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November 28, 2019

BY RESS AND COURIER

Ms. Christine Long
Registrar
Ontario Energy Board
2300 Yonge Street
27th Floor, Box 2319
Toronto, ON M4P 1E4

Dear Ms. Long;

RE: EB-2019-0018 Alectra Utilities Corporation ("Alectra Utilities") – Application for Distribution Rates and Other Charges Effective January 1, 2020 – Applicant Incentive Rate-Setting Mechanism Reply Submission

Alectra Utilities Corporation ("Alectra Utilities") is the Applicant in the above-referenced proceeding. In accordance with Procedural Order No. 1, issued by the Ontario Energy Board on July 9, 2019, please find enclosed Alectra Utilities' Reply Submission in respect of the Capitalization Policy elements of the Application. The Reply Submission has been filed on RESS; a copy has also been served on all parties via email; two hard copies will follow by courier

Sincerely,

Original signed by

Indy J. Butany-DeSouza, MBA
Vice President, Regulatory Affairs
Alectra Utilities Corporation

cc: Charles Keizer, Torys LLP
Jonathan Myers, Torys LLP

IN THE MATTER OF the *Ontario Energy Board Act,* 1998, being Schedule B to the *Energy Competition Act,* 1998, S.O. 1998, c.15;

AND IN THE MATTER OF an Application by Alectra Utilities Corporation to the Ontario Energy Board for an Order or Orders approving or fixing just and reasonable rates and other service charges for the distribution of electricity as of January 1, 2020.

CAPITALIZATION POLICY REPLY SUBMISSION

November 28, 2019

1.0 INTRODUCTION

Alectra Utilities Corporation ("Alectra Utilities" or the "Applicant") filed an Incentive Rate-setting Mechanism ("IRM") application with the Ontario Energy Board ("OEB" or the "Board") on May 28, 2019, under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to its electricity distribution rates for each of its Horizon Utilities, Brampton, PowerStream, Enersource, and Guelph Hydro rate zones ("RZs") to be effective January 1, 2020 (the "Application"). In its Application, Alectra Utilities has requested that the capitalization-related deferral accounts for the Enersource, Brampton, and Horizon rate zones be closed without clearing their balances, or that their balances be disposed to Alectra Utilities.

In Procedural Order ("PO") No. 1, the Board expressed its preliminary view that these requests constitute a motion to vary pursuant to Rule 40.02 of the OEB's Rules of Practice and Procedure. However, before making a final determination on the nature of the request, the OEB had asked for submissions on "[*whether] 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, constitutes a motion to vary pursuant to Rule 40.02*."[1] Alectra Utilities filed its submission on the preliminary questions regarding capitalization policy on July 19, 2019. OEB staff, Power Workers Union ("PWU"), Building Owners and Managers Association of Greater Toronto ("BOMA"), Vulnerable Energy Consumers Coalition ("VECC"), School Energy Coalition ("SEC") and Energy Probe Research Foundation ("Energy Probe") filed their submissions on July 29, 2019. Alectra

[1] EB-2019-0018, Procedural Order No. 1, July 9, 2019, p.6.

Utilities filed its reply submission on August 9, 2019. The OEB issued its Decision and Order on September 5, 2019.

In its Decision, the OEB found that Alectra Utilities' request to reverse the outcome of the OEB's previous decision to create the capitalization policy deferral accounts can be characterized as a motion to vary that decision; it also found that Alectra Utilities' request did not meet the threshold test for such a motion.[2]

In its Decision, the OEB reiterated that its Decision on Confidentiality and PO No. 3 in Alectra Utilities' 2019 Electricity Distribution Rate Application (EB-2018-0016), required Alectra Utilities to present different options for disposition of the capitalization related deferral accounts, including, options proposed by parties in the 2018 proceeding; and options involving adjustments to rate base. Further, in its current Decision, the OEB clarified that different options could also relate to: the calculation of the balances; the distribution of the balances amongst customer classes; the billing determinants to be used; and the timing and duration for the disposition. The OEB provided Alectra Utilities with the opportunity to file additional evidence on the different options for disposition of the capitalization deferral accounts. Alectra Utilities filed its submission in respect of the different options for disposition of the capitalization policy deferral accounts on September 16, 2019.

The OEB's September 5, 2019 Decision also provided for the submission of interrogatories in respect of: the different options for disposition of the capitalization deferral accounts; the Earnings Sharing Mechanism ("ESM") for the Horizon Utilities RZ; and the Capital Investment Variance Account ("CIVA") for the Horizon Utilities RZ. OEB staff and SEC filed their interrogatories on September 23, 2019. Alectra Utilities filed its interrogatory responses on October 7, 2019.

In PO No. 4, the OEB provided for a supplementary round of interrogatories and submissions on the capitalization policy related issues. The supplementary interrogatories were limited to the following topics: i) the calculations for the capitalization policy deferral accounts using the Account 1576 methodology; and ii) identification and quantification of merger-related costs and savings; and application of these costs and savings to the Horizon Utilities RZ ESM and CIVA. Only OEB staff

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[2] EB-2019-0018, Decision and Order, September 5, 2019, p.1.

and SEC filed supplementary interrogatories on October 24, 2019. Alectra Utilities filed its supplementary interrogatory responses on October 31, 2019.

Alectra Utilities received submissions from OEB staff, VECC and SEC on November 14, 2019; additionally, EP, AMPCO and CCC indicated their support for the SEC submission. The PWU, MANA, BOMA and DRC did not file submissions related to the capitalization policy aspects of Alectra Utilities' Application. This is Alectra Utilities' Reply Submission regarding: the capitalization policy deferral accounts; ESM for the Horizon Utilities RZ and CIVA for the Horizon Utilities RZ. Alectra Utilities provides its position as set out in the evidence, and as updated during the proceeding; it then provides the submissions of intervenors, as applicable; these are followed by Alectra Utilities' reply submission.

For the reasons that follow, it is Alectra Utilities' submission that the elements relating to the capitalization policy deferral accounts and ESM and CIVA for the Horizon Utilities RZ should be approved as filed, and as updated during the proceeding.

2.0 SUMMARY OF SUBMISSIONS

Capitalization Policy: Options for Calculation

Alectra Utilities submits that its calculation of the impact of the capitalization policy change is consistent with the OEB's Decision and Partial Accounting Order, issued December 20, 2017. The Decision and Partial Accounting Order set out the accounting details and effective date for the new accounts, without including details on how the accounts will be disposed. However, the Decision made clear that the revenue requirement should be used as the basis for determining the impact of the change in capitalization policy:

> *"the three new accounts will record the difference between the revenue requirement calculated using pre-merger capitalization policies and the revenue requirement calculated with the new capitalization policy. The revenue requirement will be calculated each year based on actual OM&A, depreciation expense, income tax and PILs, and return on capital (debt and equity)."* (p.3)

In the OEB's Decision on Confidentiality and PO No. 3 in the 2019 Rate Application, the OEB determined that it will assess different options for the change in capitalization policy in Alectra Utilities' 2020 rate application. At p. 4 of the Decision, the OEB stated *"The combined balance from the capitalization deferral accounts for the Enersource and Brampton rate zones is immaterial for*

2017, and recording for the Horizon rate zone deferral account does not commence until January 1, 2020. The OEB concludes that it is reasonable to defer this issue until the 2020 rate application to facilitate consideration of a range of options."

As provided in Exhibit 2, Tab 1, Schedule 5, p.5, Table 19, Alectra Utilities provided a comparison of the calculation of the impact of the capitalization policy change, based on submissions by SEC and OEB staff during the 2019 EDR Application proceeding. Based on this assessment, Alectra Utilities updated the Payment in Lieu of Taxes ("PILs") calculation in its revenue requirement model. Alectra Utilities initially calculated PILs on an actual taxes payable basis, and has updated its calculation to determine the PILs impact on a revenue requirement basis, consistent with the OEB's PILs model.

Subsequent to the filing of the 2020 EDR Application on May 28, 2019, Alectra Utilities' Brampton, Horizon Utilities, PowerStream and Enersource rate zones, have migrated to Alectra Utilities' Enterprise Resource Planning ("ERP") system in July 2019. Legacy ERP systems and processes were relied upon to determine the impact of the capitalization policy change in 2017 and 2018. As these legacy systems are no longer in place, and due to the complexities and costs required to maintain four additional sets of general ledgers, Alectra Utilities can no longer determine the impact based on legacy systems. Alectra Utilities proposes to rely on the actual impacts derived prior to the ERP convergence to determine the actual impacts of the capitalization policy change in 2019, and the remainder of the rebasing deferral period.

