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July 29, 2019
Our File No. 2019-0018

Ontario Energy Board
2300 Yonge Street
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Toronto, Ontario
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2019-0018 – Alectra Utilities – Capitalization Issues

We are counsel for the School Energy Coalition. Pursuant to Procedural Order #1 dated July 9, 2019, this letter sets out SEC's submissions with respect to the two questions posed by the Board.

The Board has asked two preliminary questions, as follows[1]:

> *Does Alectra Utilities' request to reverse the outcome of the OEB's decision to create the capitalization related deferral accounts for the Enersource, Brampton and Horizon rate zones, constitute a motion to vary pursuant to Rule 40.02 of the OEB Rules?*

And:

> *If Alectra Utilities' request constitutes a motion to vary, has the threshold test been met such that the request should be reviewed on the merits?*

[1] EB-2019-0018, Procedural Order #1.

Summary

SEC's conclusion is that Alectra's request is in substance a motion under Rule 40.01 to review the Board's decision in EB-2017-0024 that **a change in capitalization policy is not a benefit for the account of the shareholders, as Alectra had claimed, but the impact should instead be accounted for in amounts paid by the customers**.

The Alectra request is not:

a) A motion to review the decision to create the three accounts in the first place, because that decision (in EB-2017-0024 PO#3) was interim in nature;

nor was it

b) A motion under Rule 40.02 (which appears to SEC to be a simple typographical error in P.O. #1).

Two secondary issues – how the impact should be calculated, and what mechanism should be used to make the customers whole – have not yet been determined by the Board.

On the decision that Alectra is actually seeking to review - whether the impact is for account of the shareholders or the customers - SEC submits:

a) The motion is long out of time, and Alectra has provided no evidence to justify an extension of time by the Board; and

b) The threshold test is in any case not met, because the arguments being presented by Alectra in this proceeding are the same as it made in EB-2017-0024, which were considered and rejected by the Board on the basis of sound principles and good reasoning.

The Decisions in EB-2017-0024 and EB-2018-0016 sequentially referred the two secondary issues – calculation and mechanism – to this current proceeding. SEC submits that the Board should proceed to deal with those issues, and reject the request from Alectra to review the initial (and final) determination by the Board that the customers should be made whole.

Below SEC discusses each of the components of that analysis in turn.

Components of the Capitalization Issue

1. The applicable rule is as follows[2]:

> *40.01 Subject to Rule 40.02, any person may bring a motion requesting the Board to review all or part of a final order or decision, and to vary, suspend or cancel the order or decision.*

2. In dealing with the change in Alectra capitalization policy, the Board had to deal with a number of components: two procedural issues, and three substantive issues.

3. ***Procedural Components.*** The first procedural question was whether the impact of the capitalization change should even be an issue in the EB-2017-0024 case. Alectra argued that it should not[3], even though it had admitted that the impact in the Horizon rate zone alone was more than $6 million per year[4].

4. The Board concluded that an issue should be added to the Issues List, as follows[5]:

> *What is the appropriate way to account for the change in capitalization policy resulting from the merger for Alectra Utilities and its predecessor companies?*

5. The second procedural question was how to ensure that the Board had all options available to it, and was not dealing with a 2017 impact retroactively, given that the issue was added on November 17, 2017, and there was no likelihood that it would be decided before the end of the year.

6. To that end, the Board established deferral accounts for the Horizon, Enersource and Brampton rate zones to ensure that all impacts would be captured from the time of the amalgamation, saying[6]:

> *There was limited information in the application on the change to a common capitalization policy for Alectra Utilities. Through interrogatories, the magnitude of the change for the Horizon RZ was disclosed to be in excess of six million dollars per year. Alectra Utilities also indicated that there were changes to capitalize more costs for the Enersource RZ and less costs for the Brampton RZ. The magnitude of these changes is unknown. Furthermore, the exact date and specific*

[2] OEB Rules of Practice and Procedure, s. 40.01.
[3] EB-2017-0024, Alectra Submissions on Issues List, November 3, 2017.
[4] EB-2017-0024, HRZ-SEC-6.
[5] EB-2017-0024, Decision on Issues List and Procedural Order #3, p. 3.
[6] Ibid, p. 3-4.

