA).

351 Exhibit 1001, Page 5

352 Exhibit #407-1, Section 2(i)

353 Exhibit #349, Page 7

354 Transcript, p. 6133-6134.

355 Exhibit 1001, p. 4.

356 Transcript p. 6133

357 Transcript 6132

358 Transcript 6133 line 25

359 Transcript page 4473 line 5

360 Transcript 6132 line 23

361 Transcript page 1830

362 Reference Exhibit 403-01, page 18 for AE; Exhibit 341, page 25 for UNCA

363 Transcript page 4104-4106

364 Transcript 5911/25 - 5912/23

365 Exhibit 349, page 4

366 Decision 2000-73 [*ATCO Electric Ltd., Re* (2000), 2000 CarswellAlta 1830 (Alta. E.U.B.)], page 6

367 AE Reply Argument, page 17.

368 Transcript page 2561

369 Transcript 3390-3391.

370 Transcript, pages 5050-5052, 5090)

371 Transcript, pages 5091, 5092.

372 Transcript pages 2576-77

373 Decisions 2001-88 through 2001-91, all issued December 4, 2001.

374 Transcript, pages 3830 and 3953-54

375 Exhibit 368 (Response to Undertaking Volume 18, Page 3840-3841)

376 Transcript, page 4012-13

377 Page 10.

378 Exhibit 341, UNCA Application, page 14.

379 Exhibit 341, Appendix A, page 3, 20.

380 Transcript page 3190; Transcript page 4129-4131; Transcript page 4280-4281

381 Transcript page 3190

382 Transcript page 4129-4130

383 Transcript page 4131

384 Transcript page 4280-4281

385 Transcript page 4852

386 Transcript page 6498

387 Transcript page 3079-3080; Transcript page 4129-4131

388 Exhibit 353, page 7

389 Exhibit 353, page 11-13

390 Transcript page 3195-3196

391 Exhibit 353, page 8-10

392 Exhibit 1304, Response to Information Request ATCO.FE-10(g).

393 Exhibit 1304, Response to Information Request ATCO.FE-10(e).

394 Transcript page 2836-2837

395 Transcript page 6413-6414

396 Transcript page 6413-6414

397 Exhibit 353, page 26-27; Transcript page 2802-2804

398 Exhibit 353, page 26-27

399 Transcript page 4801-4803

400 Transcript page 2700-2701

401 Transcript page 4131

402 Exhibit 1304, Response to Information Request FIRM.FE-5(b).

403 *Decision U96001*, page 92.

404 National Energy Board, *Decision RH-2-94*, page 25.

405 Exhibit 341, Appendix A, page 3 and 20

406 Exhibit 341, Appendix A, page 2-3

407 Exhibit 341, Appendix A, page 2

408 Exhibit 353, page 13

409 Exhibit 353, page 39

410 Exhibit 1002, page 2

411 Transcript page 4782

412 Transcript page 4785

413 Transcript page 4819

414 Transcript page 4829

415 Transcript page 6454-6455

416 Exhibit 1002, page 2

417 Transcript page 4796

418 Transcript page 4798

419 Transcript page 4801

420 Transcript page 4802-4803

421 Exhibit 1002, page 3-4

422 Exhibit 1004, Response to Information Request BR.FIRM-4(a)

423 Exhibit 1002, page 3

424 Exhibit 353, page 38; Transcript page 4805-4807

425 Transcript page 4806

426 Exhibit 1103, page 11

427 Exhibit 1103, page 11

428 Transcript page 2698

429 Transcript page 2699

430 Transcript page 2699

431 Transcript page 4131

432 Transcript page 2707

433 Transcript page 2700-2701

434 Transcript page 2705

435 Transcript page 2705

436 Transcript page 4852; Transcript page 6498

437 Exhibit 1103, page 11

438 Transcript page 2707

439 Exhibit 1301, page 13 and 15 see also Exhibit 1304, Response to Information Request BR.FE-8, page 1.

440 Transcript page 6267-6268

441 Exhibit 1301, page 3 and 13; Exhibit 1304, Responses to Information Requests BR.FE-7(a), BR.FE-8, BR.FE-17, FIRM.FE-5(a); Transcript page 6678-6679; Transcript page 6718-6719.

