BY EMAIL and RESS

Jay Shepherd
jay@shepherdrubenstein.com
Direct: 416-804-2767

November 3, 2017
Our File No. EB-2017-0024

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2017-0024 – Alectra Utilities – Issues List

We are counsel for the School Energy Coalition. Pursuant to Procedural Order #2, this letter constitutes SEC's submissions on the Issues List.

SEC believes that the Revised Issues List proposed by the Board is appropriate, subject to one adjustment to deal with an issue that has come to light during the proceeding.

Change in Capitalization Policy

As OEB Staff point out in their submissions, the Applicant has disclosed in HRZ-SEC-6 that it has made a material accounting change in its Horizon Rate Zone books. An amount that, over the course of the next ten years, is projected to total $65-70 million is being collected in rates to cover OM&A, but will instead be capitalized and added to rate base. The first five years are forecast in the following table from the interrogatory response:

	2017	**2018**	**2019**	**2020**	**2021**
Direct Labour Costs	$1,726,949	$1,794,753	$1,821,276	$1,857,701	$1,894,855
Benefit Costs	$436,627	$450,321	$465,135	$474,438	$483,927
Material Handling Costs	$2,354,025	$2,376,376	$2,372,349	$2,406,103	$2,442,165
Fleet Costs	$1,762,653	$1,710,575	$1,720,082	$1,805,723	$1,894,314
Total Impact	**$6,280,253**	**$6,332,025**	**$6,378,842**	**$6,543,966**	**$6,715,261**

In the Applicant's view, external and binding requirements forced them to make this change. They describe this in the interrogatory response as follows:

> *"As part of the amalgamation of PowerStream, Horizon Utilities and Enersource, PowerStream was identified as the "acquirer", under the International Financial Reporting Standards ("IFRS") business combination standard. IFRS requires that all entities in the new organization adopt the acquirer's policy. Consequently, Alectra Utilities has adopted PowerStream's capitalization policy for the Horizon Utilities and Enersource RZs."*

SEC believes that the Board should add an additional issue to the Issues List as follows:

> **What is the appropriate way to account for the change in capitalization policy in the Horizon Rate Zone, whether by way of rate adjustment, rate rider, deferral/variance account, adjustment to any other components of the Application, or otherwise, and should the Board approve the change in capitalization policy?**

While SEC believes that this matter is already captured in Issue 1.1 (as a Z-factor), we are aware that there are a number of ways this can be seen. The Applicant has advised us that they believe their written position to us on this is protected by settlement privilege. We disagree, but see no point in arguing about it. Instead, we think it is useful to look at the five different ways that this issue arises in the context of this IRM proceeding.

1. ***Z-Factor.*** SEC believes that this is a classic Z-factor, albeit one in favour of the customers rather than in favour of the utility. The Horizon Settlement Agreement includes a standard 4th Generation IRM Z-factor[1], which under the Board's rules is the same as the 3rd Generation Z-factor. It is well-accepted that Z-factors are a symmetrical remedy[2], and in this case the $65-70 million at issue here can be tested against the Z-factor criteria[3]:

    a. ***Management Control.*** The Board says "Z-factors are events that are not within management's control." In the quote from HRZ-SEC-6, the Applicant makes clear that it was an exogenous factor – the IFRS deeming rules – that mandated this reduction in their expenses.

    b. ***Causation.*** The Board says "The amount must be clearly outside of the base upon which rates were derived." In this case, rates include an amount for OM&A. That is no longer OM&A, entirely because of the exogenous factor cited.

    c. ***Materiality.*** The Board says "The amounts must exceed the Board-defined materiality threshold and have a significant influence on the operation of the distributor." In this case, the amounts are well above the threshold, and are

[1] Horizon Settlement Agreement, p. 15.
[2] EB-2012-0459, Decision with Reasons, p. 19; EB-2015-0004, JTC2.4, p.2, and references cited therein; AUC Decision 2012-237, p. 110; and many other references.
[3] Report of the Board, 3rd Generation IRM, July 2008, Appendix A.

sufficient to fund much of the incremental capital spending planned for the deferred rebasing period. They thus have the requisite "significant influence"."

d. Prudence. The evidence does not make clear whether the amounts reported in HRZ-SEC-6 are prudent, because this issue has not yet been explored. The magnitude of the issue was only uncovered in interrogatories. This, however, does not go to whether the issue qualifies as a Z-factor, but to the quantum of the adjustment.