> *details of the transition to the harmonized capitalization policy are not clear in the evidence.*
>
> *The OEB requires confirmation that the capitalization change has no impact on 2016 earnings for the Horizon RZ, and that any impacts in 2017 are tracked for all rate zones to leave all options open for how the OEB may treat this capitalization change. Having a separate issue on this matter on the issues list ensures all options are open for consideration.*
>
> *Based on the dates within this procedural order, a decision for this proceeding will not be issued in 2017. The OEB finds it necessary to establish three new accounts to track the change in capitalization for the Horizon RZ, Enersource RZ and Brampton RZ to ensure all options remain open and available for consideration, and rate retroactivity for the 2017 period is not an issue.*

7. The Board sought submissions on the accounting order for the deferral accounts, and after reviewing those submissions, on December 20, 2017 issued a Decision and Partial Accounting Order setting up the three new accounts. The Board did not comment in any way on the disposition of the accounts.

8. ***Substantive Components.*** The Board made it clear in P.O. #3 that it was not making any substantive decisions on the issue, which made sense since it had just added the issue to the Issues List. It turned out there were three substantive components of the capitalization policy change.

9. The first substantive component was, colloquially, "who should get the money?" Alectra argued[7]

> *…the change to Alectra's capitalization policy came about entirely as a result of the merger. Under IFRS, Alectra was required to adopt a uniform capitalization policy across all of its rate zones. To the extent the capitalization change reflects a "benefit" (non-cash), that benefit is to the account of Alectra's shareholders, just as ratepayers are shielded from all merger related costs.*
>
> *…intervenor submissions on the issues list make clear that they will be looking for some form of adjustment. If accepted, this would be tantamount to the recapture of the benefits/costs associated with the*

[7] EB-2017-0024, Alectra Final Argument, p. 45. Alectra also argued that this was a non-cash change, and should not be reflected in rates, which would have a cash impact on the utility. These are the two arguments Alectra once again seeks to make in this case.

> *merger that are to accrue to shareholders under the Board's MAADs policy.*

10. The Board described in its decision the position of Alectra as follows[8]:

> *Alectra Utilities submitted that the OEB should order the closure of the capitalization related deferral accounts and the reversal of any amounts recorded in those accounts. Alectra Utilities explained that it was taking this position as the capitalization policy change is a non-cash event that had no impact, and will have no impact going forward, on the underlying cost of utility business. Further, Alectra Utilities argued that OEB policy does not support any claim for rate adjustment at this time.*
>
> *Alectra Utilities claimed that both the OEB's filing requirements and MAADs policy are clear that, where a rebasing deferral period has been approved by the OEB for a consolidation transaction, accounting changes (including changes in capitalization policy) that are required within the consolidated entity pursuant to applicable accounting standards during the rebasing deferral period, are not to be reflected in rates until such time as the consolidated entity rebases.*
>
> *Alectra Utilities argued that the capitalization policy change is a function of the integration, and that the savings or costs arising from integration are to the account of the shareholder as specified in the MAADs Handbook and, more recently, in the MAADs Decision.[emphasis added]*

11. The Board's conclusion on this key question – who should get the money – was very clear[9]:

> *The OEB finds that the change in capitalization policy is not a "benefit" accruing to shareholders as claimed by Alectra Utilities.*
>
> *…The OEB's MAADs policy was established to incent consolidations by permitting utilities to keep efficiency gains to offset the costs of the transaction. The change in capitalization policy has no impact on underlying total costs and therefore on efficiency. It simply moves some costs from OM&A to capital (for Enersource RZ and Horizon Utilities RZ) and vice versa (for Brampton RZ). The OEB finds that it is neither an efficiency gain nor a "benefit" of the merger that should accrue to shareholders, to be used to offset the costs of the merger transaction, as claimed by Alectra Utilities. [emphasis added]*

[8] EB-2017-0024, Decision with Reasons, April 6, 2018, pp. 77-8.
[9] Ibid. p. 79-80.