442 Exhibit 1304, Response to Information Request BR.FE-8, page 1.

443 Transcript page 6704-6705 See also Transcript page 6707

444 Exhibit 1304, Response to Information Request FIRM.FE-5(b); Transcript page 6262-6263; Transcript page 6424; Transcript page 6429-6430; Transcript page 6649-6651; Transcript page 6696; Transcript page 6702; Transcript page 6756-6757.

445 Exhibit 1304, Response to Information Request FIRM.FE-5(b).

446 Transcript page 6262-6263 Emphasis supplied.

447 Transcript page 6702 Emphasis supplied.

448 Transcript page 6424 Emphasis supplied.

449 Transcript page 6756-6757 Emphasis supplied.

450 Exhibit 1304, Response to Information Requests BR.FE-17 and FIRM.FE-5(b); Transcript page 6416-6417; Transcript page 6424; Transcript page 6429-6430; Transcript page 6649-6652; Transcript page 6750.

451 Exhibit 1304, Response to Information Request BR.FE-17. Emphasis supplied.

452 Exhibit 1304, Response to Information Request FIRM.FE-5(b). Emphasis supplied.

453 Transcript page 6416-6417

454 Transcript page 6649-6650 Emphasis supplied.

455 Transcript page 6652 Emphasis supplied.

456 Exhibit 1301, page 24

457 Transcript page 6413-6414

458 Transcript page 3629-3630

459 Transcript page 6455

460 Transcript page 3629-3630

461 Transcript page 4819; Transcript page 4829; Transcript page 6454-6455

462 SPPA, AIPA and ANC/MW do not address the carrying cost issue.

463 IPCCAA Argument, page 24

464 FIRM Argument, page 48

465 IFE Argument, pages 6-7

466 *Decision C78221*, December 21, 1978

467 *Decision C78221*, page 24.

468 *Decision C78221*, page 23

469 *Decision C78221*, pages 26-27

470 National Energy Board, *Decision RH-2-93*, March 1994, page 21

471 IFE Argument, page 7

472 IFE Argument, page 7. Emphasis supplied

473 ACC Argument, page 6

474 UNCA Argument, pages 23-24

475 Transcript page 4281

476 ACC Argument, page 6.

477 Transcript, page 3891

478 ACC Argument, page 6. Emphasis supplied.

479 ACC Argument, page 7.

480 Exhibit 1103, page 11

481 Decision 2001-65 p. 10

482 Transcript page 6743

483 Transcript page 4012

484 Exhibit 1310, page 4

485 Exhibit 1310, page 4

486 Transcript page 4012-4013

487 Exhibit 1310, page 3

488 The analysis in respect of *consolidated* operations is the only firm basis for Messrs. McCormick's and Demcoe's conclusion that TransAlta could have "stretched its balance sheet" to finance the deferral account balances entirely with debt. See Exhibit 1310, pages 5-6. As noted above, Messrs. McCormick and Demcoe are unable to provide a firm opinion respecting the ability of TransAlta DISCO to similarly "stretch" its balance sheet.

489 Exhibit 303, Response to Information Request BR.UNCA-20(e); Exhibit 504, Response to Information Request BR.EDI-16(c)

490 Transcript page 6244; Transcript page 2700-2701

491 Exhibit 353, page 14; Transcript page 6465; Transcript page 6272

492 Exhibit 353, page 26-27

493 Exhibit 353, page 14

494 Exhibit 341, Appendix A, page 20; Transcript page 3830

495 Transcript page 3956

496 Exhibit 341, Appendix A, page 20

497 Transcript page 3830

498 Transcript page3958-3959

499 FIRM Argument, pages 49-50

500 The analysis in respect of *consolidated* operations is the only firm basis for Messrs. McCormick's and Demcoe's conclusion that TransAlta could have "stretched its balance sheet" to finance the deferral account balances entirely with debt. See Exhibit 1310, pages 5-6. Messrs. McCormick and Demcoe are unable to provide a firm opinion respecting the ability of TransAlta DISCO to similarly "stretch" its balance sheet. Note the discussion at UNCA Argument, page 26.