The forecast impacts (2019 to 2026) presented in Table 20 of Exhibit 2, Tab 1, Schedule 5, p.7, was also based on the preliminary impacts identified in Alectra Utilities' Capitalization Policy Memo, filed in response to undertaking JT.2.32 in the 2018 EDR Application (EB-2017-0024).

Alectra Utilities proposes to determine the allocation percentage by rate zone to be applied to 2019 to 2026 distribution system plant actual in-service additions based on a ratio of the actual impact of the capitalization policy change prior to the ERP convergence, to actual in-service distribution system plant additions.

Alectra Utilities provided an updated forecast of the capitalization policy impact for each of its rate zones over the rebasing deferral period in response to capitalization policy interrogatory G-Staff-3. This analysis includes actuals for 2017 and 2018 and forecasts impacts for 2019 to 2026 based on the proposed allocation methodology.

Capitalization Policy: Options for Disposition

Consistent with the guidance in the OEB's June 25, 2013 letter, *Accounting Policy Changes for Accounts 1575 and 1576,* the disposition of the balances in the capitalization policy deferral accounts will be based on rate riders for each rate zone. Alectra Utilities recommends a one-year disposition period, at the end of rebasing deferral period. The forecasted balances in the accounts is expected to range from $1.8MM to $17MM by the end of the rebasing deferral period. In Alectra Utilities' 2018 EDR Application, the Group 1 balances approved for disposition over a one-year period ranged from $7MM to $22MM. Therefore, a one-year disposition period is reasonable for the balances in the capitalization policy-related deferral accounts.

Impact of IFRS 16

As demonstrated in response to capitalization policy interrogatory G-Staff-1, Alectra Utilities has shown that that the impacts from the implementation IFRS 16 are immaterial and have no bearing on future rates at rebasing. Alectra Utilities' total lease is comprised of building leases, the most recent of which commenced in 2011, and Alectra Utilities confirms it does not intend to enter into any new capital leases during the planning period. Alectra Utilities notes also that all current capital leases will be fully amortized by the end of 2025. For these reasons, Alectra Utilities should not be required to file additional details in its 2021 rate application, nor should it be required to establish deferral accounts to track the impact.

Horizon Utilities RZ ESM

Alectra Utilities reported on its ESM results for 2017 and 2018 for the Horizon Utilities RZ, as provided in Exhibit 3, Tab 1, Schedule 2. In the OEB's Decision in Alectra Utilities' 2018 EDR Application (EB-2017-0024), issued on April 5, 2018 (revised April 6, 2018), the OEB stated that:

> "*The approved settlement proposal did not specify how a material change in accounting practice would be treated, just that it would be noted. The approved settlement proposal was a "package deal" which the OEB approved. The approved settlement proposal did not include mandated accounting changes as a reopener, and therefore the OEB will not approve one now. For the remainder of the Custom IR term, the effect on earnings resulting from the change in the capitalization policy will be dealt with through the ESM.*" (p. 81)

As directed in the above-mentioned Decision, Alectra Utilities has flowed the impact of the capitalization policy change through the ESM for the Horizon Utilities RZ for 2017 and 2018. Further, in Alectra Utilities' 2021 EDR Application, Alectra Utilities will report on the ESM results for the Horizon Utilities RZ for 2019; Alectra Utilities will flow the impact the capitalization policy change through the ESM for 2019. This will be the fifth and final year of the ESM for the Horizon Utilities. As a result, and consistent with the OEB's Decision in EB-2017-0024, the first entry to the capitalization deferral accounts for the Horizon Utilities RZ will begin January 1, 2020.

Alectra Utilities tracks and validates its OM&A costs; Alectra Utilities is confident that its reported OM&A merger related costs and synergies represent accurate estimates. Alectra Utilities' 2017 OM&A costs were 11.5% higher than 2016 OM&A[3], driven by one-time costs, the introduction of the OEB's mandated monthly billing requirement for residential customers and general inflation. The 2015 and 2016 OM&A increases were lower than normal as a result of the pending merger. Providing information to support additional meaningful costs drivers would require an extensive amount of time and effort to complete, as the predecessor utilities operated separate ERP systems with different account formats and different ways of charging OM&A costs.

OEB staff's alternative approach is arbitrary and suggests that merger tracking of OM&A is not required as the figures can simply be developed by inflating the previous year OM&A by inflation. Alectra Utilities submits that the OM&A merger costs and savings are accurate estimates that must be relied on for the purposes of the ESM calculation.

Cost allocation ensures that costs are allocated on an appropriate basis. Alectra Utilities analyzed each cost category to be allocated to ensure an appropriate cost allocation approach was relied on. Alectra Utilities' proposal to rely on the pre-merger three-year average OM&A allocation is appropriate, as this approach accurately addresses the concerns related to anomalies of the 2016 actual OM&A results, implicitly includes a growth rate, and appropriately incorporates the pre-merger relative differences in OM&A costs to serve across the rate zones. Alectra Utilities relied on single year of allocations for general plant additions, general plant depreciation and merger capital net savings, as these cost categories are the accumulation of multiple prior year capital investments and are not subject to material variations on a year-over-year basis as compared to OM&A costs.

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[3] HRZ-Staff 1a)

Alectra Utilities submits that the ESM calculation should be approved as filed and updated through the proceeding, which represents a refund to ratepayers of $1.3MM for 2017 and $nil for 2018.

Horizon Utilities RZ CIVA

Alectra Utilities submits that it is appropriate to determine the capital additions for the CIVA based on the post amalgamation capitalization policy. As the impact of the capitalization policy change is captured through the ESM for the Horizon Utilities RZ, determining the CIVA using the pre-merger capitalization policy would result in the same capital investment variance being the basis for a refund or recovery from customers through both the ESM and the CIVA. The revenue requirement impacts from a capital variance should only be calculated once using a consistent method and not lead to the doubling of variance account treatment because of methodological differences.

Alectra Utilities also reported on the capital additions for 2017 and 2018 for the Horizon Utilities RZ, as provided in Exhibit 3, Tab 1, Schedule 3. In the 2019 EDR Application Decision (EB-2018-0016), the OEB stated that: "*The change in the capitalization policy increases the in-service capital additions for the same amount of capital work to implement the strategy. The question for the OEB is whether the capital additions for the CIVA account should be based on the capitalization policy in place at the time the Custom IR framework for the Horizon rate zone was approved, or the new post-merger capitalization policy for Alectra Utilities*."

Further, consistent with its Decision on the impact of the capitalization policy change on the ESM for Horizon Utilities, the OEB stated: "*The OEB finds that it is appropriate to defer consideration of the actual 2017 capital additions to be used for the final computation of the CIVA account until the application for 2020 rates. The OEB has previously determined that other issues related to the change in capitalization policy will be heard in the same 2020 rate proceeding*."

The capital additions presented for 2017 and 2018 are inclusive of the capitalization policy change that was a result of the consolidation that formed Alectra Utilities. Alectra Utilities is applying the impact of the capitalization policy change consistently, both in its computation of the Horizon Utilities RZ ESM per the OEB's decision in the 2018 EDR Application (EB-2017-0024), and in its statement of capital additions in 2017 and 2018.

3.0 CAPITALIZATION POLICY DEFERRAL ACCOUNTS

Background

Alectra Utilities conformed its capitalization policy in 2017 (as a result of the consolidation through which Alectra Utilities was formed, and as required under the International Financial Reporting Standards ("IFRS")) to align the capitalization policies for the Alectra Utilities rate zones.
IFRS 10 *Consolidated Financial Statements,* states that uniform accounting policies have to be adopted for like transactions in a group of companies. Further, IFRS 3 *Business Combinations* prescribes that the accounting policies of the parties to the merger should align to the acquirer's policy.

For the predecessor companies that formed Alectra Utilities, PowerStream is the acquirer in accordance with IFRS 3 and IFRS 10. Consequently, Alectra Utilities adopted the PowerStream capitalization policy.