12. The Board goes on to explain the reasons for that conclusion in some detail. It also deals with the second argument, the "non-cash" claim, just as clearly[10]:

> *Alectra Utilities stated that the change in the capitalization policy was a "non-cash event that had no impact, and will have no impact going forward, on the underlying cost of The OEB agrees. The change in capitalization policy does, however, change the type of costs (OM&A or capital) and the timing of cost recognition, which is relevant when setting electricity rates.*

13. If any of that left any doubt that the Board was determining that the impact of the accounting change should be reflected in rates, the Board dispelled that doubt by discussing what happened when utilities transitioned to IFRS, and then saying[11]:

> *The OEB finds that both the transition to IFRS and the capitalization policy change from the merger were due to mandated accounting standards established by the Canadian Accounting Standards Board (AcSB), and the OEB should apply consistent regulatory treatment.[emphasis added]*

14. In short, the Board made clear that, where accounting changes affect the mix between capital and operating costs, as here, the customers must be made whole, and the impact was not going to be a shareholder benefit.

15. This is the Board decision that Alectra now seeks to overturn. After the Board's EB-2017-0024 Decision, there was never any doubt that the impact of the change would be reflected in rates, starting with the 2017 impacts.

16. The second substantive component of the issue is the calculation of the impact. This only arises if the customers are being credited with that impact. If they are not, then the shareholders get the money and there is no reason to calculate anything. While there were a number of proposals made and positions taken with respect to calculation issues, the Board ultimately concluded in EB-2017-0024 that the calculation was complex and should be deferred to the next IRM application.

17. The third substantive component of the issue is the mechanism and timing of the credit to customers. This also arises only if the customers get the money. If the shareholders get the money, the deferral accounts are simply closed, as Alectra has proposed in this case. In EB-2017-0024, the Board concluded that the recovery mechanism could also be dealt with in the next IRM application.

[10] Ibid, p. 79-80.
[11] Ibid, p. 81-2.

18. On the second and third components, the Board said the following[12]:

> *While amounts for Alectra Utilities could be held in the accounts approved by the OEB until the next rebasing, and used as an offset to rate base, the deferred rebasing period is 10 years. This is an unreasonably long time to wait for disposition of the accounts. Given the complexities of determining amounts that should be credited to customers, such as tax treatment, the OEB finds that Alectra Utilities shall file a proposal for disposition of the deferral accounts in its application for 2019 rates for the Brampton and Enersource RZs*.

19. There was never any doubt that the Board was ordering that the impact be reflected in rates, and that the shareholders would not get the benefit of this money. All parties understood that the "proposal for disposition" ordered was to be a proposal to dispose of the impact in favour of the customers. In EB-2018-0016, Alectra's proposal for disposition was in fact in favour of customers, because they were fully aware that the Board had already made its decision as to who was going to get to the money[13].

20. ***Conclusion on the Board's First Question.*** SEC therefore concludes that the Board has, so far, made two procedural and one substantive decision on this issue:

    a) ***Issues List.*** No-one is suggesting that Alectra is objecting to the first procedural decision, i.e. adding the issue of the capitalization policy to the Issues List in EB-2017-0024.

    b) ***Deferral Accounts.*** Alectra's Submissions in Chief on this question focus on the procedural decision to set up deferral accounts, but this was clearly just to keep the Board's options open. Despite the wording of the Board's first question in Procedural Order #1, it is clear that Alectra is not, today, saying that the Board committed any error in setting up those accounts in EB-2017-0024. Once the issue was added to the Issues List, the Board really had no choice.

    c) ***Who Gets The Money?*** In its submissions, Alectra confuses the issue of who gets the money with the issues of how to calculate the amount, and what

[12] Ibid. p. 82.