501 UNCA Argument, pages 21-22.

502 UNCA Argument, pages 25-28.

503 Exhibit 102.

504 Exhibit 403-01, page 5.

505 Exhibit 403-01, page 6.

506 Exhibit 103-GENCO and Ex. 403-DISCO

507 Exhibit 102.

508 Page 4.

509 IFE Argument, page 1.

510 Transcript, page 6184, 6201-2

511 Exhibit 134, p. 2.

512 Transcript, page 4198, 4255

513 Transcript, page 2646

514 Transcript, page 2649

515 Transcript, page 2649

516 Transcript, page 6260

517 Transcript, page 6263

518 Exhibit 503, EDI Application, Cover Letter, page 1; Exhibit 503, EDI Application, Schedule C; Exhibit 503, Schedule C-1, page 20.

519 Exhibit 503, Schedule C-1, pages 2 and 20.

520 Exhibits 1301, 1302 and 1303.

521 Exhibit 1002, pages 2-4.

522 Although Dr. Rosenberg offered a similar brief position statement in respect of ATCO's and UNCA's carrying cost rates, Dr. Rosenberg offered no such statement in respect of EDI's carrying cost rate.

523 Transcript page 6388-6392

524 Transcript page 6245-6246; Transcript page 6388-6392; Transcript page 6752

525 Exhibit 506, page 7

526 See, for example, *Decision E93053*, pages 45-49. The Board reduced the cost of debt to NOVA's Alberta Gas Transmission Division, because it concluded that the NOVA Corporation cost of debt was higher than the Transmission Division stand-alone cost of debt due to the presence of the higher-risk chemical operations within NOVA.

527 Footnote in Original Text: At page 16 of its *Decision E93060*, the Board remarked on the contentiousness of return issues that arises when utility operations are required to be considered in conjunction with the other operations of a diversified and consolidated entity.

528 Exhibit 506, pages 11-13.

529 Transcript page 3195-3196

530 Exhibit 506, pages 8-10

531 Exhibit 1304, Response to Information Request ATCO.FE-10(g)

532 Exhibit 1304, Response to Information Request ATCO.FE-10(e)

533 Transcript page 6393-6396

534 Transcript page 6247-6248

535 Transcript page 6219-6220

536 Transcript page 6413

537 Transcript page 6413

538 Transcript page 6413; Exhibit 506, pages 13-14

539 Transcript page 2836-2837

540 Transcript page 6413-6414

541 Transcript page 6454-6455

542 Exhibit 506, pages 28-29; Transcript 2802-2804

543 Transcript page 2803

544 Transcript page 3137

545 Exhibit 1301, page 24

546 Transcript 6752

547 Transcript 6504-6505
548 Transcript 6504-6505; Transcript 6435; Transcript 6696-6697
549 Transcript 3860-3864
550 Transcript 3041
551 Transcript 6435-6436
552 Exhibit 383, page 3; Exhibit 506, page 20
553 Exhibit 504, Response to Information Request BR.EDI-16(c); Exhibit 303, Response to Information Request BR.UNCA-20(e)
554 Transcript 6244.
555 Exhibit 506, page 15; Transcript 6465; Transcript 6272
556 Exhibit 506, pages 28-29
557 Exhibit 506, page 15
558 IFE Argument, page 9
559 IFE Argument, page 7
560 Transcript page 4801
561 Transcript page 4802-4803
562 Exhibit 506, pages 28-29.
563 *Decision U96001*, page 92.
564 National Energy Board, *Decision RH-2-94*, page 25.
565 SPPA, AIPA and ANC/MW do not address the carrying cost issue.
566 ACC Argument, page 6.
567 IPCCAA Argument, page 24.
568 FIRM Argument, page 48
569 IFE Argument, page 8
570 Transcript 6474; Transcript 3834-3835; Transcript 3839
571 See the discussion in Section 4.4.4.2 generally, Exhibit 218 and Transcript 3025
572 Exhibit 506, page 27
573 Transcript 6469-6470.
574 Exhibit 506, page 26; Transcript 3493-3494; Transcript 3604-3606; Transcript 3834
575 Transcript 6468.
576 Transcript 3604-3605.
577 Exhibit 1301, pages 2, 10, 15 and 24.
578 IFE Argument, page 8.
579 EDI Argument, page 32.
580 EDI Argument, pages 32-33.
581 EDI Argument, pages 32-34.
582 EDI Argument, page 31.
583 EDI Argument, pages 31-32.
584 IFE Argument, page 5.
585 Transcript page 3137
586 Transcript page 4802-4803
587 Transcript page 6245-6246
588 ACC Argument, page 6.
589 EDI Argument, pages 16-17
590 Transcript page 4281
591 ACC Argument, page 6.
592 Transcript page 3181-3182
593 Transcript page 3150-3151