During the 2018 EDR Application proceeding (EB-2017-0024), in PO No. 3, the OEB established three new deferral accounts to track the change in capitalization policy for the Horizon Utilities, Enersource and Brampton RZs. In the 2018 EDR Application Decision, the OEB stated that:

> *"For the remainder of the Custom IR term, the effect on earnings resulting from the change in the capitalization policy will be dealt with through the ESM. Once the Custom IR term ends, the Horizon Utilities RZ will move to Price Cap IR per the MAADs policy, and it will be treated consistently with the Brampton and Enersource RZs. Alectra Utilities shall retain the deferral account opened for Horizon Utilities RZ, however, the first entries to the account shall begin January 1, 2020. The Brampton and Enersource RZs are on Price Cap IR. For these rates zones, the OEB finds it appropriate to retain the balances recorded in the deferral accounts approved in the Decision and Partial Accounting Order effective February 1, 2017."*

Further, the OEB stated that:

> *"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."*[4]

[4] EB-2017-0024 pg. 81

During the 2019 EDR Application proceeding (EB-2018-0016), in PO No. 3, the OEB deferred the capitalization policy issue, of calculating the capitalization impact for purposes of recording balances in the capitalization deferral accounts, to Alectra Utilities' 2020 EDR Application, and directed Alectra Utilities to file a forecast to the end of the deferred rebasing period for all options provided for the Enersource, Brampton and Horizon Utilities rate zones.

Alectra Utilities calculated the revenue requirement impact of the change in capitalization policy for each of its rate zones. The net impact of the capitalization policy change should include 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; and
- The annual return on the cumulative impact from the annual change in capitalization.

Submissions of the Parties

<u>Calculation of the capitalization policy balances</u>

OEB staff's Submission

i. In OEB staff's view, there are two distinct, viable methodologies that can be used with respect to the calculation of the balances in the capitalization deferral accounts: the revenue requirement approach and the adjustment to rate base approach (also known as the 1576 approach) (p.8).

ii. Both OEB staff and SEC submit that the capitalization deferral accounts should be calculated in accordance with the 1576 approach.

iii. OEB staff submits that with respect to solving the problem of double counting, the revenue requirement approach asks: how do current rates need to be realigned to the revised classifications of capital and operating costs? Alternatively, the 1576 approach asks: What is the cumulative net impact on rate base at the time of rebasing resulting from the revised classifications of capital and operating costs?

iv. OEB staff submits that the revenue requirement perspective essentially suggests that, since the utility is rebasing the reclassified capital, it is now entitled to earn a return on that capital, effective the year of the capitalization policy change. The utility is then also entitled to earn a return on the undepreciated capital that is brought forth for disposition in a future rate application. OEB staff submits that a utility should not be entitled to earn a return on capital that has been reclassified from OM&A. These are not incremental capital costs, but rather, converted operating expenses. Alectra Utilities has acknowledged that these are non-cash events. (p.11)

v. OEB staff agrees that Alectra Utilities' proposed method is one option for calculating the effects of changes in accounting policies during a deferred rebasing period. OEB staff also agrees that Alectra Utilities' calculations under the proposed revenue requirement adjustment approach are correct (p.13).

SEC Submission

i. SEC disagrees with both the OEB and Alectra Utilities, arguing that Alectra Utilities' proposed "utility-centric" method is wrong. SEC implies that this approach is akin to using the assumption of cost of services, while Alectra Utilities is not in cost of service. SEC states that when the Board adjusts for accounting changes, it does so to keep the customer whole, not the utility.

Alectra Utilities' Submission

The OEB's Decision and Partial Accounting Order, issued December 20, 2017, indicated that the revenue requirement approach was the basis for determining the capitalization policy impact:

> *"[T]he three new accounts will record the difference between the <u>revenue requirement</u> calculated using pre-merger capitalization policies and the revenue requirement calculated with the new capitalization policy. The revenue requirement will be calculated each year based on actual OM&A, depreciation expense, income tax and PILs, and return on capital (debt and equity)."* (p.3, emphasis added)

Further, the OEB stated that *"Alectra Utilities shall maintain records to show its <u>calculations for the revenue requirement</u> for each rate zone to at least the level of detail provided in Table 1 of the undertaking JTStaff-7."* (emphasis added, p.3)

Thus, at present, only the mechanics of the calculation should be subject to argument, and not the basis of the calculation. The OEB made clear above that the basis is revenue requirement. Requests and submissions from intervenors to the contrary should be considered a motion to vary, as per OEB's September 5, 2019 Decision and Order regarding capitalization policy.

OEB staff and SEC argue that the 1576 approach is based on established OEB rules. SEC states that:

> *"The Applicant's various approaches over the 2018, 2019 and current proceedings have been based on the erroneous assumption that they must do a cost of service calculation, in order to recalculate the revenues the utility should have received. This utility-centric approach is wrong. The Board adjusts for accounting changes, not to make the utility whole, but to make the customers whole."*

SEC is effectively arguing that the OEB will choose not to take a fair and balanced approach to rate making, disregarding the keystone principle of establishing just and reasonable rates. SEC has mischaracterized the issue in suggesting that the OEB faces a choice between holding the utility whole or holding customer whole. This statement demonstrates a fundamentally flawed understanding of the utility rate setting principles that have guided regulators for more than half a century. Utilities are "held whole" by setting rates that provide them a reasonable opportunity to recover prudently incurred costs, including the permitted return on equity. The concept of holding the utility whole applies in two directions: rates should not be designed so as to result in either under-recovery or over-recovery of costs. Hence, by definition, rates that are just and reasonable will not only hold the utility whole but must necessarily hold the customers whole. The only circumstance in which approved rates would not hold customers whole (i.e., over-charge them) would be if the rates were designed to over-recover the utility's prudently incurred costs. It appears to Alectra Utilities that SEC's argument is based on the self-interested notion that customers will not be held whole if the Board were to determine that a cost that SEC wants disallowed were deemed by the OEB to be prudent and recoverable. It follows that the OEB's decision rests simply on the question of which approach to determining the capitalization policy impact most accurately reflects the impact that should be recoverable in order to "hold whole" both customers and the utility.

OEB staff acknowledges that there are two viable approaches to calculating the impact of the capitalization policy change. The OEB also reviewed Alectra Utilities' calculation and agrees that the amounts have been correctly reflected under the revenue requirement approach.

OEB staff's view is that there are two distinct, viable methodologies that can be used with respect to the calculation of the balances in the capitalization deferral accounts, as follows: (i) the revenue requirement approach focuses on the realignment of current rates to reflect the reclassifications of capital and operating costs; and (ii) the 1576 approach considers the net impact on future rates at the time of rebasing.

In the OEB's December 20, 2017 Decision and Partial Accounting Order, the OEB states in its description of the accounting details for the new accounts, at p. 1:

> *"The revenue requirement will be calculated based on actual costs each year for operations, maintenance and operating costs (OM&A), depreciation expense, income tax or payments in lieu of taxes (PILs), and return on capital (debt and equity)".*

The December 20, 2017 Decision and Partial Accounting Order also focuses on capturing, tracking and recording the actual annual impact of this change. Based on this, and the fact that the Accounting Order specifies that Alectra Utilities record the revenue requirement impact, it follows that all elements of the calculation, <u>including</u> the return on equity, must be factored into the calculation. As stated in the response to the supplementary interrogatory G-Staff-6, to ensure that the impact results in a fair, balanced and principled approach, Alectra Utilities' calculation ensures that the full impact to OM&A is refunded (dollar for dollar) to customers. This is partially offset by (i) increased depreciation expense which is not being recovered in rates; (ii) a return on rate base that Alectra Utilities is not earning during the rebasing deferral period as this capital cannot be added to rate base; and (iii) a minimal impact to PILs. If the capitalization policy change would have been in place at the time of each legacy utilities' rebasing applications, each legacy utility would have been earning a higher return on rate base and OM&A would have been lower. As a result, Alectra Utilities should (consistent with its proposal) refund the OM&A impact to customers. In order to ensure a fair and balanced approach to the calculation of the impact, the calculation must also account for the return that is not added to rate base in each year. Not only is Alectra Utilities not able to include the lost return of the additional capital in each incremental year, but the return in a prior year is also not earned in each subsequent year. Consequently, the impact and the return must be calculated on the cumulative capital, consistent with the itemization of the impact presented in JT Staff-7 in the 2018 rate proceeding.