[13] See our references in the next section, on whether an extension of time should be allowed. There is no doubt that Alectra was aware in EB-2018-0016 that the previous decision had gone against them, and the customers were going to be made whole. Suggestions in the Submissions in Chief of Alectra in this proceeding that the question of who should get the money was still open are neither true, nor anything Alectra actually believed in EB-2018-0016, or now.

mechanism should be used to make the customers whole. Alectra is unquestionably objecting to the Board's decision that the impact of the capitalization policy change should be reflected in rates. It is not objecting to any Board decision on calculation or disposition mechanism, because the Board has not yet made those decisions.

21. It is therefore submitted that Alectra is in substance seeking to vary the Board's decision on April 6, 2018 in EB-2017-0024 that the impact of the capitalization policy change should be reflected in rates.

Should an Extension of Time be Allowed?

22. The Board's rules state[14]:

> *40.03 The notice of motion for a motion under **Rule 40.01** shall include the information required under **Rule 42**, and shall be filed and served within 20 calendar days of the date of the order or decision.*

23. Section 7 of the Rules also allows the Board to extend or abridge the time for any matter under the rules. The Board's normal practice is that, where a party files late, it is expected to give reasons why the Board should allow the late filing anyway. This is especially true if the late filing is very long after the deadline[15].

24. Alectra is in this proceeding seeking to overturn the Board's decision in EB-2017-0024. SEC interprets the Board's Procedural Order #1 in this proceeding to be an invitation to Alectra to turn that request into a motion for review of the Board's previous decision.

25. Alectra elected not to do that, but instead, in its Submissions in Chief, it has argued that no decision has yet been made, and therefore there is nothing to review or vary. As discussed above, this is clearly wrong (see also below).

26. Had Alectra taken the Board up on its offer, we would have expected them in their Submissions in Chief to include two things:

    a) The information required under Rule 42, including the grounds for review, the specific errors they believe the Board made in the EB-2017-0042 Decision, etc.

    b) Reasons why they ask, in an application filed on May 28, 2019, that a prior

[14] OEB Rules of Practice and Procedure, s. 40.03.

[15] We will not go through the cases and commentary on extensions of time, as they are well known to the Board and the parties.

Board decision April 6, 2018 be overturned, rather than filing for a motion to review and vary within the time limited by the rules, i.e. thirteen months ago.

27. We will deal with the information required under Rule 42 in the next section, on the threshold issue. On the late filing, the issue is much simpler. Alectra has not provided any information to justify an extension because there is none to provide. They previously accepted their (unfair, in their minds) loss in EB-2017-0024 on the capitalization policy issue, and now have had a change of heart. Since they are asking for a substantial change in Board policy with the M-factor proposal, what is their downside to asking for the capitalization policy decision to be overturned as well?

28. ***The Intervening EB-2018-0016 Proceeding.*** In EB-2018-0016, Alectra included the following clearance of a deferral account in its orders requested for Enersource rate zone[16]:

> *The refund of the net financial impact of the new capitalization policy in 2017 through rate rider over a one year period effective January 1, 2019;*

29. A similar request was made for Brampton rate zone, although the amount was a charge to customers, as the capitalization policy had an opposite impact.

30. Similarly, in the body of the Application, Alectra deals with the Enersource rate zone refund to customers as follows:

> *The total 2017 net impact of the financial differences arising from the change to Alectra Utilities' capitalization policy in the Enersource rate zone is an increase in revenue requirement of $1.2MM.*
>
> *The net impact of the capitalization policy change includes the following items:*
> - *The actual impact on OM&A expenditures in each year following the change in capitalization policy until rebasing;*
> - *The actual impact on depreciation expense over the life of the underlying assets as a result of the increase/decrease in capitalization costs;*
> - *The impact on income tax or PILs for the amount paid to taxation authorities; and*
> - *The annual return on the cumulative impact from the annual change in capitalization.*

[16] EB-2018-0016, Ex.1/1, p. 19.