594 Transcript 3160-3161
595 Transcript, page 4281
596 Transcript, page 6670
597 Transcript, page 6670
598 Transcript, page 6246, 6272
599 Transcript, page 4281
600 Transcript, page 6249 (AE); page 6391-6392 (EDI)
601 Transcript, page 2803
602 Transcript, page 2803
603 Transcript, page 2404
604 Transcript, page 2577
605 Transcript page 6459-6460
606 Transcript page 2548
607 Transcript page 2409-2410
608 IFE Argument, page 5.
609 Transcript, page 2432-2437
610 Transcript, page 2570-2571
611 IFE Argument, page 6-7.
612 Pages 21-22.
613 Pages 11-14.
614 IFE Argument, page 5
615 Pages 38-42
616 Cities Reply Argument, page 3
617 FIRM Argument, page 42
618 ACC Argument, page 6-7
619 ACC Argument, page 6
620 Exhibit 403-01, Tab C, page 6.
621 Argument, page 27
622 Argument, page 11
623 Argument, page 27
624 Argument, page 28
625 Argument, page 29
626 Argument, page 29
627 Argument, page 11
628 Argument, page 11
629 IFE Argument, page 7
630 IFE Argument, page 6-7.
631 Argument, page 22
632 TRANSCRIPT page 4801-4803
633 Argument, page 6
634 Argument, page 6
635 TRANSCRIPT PAGE 4785
636 EUB Decision 2000-41, page 21.
637 Exhibit 1310.
638 Exhibit 1310, page 7
639 TRANSCRIPT page 4801-4803
640 AE Argument, page 29.

641 Exhibit 1402.

642 Exhibit 1402.

643 IFE Evidence, Exhibit 1301, page 24.

644 See, e.g. 15T2821; 15T2929-2930; 18T3592.

645 Exhibit 1304

646 16T3065, 16T3072

647 13T2414.

648 16T3093.

649 20T4350; 20T4356

650 15T2818.

651 See e.g. Decision E92086; Decision E93060, pages 47-49.

652 For a discussion of this concept see 16T3079-81.

653 26T6233-6234.

654 26T6466; IFE Opening Statement, Exhibit 1306, page 3

655 See "Maria Montessori" discussion at 15T2919-2920.

656 IFE Evidence, Exhibit 1301, pages 19-20.

657 IFE Evidence, Exhibit 1301, pages 19-20.

658 See IFE Evidence, Exhibit 1301, pages 15-16; ATCO-FE.14; ATCO-FE.15(c); ATCO-FE.32(c); 26T6166-6168.

659 See e.g. 26T6197; 26T6261-6262; 27T6431.

660 See 16T3036-3043.

661 IFE Evidence, Exhibit 1301, page 15.

662 Exhibit 218.

663 See 27T6488ff; 28T6611ff.

664 28T6611-6612.

665 27T6473; 28T6667

666 See IFE Argument, page 5 and evidence cited there.

667 See BR-ATCODISCO-PP-17 (Revised), page 4.

668 EDI Argument, page 28.

669 EDI Argument, pages 11 and 29.

670 IFE Argument, pages 6-7.

671 16T3065.

672 EDI Argument, pages 30-36.

673 27T6489; 28T6667

674 See 28T6612; 27T6411-6412.

675 16T3124.

676 AE Argument, page 27.

677 AE Argument, page 28.

678 IFE Evidence, Exhibit 1301, pages 15-16; see also ATCO-FE.14; ATCO-FE.15(c); 26T6166-6168.

679 ATCO-FE-18; see also 28T6673

680 AE Argument, page 29. EDI made a similar allegation at page 27 of its argument.

681 Exhibit 1301, page 16

682 See Firm.FE-01and Lethbridge.FE-01.

683 AE Argument, page 29.

684 BR-FE.13.

685 Exhibit 1301.

686 26T6282.

687 BR.FE-10 and BR.FE-15(b)

688 Exhibit 1301, page 13: "Shareholder comfort letters have been know to provide sufficient assurance to the lenders in order that large financings of this type can be done at highly competitive rates with no direct equity support." See also BR.FE-15(b)

689 Exhibit 1301, page 14: "Enhancements may include full or partial guarantees from parent or affiliated companies. It would be expected that these would be compensated for in the rate rider." See also BR.FE-15(b).