OEB staff relies on the fact that *"Alectra Utilities has acknowledged that these are non-cash events"* to argue that Alectra Utilities should not be entitled to earn a return on capital. In its April 6, 2018

Decision and Order in EB-2017-0024, the OEB agreed with Alectra Utilities that the change in capitalization policy was a non-cash event. The Board found as follows, at p. 79-80:

> *"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 utility business.' 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."*

It is precisely because the change in capitalization policy was a "non-cash event" that it should not result in net-negative cash consequences to Alectra Utilities. As the OEB found above, the change in capitalization policy had no impact on Alectra Utilities' cashflow. Yet the OEB's decision to order the use of capitalization-related deferral accounts transformed this non-cash event into a cash event by reducing Alectra Utilities' revenue by the amount required to be recorded in the deferral accounts and distributed to customers. The direct consequence of this decision was to immediately reduce the annual funding for distribution-related activities over the 10-year rebasing deferral period. As a result, Alectra Utilities suffers as a cash impairment from what was supposed to be a non-cash event. The 1576 approach would exacerbate this by penalizing Alectra Utilities' cashflow twice: first by reducing revenue through the use of deferral accounts, and second by denying Alectra Utilities the opportunity to earn a return on capital that has been reclassified from OM&A. This approach also fails to acknowledge that, had the new capitalization policy been in place at the time of rebasing for each legacy utility, Alectra Utilities would be earning a return on this capital. Regardless of how the expenditure is characterized – either as capital or OM&A – the funds were expended. The change in capitalization may not cause cash to be spent, but cash already spent and treated as capital should be eligible to earn a return. Otherwise, the ratepayers are earning the benefit for capital for which no cost is incurred. This results in the subsidization of the ratepayer.

Penalizing Alectra Utilities' cashflow twice, especially when this would not have occurred with respect to the legacy utilities, is not a fair and balanced approach, nor is it inconsistent with the notion that the change in capitalization policy is a non-cash event. If it is truly a non-cash event, then the negative cashflow consequences to Alectra Utilities should naturally be offset by the annual return on cumulative capital, which can only be added to a distributor's rate base at rebasing.

Alectra Utilities submits that the central question facing the OEB on this matter is whether the accounting changes resulting from merger should be addressed in the same manner as the accounting changes that resulted from the transition to IFRS. If the OEB accepts that the consequences of the accounting changes resulting from the merger are the same as the consequences of the accounting changes resulting from the transition to IFRS, which is the position of Alectra Utilities, then it follows that the OEB's decision regarding the calculation of the capital policy changes should be based on the merits of the options, not by adherence to a "precedent" that was established in an entirely different circumstance.

In Alectra Utilities' view, the arguments of OEB staff and SEC rest on the assumption that the consequences of the capitalization policy changes that have resulted from the merger should be treated in the same manner as the consequences of the transition to IFRS. Alectra Utilities disagrees. The transition to IFRS was a mandatory and one-time event; hence, the method used could have no impact on future decisions of utility management. In contrast, the OEB's decision with respect to the treatment of accounting changes that result from a merger will establish a precedent that will be a consideration in future merger decisions. Merging parties will inevitably have to consider the OEB's decision in this case in making decisions and undertaking valuations when future mergers are considered. For this reason, it is particularly important to ensure that the utility (and, by implication, customers) are held whole by allowing for full recovery of prudently incurred costs. The OEB should not simply adopt the approach used for the capitalization policy consequences of the transition to IFRS, but should ensure that it makes a decision based on the merits of the arguments in the current circumstances. By doing so, it will not tilt the playing field against future mergers.

The revenue requirement approach is equitable and principled basis for future decision-making. It allows for full recovery of costs without any gain or loss for either the utility or its customers relative to the no-merger scenario. As explained in response to the supplementary interrogatory G-Staff-6, had the capitalization policy change been in place at the time of each legacy utility's rebasing applications, Alectra Utilities would be earning a higher return on its rate base and OM&A would have been lower. The revenue requirement approach reflects this by ensuring, on the one hand, that the full impact to OM&A is refunded to customers and, on the other hand, that Alectra Utilities earns an annual return on cumulative capital to account for the return that is not added to rate base each year. This ensures that the impact of the capitalization policy change is not recovered from customers twice in rates (once through OM&A and again through capital), while also ensuring that the cash position of the utility is not unduly penalized by a "non-cash event."

On the other hand, if the OEB finds that the MAADs-related accounting changes are indistinguishable from the transition to IFRS-related accounting changes, then consistent treatment would imply that the 1576 approach should be applied only to the normal rebasing period, which corresponds to the applicability of the 1576 approach. It would artificially and unjustly penalize Alectra Utilities to intertwine the 1576 approach for the transition to IFRS and the treatment of Alectra Utilities' merger-related accounting changes with the result that the impacts of the capitalization policy changes would apply beyond the normal rebasing term. The rationale for extending the rebasing term to 10 years due to the merger is not a just rationale for failing to recognize cost recovery in rates amounts that would have been accepted under the rebasing regime that would have prevailed in the absence of the merger. Clearly, cost recognized in the 2022-2026 period would have been included in rates but for the merger. Disallowing these costs as a result of adopting an extended period before rebasing would be inconsistent with the rationale for the extended period before rebasing, which is simply to enable the merged utility to benefit from pursuing efficiency gains more aggressively and for more years. Denying costs that would otherwise be recognized undermines the goal of encouraging Ontario electricity distributors to merge in cases where efficiency gains are expected. Any treatment that results in financial losses as a direct result of a merger will discourage efforts to rationalize the sector.

<u>Nature, timing and duration of disposition</u>

OEB staff's Submission

i. OEB staff agrees with Alectra Utilities' proposal to dispose of the capitalization account balances using rate riders in each rate zone. In accordance with the OEB's rationale presented in the OEB's 2013 letter, disposing balances via rate riders provides for greater flexibility, as the clearance of the accounts is independent of the length of the subsequent rate-setting term. However, OEB staff shares the concerns raised by the OEB about delaying disposition and submits that the account balances should be disposed of on an annual basis.

ii. OEB staff notes that, in the event that the OEB approves disposition of any of the capitalization policy deferral account balances in this proceeding, Alectra Utilities has not made a proposal on how it would allocate balances in the capitalization policy deferral accounts to the various rate classes and the billing determinants that it would propose to utilize. Alectra Utilities may choose to confirm, in its reply submission, that the cost allocations and rate design for balances in these accounts would be consistent with its proposal in the 2019 rate proceeding. OEB staff supports the proposed included in the 2019 proceeding.

iii. OEB staff suggests that the OEB direct Alectra Utilities provide a draft accounting order at the Draft Rate Order stage of this proceeding, for the purposes of the OEB's review in approving this deferral account.

Alectra Utilities' Submission

As provided in response to capitalization policy interrogatory G-Staff-3, Alectra Utilities reviewed the OEB's policy regarding the disposition of balances in Accounts 1575 and 1576. For 2013 rebasing applications, the OEB's Appendix 2-EA specified that the impact would be included as an adjustment to revenue requirement on rebasing.

On June 25, 2013, the OEB issued its letter, *Accounting Policy Changes for Accounts 1575 and 1576,* to inform distributors of the accounting policy changes to Accounts 1575 and 1576 with respect to the disposition of these account balances for the 2014 cost of service rate applications and subsequent rate years. At p. 2 of the Letter, the OEB states:

> "*The Board's policy for Accounts 1575 and 1576 requires the dispositions of these account balances in rates to be applied through adjustments to the revenue requirement in the cost of service rate applications. The recoveries or refunds arising from the disposition of these balances were usually set for a period of four years to align with the rate-setting cycle. Due to the changes arising from the Renewed Regulatory Framework for Electricity, which provides distributors with rate application filing options, i.e., 4th Generation Incentive Rate-Setting ("IR"), Custom IR and Annual IR Index, there will be different rate-setting cycles for distributors depending on the option selected. As a result, the Board will require the use of separate rate riders for the disposition of these account balances to permit greater flexibility, effective for the 2014 cost of service rate applications and subsequent rate years.*"

Consistent with this guidance, the disposition of the balances in the capitalization policy deferral accounts will be based on rate riders for each rate zone.