> *Alectra Utilities proposes to refund this amount over a one year period from all customers in the Enersource rate zone. Tables 132 to 135 below provide the total 2017 impact of the change in capitalization policy for the Enersource RZ.*

31. There is no reference in the Application to any doubt as to whether the capitalization policy changes were for the account of the customers. It was clear, and Alectra knew it.

32. The first time Alectra objects to this is in interrogatory responses, where it expressly admitted that it was unsuccessful in EB-2017-0024[17]:

> *Alectra Utilities reiterates its position in its 2018 electricity distribution rate application that changes in accounting policy or estimates that arise as a consequence of merger conformance should not be settled through variance account or other rate adjustment mechanisms within the OEB-approved rebasing deferral period. Within such period, these changes are non-cash and as a result, have no economic value. These are matters that should be addressed in rebasing applications. Alectra Utilities submits that the OEB should address such in the broader context of its Mergers, Acquisitions, Amalgamations and Divestitures ("MAADs") policy which, in its present form, clearly allocates economic outcomes from a merger within a rebasing deferral period to shareholders. <u>The OEB, in considering and making such changes to revise its MAADs policy, should revisit the approach taken in the case of the Alectra Utilities application, and take such necessary decisions as to unwind the Decision made in EB-2017-0024.</u> [emphasis added]*

33. They then doubled down on this in their direct oral evidence where their senior executive witness, during a surprisingly blunt three-page argument against the Board's decision in EB-2017-0024 on the capitalization policy change, ended with the following[18]:

> *MR. BASILIO: …As such, we submit that rate-making impacts from accounting policy changes are best considered in the broadest context of rate-making policy at the time of a full rebasing application, with appropriate rebalancing of revenue, with consideration of all components of rate base, and review of the impacts of other externalities and OEB policy changes in the deferral period.*

[17] EB-2018-0016, G-STAFF-5.
[18] EB-2018-0016, Tr.1:17-18.

> *MR. SMITH: So we began -- those are issues by and large, obviously, Mr. Basilio, that is going to be relevant next year, but I want to bring it back to today.*
> *MR. BASILIO: That's correct.*

34. The Board quite properly responded the next day to the lengthy objections by Mr. Basilio to the EB-2017-0024 Decision, saying[19]:

> *MS. ANDERSON: …The OEB is specifically not taking into consideration the extensive comments by Alectra about the correctness of previous OEB decisions provided as part of its examination-in-chief. This commentary is out of scope and not relevant to this proceeding.*

35. ***Conclusion.*** Two things are clear from the EB-2018-0016 proceeding:

    a) Alectra knew very well that the Board's decision in EB-2017-0024 was to reject their position, and to determine that the impact of the capitalization policy change was a cost or benefit to the customers, not the shareholders.

    b) Alectra had ample opportunity to challenge the EB-2017-0024 decision long before today, but made a deliberate choice not to pursue the normal remedy, a Rule 40.01 motion to review and vary[20].

36. Based on the foregoing, SEC submits that the Board should not exercise its discretion under Rule 7 to extend the time for filing a motion to review and vary, and should therefore declare Alectra's challenge of the EB-2017-0024 to be out of time.

Threshold Test

37. The Board's second question is whether, if this is in substance a motion to review and vary, the threshold test has been met and the issue should be considered on the merits.

38. ***Simple Answer.*** The simple answer to that is no. Alectra has not taken the opportunity to provide the information required under Rule 42, and so has not alleged any errors in the EB-2017-0024 Decision. The onus is on Alectra. Despite the Board, in PO#1, giving them the opening to meet that onus, they declined to do so.

39. This is not really surprising. The Board determined in EB-2017-0024 that Alectra

[19] EB-2018-0016, Tr.2:8.

[20] Alectra was represented by experienced regulatory counsel throughout. We can only assume that they didn't file a motion under Rule 40.01 to vary the EB-2017-0024 Decision because they knew they would just be re-arguing the case they had already lost, i.e. they had no grounds for review.

can't collect this money twice from customers (as OM&A in rates, and then again later in rate base on rebasing), and that waiting ten years to have this dealt with is "unreasonable".