At this point in the proceeding, SEC submits that it is not necessary for the Board to determine whether this is a Z-factor, although certainly if the Board did so then the issue would be included in existing Issue 1.1. Our submission is that at this stage it is enough for the Board to determine that parties should be able to argue this issue.

2. ***Requirement for Board Permission***. OEB Staff has noted in their submission that the Horizon Settlement Agreement stipulates that Horizon will not make changes to accounting policies without the approval of the Board. While this provision arises in the Settlement Agreement in the context of the ESM discussion, it is not in any way limited to that. We agree with OEB Staff that this issue necessarily arises because Board approval of the change is required. It is also submitted that, where Board approval is required for anything that may impact rates, it is normal Board practice to determine what conditions or other directions, if any, should arise in the course of granting that approval.

3. ***Earnings-Sharing Mechanism.*** The express Settlement Agreement reference to accounting changes in the ESM context makes clear that accounting changes are a live issue when ESM is an issue. This may or may not be applicable in this case. We do not have information on the record to know whether, in the course of making the accounting change for 2017, the Applicant was required to restate the prior year, as has often been the case with IFRS changes. It may therefore be a live issue for the 2016 ESM. However, SEC is opposed to this position. Adjusting earnings for ESM purposes gives customers a maximum of 50% of the impact of this accounting change. It is, in our view, unconscionable that the Applicant would collect $65-70 million in rates for OM&A, give up to half of it back in ESM, and then collect the other half from customers a second time through rate base. We therefore do not believe that ESM is the best way to deal with this accounting change, but we do believe that the Issues List should characterize the issue broadly enough that parties can argue this position.

4. ***ICM Threshold.*** Some parties may argue that the ICM threshold for the Applicant should be calculated on a utility-wide basis. If that were the case, a party could argue that there should be an adjustment to the threshold calculation to reflect the fact that this amount of OM&A has been shifted to capital. SEC does not agree with this characterization of the impact, but believes that parties should be free to argue this position.

5. ***ICM Availability.*** It is also possible to argue that this additional amount constitutes incremental funding available to the Applicant for capital spending. Rates were set on the basis that these amounts would be expensed. Instead, they are being capitalized, meaning that the Applicant will have about $6.5 million per year in extra revenue. This

windfall could be used to fund incremental capital, probably well over $100 million, over the ten year deferred rebasing period. The ICM is a discretionary remedy offered by the Board, but in every case the Board has to make an assessment whether the additional capital "needs" of the utility warrant a special rate rider, i.e. incremental charges to customers. While SEC does not believe that this is the preferred way of dealing with this issue, we believe the Board should be free to determine in this proceeding that, as a result of this accounting change, the Applicant does not need additional rate funding to cover its capital plans.

Because of the range of positions that parties may wish to take on how to deal with this, and because of the range of options potentially available to the Board to address this, SEC believes that the appropriate approach is to add an express issue engaging the full scope of the analysis of this issue.

Technical Conference

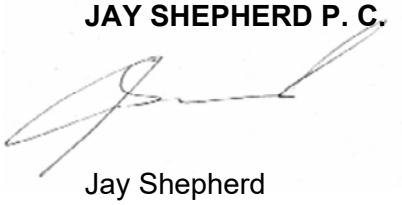
SEC is aware that some parties may be proposing the addition of a technical conference in this proceeding. SEC supports those submissions, for two reasons:

- It appears likely that at least some of the issues – including those relating to capital plans – will need to be dealt with by the Board in an oral hearing. Because some of the questioning on those capital projects may be detailed and technical, it will likely be more efficient to do most of that in a technical conference. That is, in essence, the purpose of the technical conference: to deal with detailed oral evidence without requiring the Board panel to sit through all of it. By the time it gets to the oral hearing, only the most important parts will still need to be addressed, thus focusing the evidence the Board panel has to hear, and shortening the hearing.

- There are unanswered questions relating to the accounting change, including whether it applies to 2016, and the components of the estimates in HRZ-SEC-6, among other things. It would appear to us that these are most efficiently handled in a technical conference.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.



Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested Parties