Alectra Utilities recommends a one-year disposition period, at the end of rebasing deferral period. As identified in response to capitalization policy supplementary interrogatory G-Staff-8, the forecasted balances in the accounts is expected to range from $1.8MM to $17MM by the end of the rebasing deferral period. In Alectra Utilities' 2018 EDR Application, the Group 1 balances approved for disposition over a one-year period ranged from $7MM to $22MM. Therefore, a one-year disposition period is reasonable for the balances in the capitalization policy-related deferral accounts. OEB staff shares the concerns raised by the OEB about delaying disposition and submits that the account balances should be disposed of on an annual basis. However, as Alectra Utilities identified above, the forecasted balances over the rebasing deferral period are comparable in size to Group 1 balances on an annual basis, for which no rate mitigation has been required by any of Alectra Utilities' rate zones. Therefore, Alectra Utilities submits that the balances be disposed of at the end of the rebasing deferral period. If the OEB decides that delaying disposition of the balances may impact customers, Alectra Utilities proposes that the balances be disposed of on a five-year cycle, consistent with the disposition of Group 2 balances and in line with the OEB staff submission in the Alectra Utilities MAADs December 8, 2016 Decision and Order (EB-2016-0025) at p. 27.

> *"Group 2 accounts should be cleared at least every five years, as would be the case for a nonconsolidating distributor on the Price Cap IR rate-setting option and that this can be done through a stand-alone application."*

<u>Tracking of capitalization policy impacts</u>

OEB staff's Submission

i. OEB staff suggests that the OEB direct Alectra Utilities provide a draft accounting order at the Draft Rate Order stage of this proceeding, for the purposes of the OEB's review in approving this deferral account.

ii. OEB staff submits that an allocation methodology based on best available data prior to the ERP convergence is a reasonable approach to proxy the actual impacts. OEB staff also agrees with Alectra Utilities that running four separate accounting systems simply for this purpose would be a costly and wasteful endeavor, and doing so would inhibit the genuine synergies to be realized from aligning ERP systems.

iii. OEB staff submits that the allocation methodology proposed by Alectra Utilities should be tested on its own merits in Alectra Utilities' 2021 rate application.

SEC's Submission

iv. SEC submits that the Applicant, knowing that the Board was concerned about this issue, should not have taken any steps that would prevent it from complying with any Board order as to the capitalization policy change. SEC therefore submits that the Applicant should be ordered to maintain proper records of the capitalization impact in each year (i.e. the difference in the amounts capitalized under old and new accounting policies) and file the results and calculations with the Board, for information purposes, in their annual rate cases during the deferred rebasing period.

Alectra Utilities' Submission

As identified in Alectra Utilities' Capitalization Policy submission, filed September 16, 2019, the BRZ, HRZ, PRZ, and ERZ rate zones, have migrated to Alectra Utilities' Enterprise Resource Planning ("ERP") system in July 2019. Legacy ERP systems and processes were relied upon to determine the impact of the capitalization policy change in 2017 and 2018. As these legacy systems are no longer in place, and due to the complexities and costs required to maintain four additional sets of general ledgers, Alectra Utilities can no longer determine the impact based on legacy systems.

Further, consistent with the OEB's findings in the MAADs Decision (EB-2016-0025) with respect to reporting requirements for the utility, at p. 26 the OEB stated that "*the Handbook to Electricity Distributor and Transmitter Consolidation sets out that having consolidating entities operate as one entity as soon as possible after the transaction is in the best interest of consumers. The OEB is of the view that this principle continues to be applicable in this case. The OEB does not require, nor encourage reporting on a "separate" utility basis.*"

Alectra Utilities has used the actual impacts derived prior to the ERP convergence (2017 and 2018) as a proxy to calculate the actual impacts of the capitalization policy change in 2019, and the remainder of the rebasing deferral period.

Alectra Utilities agrees with OEB staff that the allocation methodology proposed by Alectra Utilities should be tested in Alectra Utilities' 2021 rate application.

Alectra Utilities submits that SEC's position that the Applicant should be ordered to maintain proper records of the capitalization impact in each year (i.e., the difference in the amounts capitalized under old and new accounting policies) and file the results and calculations with the Board, for information purposes, in their annual rate cases during the deferred rebasing period would result in Alectra Utilities being arbitrarily and unnecessarily penalized for undertaking the merger by being denied the opportunity to undertake prudent efficiency gains consistent with expectation of the

OEB's policies related to MAADs applications. To be denied the opportunity to reduce ERP system costs for the full period to the next rebasing (2026) would deny Alectra Utilities the opportunity to recoup its initial merger-related costs through expected efficiency gains. The position of OEB staff reflects the responsible and pragmatic position that an allocation methodology based on the best available data, while being less precise, honours the goal of pursuing greater operating efficiency through mergers.

4.0 IFRS 16, LEASES

Background

IFRS 16 establishes the principles for the recognition, measurement, presentation and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that represents those transactions. The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between the operating and finance leases. Short term leases, which are defined as those that have a lease term of 12 months or less and leases of low-value assets are exempt. Under the new standard, a lessee recognizes a right of use asset and a lease liability. The right of use asset is depreciated, similar to other non- financial assets and the liability accrues interest. The lease liability is initially measured as the present value of the lease payments over the lease term, discounted at the rate implicit in the lease.

Alectra Utilities adopted IFRS 16 effective January 1, 2019. The key change resulting from the new standard is that all operating leases previously recognized on the income statement as a lease expense will be recognized on the balance sheet as a lease liability with an offsetting right of use lease asset, and depreciation and interest expense recognized on the income statement. Further, the lease liability is reduced by the lease payments made, net of accrued interest; the right of use lease asset is depreciated in accordance with IAS 16, Property Plant and Equipment; both the asset and liability are fully reduced by 2025.

Submissions of the Parties

OEB staff's Submission

i. Both OEB staff and SEC notes that the analysis prepared by Alectra Utilities appears to capture only the impact of the "implementation of IFRS 16" which considered the "operating leases previously recognized on the income statement." Therefore, the OEB staff suggests that Alectra Utilities confirm the underlying assumptions of its analysis in its reply submission.

ii. OEB staff and SEC submit that the OEB direct Alectra Utilities to provide further details on the impact of IFRS 16 in its pre-filed evidence in its 2021 rate application, including the rate base impacts and revenue requirement impacts inclusive of future, newly capitalized leases.

iii. OEB staff submits that if Alectra Utilities concludes that the IFRS 16 impact table requires no revisions, then it shall provide detailed explanations for how it determined that no future leases will be entered into over the deferred rebasing period that will be impacted by IFRS 16. OEB staff also submits that the OEB should establish a deferral account for Alectra Utilities to capture the cumulative impacts of IFRS 16 over the deferred rebasing period.

iv. In OEB staff's view, Alectra Utilities' has not provided sufficient evidence to demonstrate that the cumulative net impact over the deferred rebasing period from the adoption of IFRS 16 is, in fact, immaterial.

SEC's Submission

v. SEC submits that it is not clear on the evidence that the lifecycle cost of these operating leases is the same treated as OM&A as it will be under IFRS 16.

Alectra Utilities' Submission

Alectra Utilities' leases are comprised almost entirely by building leases. These building leases include the leases for Alectra Utilities' Mavis building and Jane Street building—which commenced in 2008 and 2011, respectively, and are both treated as operating leases under IAS 17—and the Addiscott building which commenced in 2008 and was treated as a finance lease under IAS 17. Alectra Utilities has not entered into any new leases since 2011 and does not intend to obtain new leases over the course of planning period.

Under IFRS 16, in the transition year, the lease liability is calculated on the transition date. The lease liability is the net present value of the lease payments discounted using the rate implicit in the lease; if that rate is not readily available then the corporation's incremental borrowing rate is used, which Alectra Utilities has done. The right-of-use asset is initially equal to the lease liability and adjusted for any prepayments or initial direct costs. Subsequently, the right-of-use asset is amortized over the lease term. Interest is calculated on the lease liability, and the payments are applied against the liability balance. Over the life of the lease there is no difference in the total cost of depreciation and interest expense under IFRS 16 compared with the total rent expense under IAS 17. The annual differences between IFRS 16 and IAS 17 are timing related only.

Alectra Utilities maintains that the analysis in interrogatory response, G-Staff-1 is correct and reflects these assumptions and accounting guidelines, demonstrating that the net income statement impact is immaterial, and that the leases in question will be fully amortized by the end of 2025. As a result of this information, Alectra Utilities submits that the impacts are solely timing-based in nature and have no bearing on future rates at rebasing. Therefore, Alectra Utilities should not be required to file additional details in its 2021 rate application, nor should it be required to establish deferral accounts to track the impact.

5.0 HORIZON UTILITIES RZ ESM

Background

Alectra Utilities reports on its ESM results for 2017 and 2018 for the Horizon Utilities RZ. The regulatory net income and ROE have been calculated in accordance with the Settlement Agreement.