40. ***Complicated Answer.*** Perhaps Alectra was confused by the wording of the Board's first question in PO#1, and didn't realize that it had to deal with the substantive decision in EB-2017-0024 that their shareholders were not going to get this windfall. Can an allegation by Alectra of an error or other grounds satisfying Rule 42 be found somewhere in the record, even though Alectra has not offered one in response to PO #1?

41. The answer to the more complicated question is also no. Alectra has, through all of this, only offered two arguments in favour of shareholders over customers:

    a) The Board's MAADs policy allows them to keep the benefits of their MAADs transaction during a deferred rebasing period, and this is one of those benefits.

    b) This is a non-cash transaction, and making the ratepayers whole means reducing the utility's cash flow.

42. In EB-2017-0024, the Board answered both of those questions fully and carefully:

    a) It was never the Board's intention that accounting changes such as this would be considered part of the "benefits" of a distributor consolidation. The shareholders are supposed to be able to keep the **efficiency** benefits for a period of time. This has nothing to do with efficiency, and is not something that is for the account of the shareholders. That, said the Board, is an incorrect interpretation of the Board's MAADs policy.

    b) While changes in capitalization policy are non-cash items, that in itself is not determinative. Whether something is a capital cost or an operating cost does have an impact on the annual cost to be charged in rates[21].

43. It is therefore clear that the Board has already made the right decision. Alectra has nothing new to say on this subject, and it is just looking for a chance to re-argue its case. It is well-known that a motion to review and vary is not an opportunity to re-argue the same things before a different panel.

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[21] The Board in EB-2017-0024 did not spend a whole lot of time analysing this second ground, perhaps because it is so obvious. Capital is recovered in rates through the combination of return on capital and return of capital (depreciation). Operating costs are recovered in rates on a dollar for dollar basis as incurred (or, more correctly, forecast). Both the timing and the mechanism for recovery change between OM&A and capital, so rates are necessarily affected. Of course they have less cash to spend if a larger amount is capitalized. It is capital, so it is supposed to be financed, not recovered immediately.

44. ***Conclusion.*** SEC therefore concludes that, even if the Board allows an extension of time, and infers Alectra's Rule 42 "submissions" from its other statements, there is no legitimate argument that the threshold test has been met.

Conclusion

45. SEC therefore answers the Board's first question as follows:

> *Alectra's request is in substance a motion under Rule 40.01 to review the Board's decision in EB-2017-0024 that a change in capitalization policy is not a benefit for the account of the shareholders, as Alectra had claimed, but the impact should instead be accounted for in amounts paid by the customers.*

46. SEC submits that, prior to answering the second question, it is necessary to deal with the question of whether an extension of time should be granted under Rule 7, and it is our view that the Board should not do so.

47. If the second question still arises, SEC would answer it as follows:

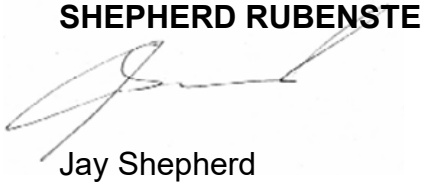
> *The threshold test is not met, because the arguments being presented by Alectra in this proceeding are the same as it made in EB-2017-0024, which were considered and rejected by the Board on the basis of sound principles and good reasoning.*

48. SEC therefore submits that the Board should proceed, in this proceeding, to answer the two remaining questions related to capitalization policy:

    a) How should the impact of the capitalization policy be calculated?
    b) What is the appropriate mechanism to use to ensure that the ratepayers are made whole in a timely, efficient, and complete manner?

All of which is respectfully submitted.

Yours very truly,
SHEPHERD RUBENSTEIN PROFESSIONAL CORPORATION



Jay Shepherd
cc: Wayne McNally, SEC (email)
Interested Parties