690 ATCO-FE-20 and BR.FE-15(b)

691 Decision U99099, page 199

692 Decision U99099, page 200

693 Decision U99099, page 200-201

694 Decision U99099, page 202

695 Decision U99099, page 228

696 Decision 2000 — 52, page 1

697 Decision 2000-52, page 6

698 Decision 2000-52, page 7

699 Transcript page 5715-16

700 Transcript page 5717

701 Decision 2000-60, page 19

702 Transcript page 2402, 2403

703 Transcript page. 2459

704 Transcript page 2456

705 Transcript page 2457

706 Transcript page. 2458-2459

707 Transcript page 2465

708 Transcript page 2561

709 Transcript page 2576 -77

710 Transcript page 2596 — 2598

711 Transcript page 2612 - 2613

712 Transcript page 2598

713 Transcript page 2614, line 7 — 10.

714 Transcript page 2631

715 Transcript page 2632

716 Transcript page 2632

717 Transcript page 2648

718 Transcript page 2681

719 Transcript page 2692

720 ACC Evidence, Exhibit 1103, page 9, lines 14-19

721 Exhibit 349, page 9

722 Exhibit 349, page 3

723 Exhibit 349, page 4

724 Exhibit 349, page 5

725 Exhibit 349, page 7-8

726 Transcript p 3571

727 Exhibit 1209 narrative, page 2 of 12

728 UNCA Argument page11-14

729 Transcript page 5869-5871

730 FIRM Argument page 40

731 SPPA Argument page 61

732 SPPA Argument page 62

733 IPCCAA Argument page 24

734 IPCCAA Argument page 24

735 Volume 23, Transcript pages 5043, 5056

736 Transcript 2903.

737 Transcript 2907-2908.

738 Transcript 2562.

739 Transcript 3390-3391.

740 *Decision U99099*, pages 136-137.

741 Transcript 2798-2800.

742 Exhibit 513.

743 Transcript 2798.

744 Transcript 3169.

745 T15: 2903 and 2907-08.

746 ATCO Electric Regulated Rate Option Tariff Application Filing, page 4-5

747 Exhibit 1201, page 6

748 Transcript 2401/22 — 24 & 2422/24 - 26

749 Exhibit 1201, SPPA Direct Evidence, page 21

750 Exhibit 1212, page 5 of 6, (UNC + AE energy sales) / (total energy sales — exports)

751 Exhibit 1209, page 6, ATCO Power hedged some of its Joffree output, Transcript 662/24 — 663/1, TAU noted that their annual report states that some non-regulated output was hedged in 2000.

752 Exhibit 1212, page 2

753 Exhibit 1212, page 4

754 Compare table on page 5 of Exhibit 1212 with Exhibit 1203, BR.SPPA-3.

755 Transcript 5699/2 - 9

756 Exhibit 348, page 3

757 Decision U99099, page 131 — 135, IPCCAA, IPPSA/SPPA, the FIRM and ENMAX all raised market power as a concern.

758 Exhibit 348, page 4

759 As it turns out, the high cost of imports caused the deferral accounts to be much larger than they otherwise would have been. SPPA is not asking the Board to consider any adjustment in this regard.

760 Exhibit 348, bottom of page 7

761 Exhibit 348, bottom of page 8

762 Exhibit 106, page 22 to 28

763 Exhibit 106, page 24/36 — 25/4

764 TRANSCRIPT 4875/2-10

765 Exhibit 1206, page 40/17-25

766 Not only was the potential for market power abuse a concern to consumers in the 1999/2000 GTA. The level of the pool price forecasts was also felt to be low. In Exhibit 1206, starting at page 31, IPPSA and SPPA point to numerous downward biases in the generation modeling done by all three applicants.

767 Exhibit 106, page 28/2-7

768 Exhibit 106, page 28/17-19

769 Exhibit 1209, page 4

770 TAU Argument, page 12, l. 29-36

771 Exhibit 111-3, Appendix B, Schedule 2.24, Page 3 of 16

772 Exhibit 1209

773 AE Argument, page 8

774 The applicant's affiliates should also have been aware of the applicant's obligations under the regulatory compact.

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