Alectra Utilities moved quickly to operate and report as one company in 2017, consistent with the OEB's direction in the MAADs decision. Alectra Utilities is able to track distribution revenue and the majority of other revenues and certain costs by rate zone. However, operating costs, general plant, taxes and other costs cannot be attributed to a specific rate zone, and therefore requires an allocation methodology to allocate costs and revenues to rate zones for the purpose of the ESM calculation. The supporting details for the ESM calculation including the related cost category and allocation methodology are provided in Exhibit 3, Tab 1, Schedule 2 of the pre-filed evidence. Further evidence was provided in response to interrogatories HRZ-Staff 1, 2, 3, 6, 7,17 and 24.

In the OEB's Decision in Alectra Utilities' 2018 EDR Application (EB-2017-0024), issued on April 5, 2018 (revised April 6, 2018), the OEB stated that: "*For the remainder of the Custom IR term, the effect on earnings resulting from the change in the capitalization policy will be dealt with through the ESM."* The treatment of the impact of the capitalization change has evolved during Alectra Utilities' 2018 and 2019 EDR proceedings. During the 2019 EDR Application proceeding (EB-2018-0016), in PO No. 3, the OEB deferred the capitalization policy issue to Alectra Utilities' 2020 EDR Application. The PO also provided for an oral hearing that was convened on December 5 and 6, 2018 to address the York Region Rapid Transit ("YRRT") Incremental Capital Module ("ICM") project and the Earnings Sharing Mechanism ("ESM") for the Horizon Utilities Rate Zone ("RZ"). Alectra Utilities and the Parties reached a Settlement Agreement on the ESM for the Horizon Utilities RZ. The Parties agreed that the allocation of costs between Alectra Utilities' rate zones to determine the Horizon Utilities RZ ESM for 2017; and the interaction between the calculation and the change in capitalization policy, should be deferred to the 2020 EDR Application proceeding. Further details on the impact of the capitalization policy change, is discussed below.

As directed by the OEB in its Decision, the impact of the capitalization policy change has been addressed through the ESM.

Submissions of the Parties

OEB staff's Submission

i. OEB staff supports Alectra Utilities' proposed treatment to flow the impacts of the changes in accounting policy through the ESM. In OEB staff's view, the OEB was explicit in the 2018 rate application Decision and Order as to how the capitalization policy impacts should be dealt with in the Horizon RZ during the duration of the Custom IR term. SEC submits that the ESM should be calculated as if the accounting policy change had not been made.

ii. OEB staff agrees that merger-related activity should be excluded for the purposes of ESM and accepts Alectra Utilities' determination of merger-related capital savings and transition costs. (p.21)

iii. OEB staff does not support Alectra Utilities' reported figures of merger-related OM&A savings (costs). OEB staff proposes an alternative approach to determining the OM&A figures that includes escalating actual 2016 OM&A figures by the actual historical average annual increase over the previous five years. This will be compared to actuals and the resulting differential will be merger-related. (p.22; p.25)

iv. OEB staff agrees with Alectra Utilities' proposed allocations of general plant capital additions and general plant depreciation expense. OEB staff does not, however, agree with the use of a 2014 to 2016 average OM&A figure as the allocator for OM&A and certain allocations within

PILs. OEB staff submits that 2016 OM&A (and related PILs impacts) should be used as the allocator (p.28)

Alectra Utilities' Submission

i. Alectra Utilities' agrees with OEB staff's submission regarding the proposed treatment to flow the impacts of the changes in accounting policy through the ESM. The OEB was explicit in the 2018 rate application Decision and Order as to how the capitalization policy impacts should be dealt with in the Horizon RZ during the duration of the Custom IR term. Alectra Utilities has followed the OEB's direction to flow the impacts of the changes in accounting policy through the Horizon ESM. Alectra Utilities disagrees with SEC's submission that the ESM should be calculated as if the accounting policy change had not been made. This is contrary to the OEB's decision.

ii. Alectra Utilities agrees with OEB staff's submission that merger-related activity should be excluded for the purposes of ESM. Alectra Utilities agrees with OEB staff's submission in the determination of merger-related capital savings and transition costs. OEB staff states, "*OEB staff is satisfied with the evidence provided with respect to estimating the capital-related merger savings used for the purposes of ESM.*"

iii. Alectra Utilities disagrees with OEB staff's submission in the determination of merger-related OM&A savings and transition costs. OEB staff states, "there is a high probability that Alectra Utilities has overstated its merger-related savings and/or understated its merger-related costs with respect to OM&A for both 2017 and 2018." (p.22)

OEB staff draws an incorrect conclusion based on the lack of information provided to support the OM&A increase from the total 2016 legacy utilities OM&A to the actual 2017 Alectra Utilities OM&A.

Alectra Utilities explained the challenges in developing an adequate comparison of OM&A cost drivers from 2016 to 2017. In the response to HRZ-Staff 1.c, Alectra Utilities stated:

> *"Each of Alectra Utilities' predecessor utilities operated separate Enterprise Resource Systems with different charts of accounts and different ways of charging costs. For example, in some legacy utilities, software licensing costs were all charged centrally*

to Information Technology ("IT") while in others they were decentralized. As a result, there is no simple way to combine the financial results of the legacy utilities and provide meaningful variance analysis. The account structures and treatment of costs were completely different. After the creation of Alectra Utilities, the Finance team worked to create a common mapping structure and align costs in order to report financial results in 2017. However, the process of aligning costs and mapping the four legacy account structures into a common reporting structure took several months to complete in 2017. Since Alectra Utilities was a new entity and was not required to report prior year comparative results for financial reporting purposes, this mapping and cost alignment exercise was not undertaken for 2016 results. Therefore, there is no common account structure or cost alignment in place to allow 2017 and 2016 OM&A to be compared at a detailed level for Alectra Utilities."

Alectra Utilities estimates that, similar to the common reporting structure created for 2017 when Alectra Utilities was formed, it would require a significant resource commitment and several months to create a meaningful analysis of the cost drivers from 2016 to 2017.

It is unreasonable for OEB staff to simply ignore these complexities and arbitrarily draw the conclusion that there is a high probability that Alectra Utilities has overstated its OM&A merger-related savings and/or understated its merger-related costs.

OM&A costs are subject to fluctuations on a year-over-year basis for various reasons, not excluding management control. 2016 was not a normal year for the legacy utilities that comprise Alectra Utilities. The reality is that the initial planned/contemplated date of the Alectra Utilities merger was expected to be January 1, 2016. This had varying impacts related to legacy utility OM&A as new department locations, decisions on future Alectra systems and other related merger decisions became known.

This conclusion is supported by analyzing total OM&A of each legacy of the utilities from 2012-2016, as provided in Table A, Historical OM&A Figures, in the Board's reply argument (HRZ-Staff-1a). The table illustrates that increases in OM&A were collectively higher in the years 2013 to 2014 (3.5% and 5.4%, respectively) than compared to the years leading up to the merger 2015 and 2016 (2.2% and 2.6%, respectively). This supports the conclusion that OM&A costs were in fact lower than they otherwise would have been as the actual merger approached.

Alectra Utilities is confident that its reported OM&A merger-related costs and synergies represent accurate estimates. *"Alectra Utilities compared the actual operating and capital expenditures in 2017 and 2018 against the merger business plan that was put forward at the time of the MAADs application. The merger business plan was derived from the approved financial plans of each of the legacy organizations. The merger business plan is not revised annually, however, new information that Alectra Utilities did not have is discussed with synergy business units and considered when evaluating and reporting actual costs and synergies."* (Reference HRZ-Staff-17.a)

Alectra Utilities established an independent department, the Integration Management Office ("IMO"), with the responsibility and accountability to report on merger costs and saving to the Executive Committee, Integration Committee, and Board of Directors.

The IMO conducts on-going monthly synergy review meetings with business units to evaluate merger synergies and transitions costs, with the support of the Capital Reporting and Budgeting teams whom provide actual financial results sourced from and reconciled against the legacy ERP systems. These results are compared against the merger business case and reviewed with business unit leaders to validate accuracy and reliability prior to reporting.

The IMO participates in the development of the annual Financial Plan. Annually, the IMO updates the merger synergy forecast by incorporating new information that would not have been available at the time of the merger.

Alectra Utilities is confident that it has accurately and fully reported on all merger costs and savings which were both anticipated in the merger, and which have resulted due to changing business requirements since becoming Alectra Utilities.

OEB staff was satisfied with the evidence provided with respect to estimating the capital-related merger savings used for the purposes of the ESM & CIVA. Alectra Utilities relied on the same departmental resources, processes, assumptions, controls, validations and overall attention to detail in determining the OM&A merger-related costs and synergies.

OEB staff's proposed alternative approach to determining the 2017 and 2018 OM&A figures that exclude the merger-related operating costs/savings is arbitrary and fundamentally flawed. Alectra Utilities has provided a foundation which supports the accuracy of the tracking and recording of merger costs and savings. Merger savings and costs are tracked and recorded on a monthly basis, reviewed by senior management and further reviewed periodically by the Internal Audit department. This process of development, review and validation supports the accuracy of the OM&A and capital-related merger costs and savings[5].

OEB staff's simple and arbitrary approach relied on escalating actual 2016 OM&A figures by the actual historical average annual increase over the previous five years to arrive at what is believed to be a "reasonable estimate." The Board Staff only included two cost drivers and ignored the challenges Alectra Utilities faces in developing an adequate comparison of OM&A cost drivers from 2016 to 2017. In addition, in calculating the 2018 OM&A figure, OEB staff did not include the impact of the reoccurring monthly billing costs, instead assuming that these costs were somehow not reoccurring.

In summary, OEB staff's alternative approach is arbitrary and suggests that merger tracking of OM&A is not required, as the figures can simply be developed by inflating the previous year OM&A by inflation. Alectra Utilities submits that the OM&A merger costs and savings are accurate estimates that must be relied on for the purposes of the ESM calculation.

iv. Alectra Utilities agrees with OEB staff's submission which supports the proposed allocations of general plant capital additions and general plant depreciation expense. Alectra Utilities disagrees with the Board Staff's submission that the appropriate allocator for OM&A (and related PILs impact) is the single-year 2016 actual OM&A.

Several OM&A allocation approaches were analyzed as part of this proceeding. This included an OM&A allocator which relied on pre-merger averages of five-years, three-years and a one-year actual (HRZ-Staff-2.e). In addition, OEB staff requested analysis to compare the approach Alectra Utilities proposed, based on a three-year pre-merger average, to an approach which was developed based on a customer growth rate (HRZ-Staff-3 and G-Staff-7).

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[5] HRZ-Staff-18

A summary of the various approaches and the resulting OM&A allocated to the Horizon RZ as compared to the original filed application is shown in Table 1. The information provided in this table was produced from the responses to HRZ-Staff 2.e and HRZ-Staff-3.

Table 1: Horizon RZ Summary of OM&A Allocations ($ Millions)

OM&A Allocation Approach	2017 $ OM&A	2017 $ Change vs 3 Year Average OM&A Original	2018 $ OM&A	2018 $ Change vs 3 Year Average OM&A Original
3 Year Average OM&A - Original per Application	61.3		62.8	
3 Year Average OM&A - Revised for IR responses	60.4	-0.9	61.8	-1.0
5 Year Average OM&A	59.8	-1.5	61.2	-1.6
1 Year Actual - 2016 OM&A	58.8	-2.5	60.0	-2.8
Customer Growth Rate Allocation	60.6	-0.7	61.3	-1.5

All the allocation approaches (five-year, three-year and customer growth rate), except the one-year (2016) actual allocation approach, eliminate the potential anomalies in OM&A costs of a single, given year.

In reviewing the impact of the various approaches relied on to allocate OM&A, as provided in Table 1, it is evident that the use of the one-year (2016) actual results to allocate OM&A represents an anomaly or outlier approach. The OM&A allocated under this single-year allocation approach results in a variation of $1.0MM (or 1.7%) for 2017 and $1.2MM (or 2.0%) for 2018, as compared to the nearest alternative approach which is the five-year OM&A average. Alternatively, the three-year average OM&A allocation approach results in an OM&A allocation which is in line with and not materially different than the five-year OM&A average. In fact, the three-year average results in a more favorable allocation of OM&A and resulting ESM refund to rate payers than the customer growth rate approach in 2017.

Alectra Utilities believes that 2016 was an anomalous year which influenced the actual OM&A results. OEB staff incorrectly draws a conclusion that, *"…it is evident that the Horizon RZ made significant efficiency gains in terms of reducing its OM&A from 2014 to 2016 relative to other legacy utilities. In fact, it is the only rate zone to report lower OM&A in 2016 than in 2014."*

The initial planned/contemplated date of the Alectra Utilities merger was expected to be January 1, 2016. This had varying impacts related to legacy utility OM&A as new department locations, decisions on future Alectra Utilities systems and other related merger decisions became known. For example, in 2016 Horizon RZ experienced a reduction of 5 FTE (RRR filing) relative to 2014 where over this same period there was an increase in of over 4,000 new customers. Alectra Utilities submits that the reduction in OM&A in 2016 was not as a result of efficiency gains; rather, it was as a result of information related to merger-related decisions which influenced staff to exit the company**.** In addition, merger-related decisions regarding Alectra Utilities' IT systems were being finalized. The PowerStream CIS became the base for the Alectra Utilities CIS and the Enersource ERP system was approved as the system for Alectra Utilities. These decisions impacted 2016 OM&A, further contributing to it as an anomalous year.

All of the allocation approaches analyzed (five-year, three-years and customer growth rate), except the one-year (2016) allocation approach, implicitly include a growth rate which would include OM&A cost increases to serve new customers over the period.

OEB staff requested that Alectra Utilities develop an OM&A allocator approach based on a customer growth rate. In addition, OEB staff requested that Alectra Utilities compare the results of this customer growth rate approach to the proposed three-year pre-merger OM&A average (HRZ-Staff-3 and G-Staff-7). OEB staff was obviously concerned that the appropriate allocation approach should include a growth rate component to account for changes in OM&A on a year-over-year basis. In the response to HRZ-Staff 3, Alectra Utilities identified that the proposed pre-merger three-year average OM&A approach implicitly includes a growth rate which includes increases in costs to serve new customers.

In addition, the comparison of OEB staff's customer growth rate approach resulted in an immaterial OM&A difference to the proposed pre-merger three-year average approach. The comparative results in Table 1 above illustrate that the impact to the Horizon RZ resulted in a higher allocation in 2017 ($0.2MM) and a lower OM&A allocation in 2018 ($0.5MM). Overall, the customer growth rate approach resulted a similar allocation of OM&A allocated to the Horizon rate zone as the proposed pre-merger three-year average. In fact, all of the allocation approaches, except the single-year (2016) actual allocation, result in immaterial differences to the Horizon RZ allocation of OM&A.

Alectra Utilities submits that the pre-merger three-year OM&A average is the most appropriate allocator for the purposes of determining the Horizon RZ's share of OM&A. The three-year OM&A average most appropriately addresses the requirement of appropriate representation of pre-merger costs, implicitly includes a growth rate to capture costs increases and eliminates any anomalies of the 2016 OM&A actuals.

OEB staff suggested that it is inconsistent to use multi-year averaging in one cost category allocation, while using a single-year representation in others. OEB staff states, *"Furthermore, Alectra Utilities has utilized a single-period for allocations of general plant additions, general plant depreciation, and for merger capital net savings, rather than the average capital additions or depreciation over a three-year period. It would be inconsistent to use multi-year averaging in one cost category allocation, while using a single-year representation in all others."*

Alectra Utilities submits that cost allocation is about ensuring that costs are allocated on an appropriate basis. In determining the appropriate allocator for the cost category, Alectra Utilities analyzed the cost category to be allocated to ensure that an appropriate cost allocation approach was relied on (HRZ-Staff-24). In determining the appropriate allocation of OM&A costs, consideration was given to the potential for year-over-year fluctuations. It is evident that OM&A costs can vary for a variety of reasons on a year-over-year basis, not excluding the influence of management control. Relying on a single-year allocation could result in a significant impact and therefore does not represent an appropriate cost allocation approach. This was provided as evidence throughout the proceeding as a significant factor in the determination of the Alectra Utilities' proposed allocator the three-year OM&A average. The discussion and summary table above support the evidence provided.

OEB staff's submission stated, *"OEB staff agrees with Alectra Utilities' proposed allocations of general plant capital additions and general plant depreciation expense"* (p.28). The single-period allocations relied on for general plant additions, general plant depreciation and merger capital net savings represented an appropriate cost allocator for the cost category.

Alectra Utilities discusses each of these single period allocations to support the appropriateness of the allocator used.

General Plant Additions

With the formation of Alectra Utilities, general plant is not identifiable by rate zone, as general plant assets support the operations of all rate zones (Exhibit 3, Tab 1, Schedule 2, p. 8). For the purposes of determining the Horizon RZ allocation of general plant additions for 2017 and 2018 for calculating the CIVA, Alectra Utilities relied on each rate zone's percentage share of the total 2016 rate base. The purpose of general plant is to support the overall business; therefore, the allocator that most appropriately represents the proportion of each legacy utility's share of the total distribution business pre-merger is rate base (reference HRZ-Staff-24). Alectra Utilities relied on the 2016 rate base from the 2016 annual RRR filings (2.1.5.6) to allocate a proportion of general plant additions. An important consideration in the selection of 2016 rate base as the allocator for 2017 and 2018 general plant additions was that, unlike OM&A, rate base is not subject to material variations on a year-over-year basis, as it is mainly the result of cumulative years of investment captured by reported net fixed assets. In addition, general plant additions represent a relatively small portion of the total capital investments in any given year. It is important to note that the ESM calculation is not impacted by the allocation of general plant additions.

General Plant Depreciation

For the purposes of determining the Horizon RZ allocation of general plant depreciation for 2017 and 2018 for calculating the ESM, Alectra Utilities relied on each rate zone's percentage of the total 2016 general plant depreciation expense adjusted for merger impacts. Similar to the conclusions provided above regarding 2016 rate base as an appropriate allocator for general plant additions, relying on 2016 general plant depreciation is an appropriate allocator for 2017 and 2018 general plant depreciation expense. General plant depreciation expense is the accumulation of multiple prior years of invested capital and is not subject to material variations on a year-over-year basis, unlike OM&A. In addition, general plant depreciation represents a relatively smaller portion of the total allocations (approximately 14% of the OM&A allocation) relied on for the Horizon ESM calculation.

Merger Capital Savings

For the purposes of determining the Horizon RZ allocation of merger related capital net savings for 2017 and 2018 for calculating the CIVA, Alectra Utilities relied on each rate zone's percentage share of the total 2016 rate base. This allocator was relied on consistently with the allocator for general plant additions, as the merger-related capital costs and savings were classified as general plant. Similarly, and consistently, the net merger OM&A costs/savings were allocated to the rate zones based on the pre-merger three-year average OM&A.

In summary, the purpose of cost allocation is to ensure costs are allocated on an appropriate basis. As detailed in the response above, Alectra Utilities analyzed each cost category to be allocated to ensure that an appropriate cost allocation approach was relied on. Alectra Utilities' proposal to rely on the pre-merger three-year average OM&A allocation is appropriate, as this approach accurately addresses the concerns related to anomalies of the 2016 actual OM&A results, implicitly includes a growth rate, and appropriately takes into account the pre-merger relative differences in OM&A costs to serve across the rate zones (HRZ-Staff-3). Alternatively, a single year of allocations were relied on for general plant additions, general plant depreciation and merger capital net savings, as the single year represented an appropriate cost allocator for the cost category. As set out above, relying on a single year of rate base and depreciation expense as allocators is appropriate, as the results of these cost categories are the accumulation of multiple prior year capital investments, and they are not subject to material variations on a year-over-year basis as compared to OM&A costs.

6.0 HORIZON UTILITIES RZ CIVA

Background

Horizon Utilities' 2015 - 2019 Custom IR Settlement Agreement provided for the introduction of a deferral account (1508 Sub-account "Capital Additions Variance Account", referred to in the Settlement Agreement as the Capital Investment Variance Account ("CIVA")) to refund to ratepayers any difference in the revenue requirement should in-service capital additions be lower than, or the pacing of capital additions be slower than, forecast over the 2015-2019 period.

The Parties agreed to track variances in the revenue requirement due to variances in the capital budget. Over the term of the plan, if Horizon Utilities spends less than its capital forecast, the reduced revenue requirement impact of this will be returned to customers. The Parties agreed, and the OEB approved, that the CIVA balance would be disposed of following the end of the five-year Custom IR term, if applicable.

Alectra Utilities reports the capital additions for 2017 and 2018 for the Horizon Utilities RZ in this Annual Filing. In the 2019 EDR Application Decision (EB-2018-0016), the OEB stated that: *"The* *change in the capitalization policy increases the in-service capital additions for the same amount of capital work to implement the strategy. The question for the OEB is whether the capital additions for the CIVA account should be based on the capitalization policy in place at the time the Custom IR framework for the Horizon rate zone was approved, or the new post-merger capitalization policy for Alectra Utilities."* Further, consistent to its Decision on the impact of the capitalization policy change on the ESM for Horizon Utilities, the OEB stated: *"The OEB finds that it is appropriate to defer consideration of the actual 2017 capital additions to be used for the final computation of the CIVA account until the application for 2020 rates. The OEB has previously determined that other issues related to the change in capitalization policy will be heard in the same 2020 rate proceeding."*

Submissions of the Parties

OEB staff's Submission

i. OEB staff agrees with Alectra Utilities that there should be no entry for the CIVA account for 2018, as the cumulative total capital additions from 2015 to 2018 exceed the cumulative forecast for that period, and agrees that adjusting the capital additions to account for the net capital savings attributable to the merger restores the Horizon RZ capital expenditures to a comparable basis as the forecast plan that was included in the OEB-approved settlement agreement.

ii. OEB staff submits that the in-service capital additions for the purposes of the CIVA should be calculated using the pre-merger Horizon Utilities capitalization policies. OEB staff further submits that in the event that a CIVA entry is required as part of Alectra Utilities 2021 Rate Application (for the 2015 to 2019 cumulative variance), the impacts of double-counting (if any) between the CIVA and the ESM can be adjusted for at that time.

iii. OEB staff suggests, for the purposes of regulatory efficiency, that if the OEB defers approval of the 2017 and 2018 capital additions to Alectra Utilities' subsequent rate application, it direct Alectra Utilities to provide the capital additions from 2015-2019 under both sets of capitalization policies, similar to the table above, in its pre-filed evidence for that proceeding.

iv. SEC submits that the CIVA should then be calculated using the lower capital additions that reflect the previous capitalization policy, *Alectra Utilities' Submission*

Alectra Utilities submits that as the impact of the capitalization policy change is captured through the ESM for the Horizon Utilities RZ, determining the CIVA using the pre-merger capitalization policy would result in the same impact being refunded to or recovered from customers through both the ESM and the CIVA. Therefore, it is appropriate to determine capital additions on the post amalgamation capitalization policy. Although OEB staff submits that the CIVA should be calculated using the pre-merger capitalization policy (i.e. the capitalization policy of Alectra Utilities' predecessor, Horizon Utilities), OEB staff goes on to state that if any double counting of the impact is required as part of the 2021 application, it can be adjusted at that time. OEB staff essentially acknowledges that its approach may result in double counting the impact under two different regulatory mechanism, which would be incorrect. Alectra Utilities' approach eliminates this risk. Therefore, Alectra Utilities submits that the OEB approve the post amalgamation 2017 and 2018 capital additions for the Horizon RZ of $52.4MM and $49.4MM, respectively. These capital additions, inclusive of the approved 2015 and 2016 capital additions, result in a cumulative actual total capital addition of $192.7MM. In comparing the actual capital additions to the Board approved 2015-2018 cumulative total forecasted capital additions of $172.2MM, this results in $20.5MM higher capital additions (Reference - HRZ-Staff-6a table 4) and therefore no CIVA entry is required.

7.0 CONCLUSION

Alectra Utilities' evidence, as it relates to the capitalization policy change is provided in Exhibit 2, Tab 1, Schedule 5 (Capitalization Policy), Exhibit 3, Tab 1, Schedule 2 (Horizon Utilities RZ ESM), and Exhibit 3, Tab 1, Schedule 3 (Horizon Utilities RZ CIVA), and as updated through the proceeding. Alectra Utilities has proposed an allocation methodology to calculate the impact of the capitalization policy change in 2019 to 2026 as a result of the ERP implementation. Alectra Utilities submits that these elements be approved as filed, and as updated through the proceeding.

All of which is respectfully submitted this 28th day of November 2019.

ALECTRA UTILITIES CORPORATION

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Indy J. Butany-DeSouza, MBA

Vice President, Regulatory Affairs