May 25, 2009

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Subject: Variance and Deferral Account Review Initiative
Board File No: EB-2008-0046

In response to the letter from the Ontario Energy Board ("the Board") seeking comments on the Board Staff Discussion Paper on an Electricity Distributors' Deferral and Variance Account Review Initiative, the Coalition of Large Distributors ("CLD") consisting of Enersource Hydro Mississauga, Horizon Utilities, Hydro Ottawa, PowerStream, Toronto Hydro-Electric System Limited and Veridian Connections, wishes to offer the following comments.

A major premise of the discussion paper is the segregation of the variance and deferral accounts into categories such that some accounts will have an expedited review when balances are to be cleared, and some more detailed scrutiny. The CLD fully supports the concept of this proposal; however the CLD is recommending some changes to the types of categories, accounts to include in each category and threshold amounts.

Summary of Recommendations

1. Accounts should be classified in categories based on the nature and scope of the Board's review to clear balances (e.g. requirement for prudence review), but not based on different thresholds. Category #1 account balances would require no prudence review, Category #2 would need a detailed review and Category #3 balances may not need to be cleared or are to be cleared based on specific or unique instructions from the Board.
2. Account 1582 RSVA – One-Time Wholesale Market Service should be in the same category of accounts as all other retail settlement variance accounts ("RSVAs").
3. Thresholds should only be used as a trigger for a distributor to review balances and propose whether disposition is required or not. Thresholds should not be used to clear balances on an automatic basis because the distributor should review whether any accounts have balances that will self-clear in time, or other considerations.
4. A threshold of $0.001/kWh should be set as the trigger for the disposition of accounts during an Incentive Regulation Mechanism ("IRM") rate application based on trial balance data; however, a distributor should have the option of providing rationale why the disposition (or a portion of the disposition) is not required at that particular time.
5. A threshold of $0.005/kWh should be set as the trigger for the disposition of the quarterly reported balances for all Category #1 accounts, not just Account 1588.

6. No threshold would be set for the clearing of balances as part of a cost of service rate application, but the net balances should be material enough to result in a rate rider within the fourth decimal place of a rate, e.g. $0.0001/kWh or $0.0001/kW.
7. A rate mitigation proposal is required if the total bill impact to any customer class exceeds 10%.
8. When, as part of an IRM rate application, a distributor self-identifies that a threshold has been met to trigger the disposition of balances, this would include Category #1 accounts but could also be combined with Category #2 and Category #3 accounts with comprehensive evidence.
9. The selected allocation factor for each particular variance or deferral account must be the same across all classes and should be selected based on how the costs were incurred. This is generally how it was done in the past.
10. The Board should maintain existing procedures for determining the appropriateness of balances to be cleared; an audit from the distributor's external auditors should not be required.

Scope

Board staff has proposed that the scope of the initiative be extended beyond Account 1588 to include all variance and deferral accounts. The CLD completely agrees. The balances in these accounts form regulatory assets or liabilities recorded on a distributor's balance sheet. Clarity on the approach that the Board will take to clear all such regulatory assets/liabilities is of significant importance to distributors, and may be even more critical with the move to International Financial Reporting Standards ("IFRS").

Accounts Classification Criteria

The CLD agrees that it is appropriate to have three categories of variance and deferral accounts. However, rather than setting the categories based on whether a threshold is met, the categories should be set based only on the required scope and depth of the Board's review of balances before they are cleared. This results in a similar categorization as the Board staff proposal, but with some adjustments. It is recommended that in addition to assigning existing accounts into a category, detailed descriptions be developed for each category to assist in assigning of future accounts and to ensure that the process for clearing balances is clear. The CLD would define the categories as follows:

<u>Category #1 Accounts</u>

For this category, no prudence review would be required for the disposal of balances. As such, the accounts included in this category should fall into two types:

1. Amounts related to the pass-through of the cost of power to customers;

   While no prudence review is required, in clearing balances it is appropriate for the Board to be satisfied that the distributor's accounting for these accounts follows procedures established by the Board. It should be noted though that even when the balances are cleared, the accounts remain open. Therefore, if a distributor needs to make an adjustment related to a prior period that has already been cleared, the adjustment would simply be recorded in the current balance for disposition at the next opportunity, so that both the distributors and customers are held whole.

   Accounts that fall into this category comprise the RSVAs and the low voltage variance account, which is similar in nature to an RSVA. These accounts are by nature a pass-through to customers of cost of power items charged by others (typically the IESO and Hydro One Networks).

   The CLD disagrees with the Board staff's proposal to put the $\text{RSVA}_{\text{one-time}}$ in a different category from the $\text{RSVA}_{\text{wholesale market}}$. The description of this account in the Accounting Procedure Handbook ("APH") is clear that it only relates to costs from IESO settlement invoices. On that basis, the $\text{RSVA}_{\text{one-time}}$ should be included in the same category as all other RSVAs.

   In summary, accounts of this type include:

   1550 Low Voltage Variance Account
   1580 RSVA – Wholesale Market Service Charges
   1582 RSVA – One-Time Wholesale Market Service
   1584 RSVA – Retail Transmission Network Charges
   1586 RSVA – Retail Transmission Connection Charges
   1588 RSVA – Power (including the Global Adjustment Sub-account)

2. Amounts / Costs that have been approved by the Board in a previous proceeding;

   Since the costs have already been approved by the Board, no further prudence review should be required at the time that the balances are cleared. In certain cases in which the Board is approving costs on a forecast basis as part of an overall plan, it may be appropriate for the Board to confirm that the distributor's actual costs are in accordance with the approved plan.

   Of particular note are the balances in accounts 1590 and 1595 which are used to record the difference between the amounts approved by the Board for disposition from variance and deferral accounts and the amounts actually collected from customers through the approved rate rider. While it is acknowledged that it is not appropriate to clear balances in these accounts until the associated rate rider has ended, the approval of the Board to clear the final variance should be a straightforward process requiring limited review.

   Other types of variance and deferral accounts could include future accounts to support the Green Energy Act. It is expected that the Board will approve a distributor's plans for

CDM programs and to facilitate the connection of renewable generators and to develop and implement a smart grid. Variance or deferral accounts may be used in connection with these programs. Provided that the Board has approved the spending plans, and the distributor has spent according to their plan, no further prudence review should be required. On this basis, the Board should only require minimal review prior to approving the clearing of account balances (to confirm that the distributor spent in accordance with the Board-approved plan).

In summary, accounts of this type include:

1590 Recovery of Regulatory Asset Balances
1595 Disposition and Recovery of Regulatory Balances Control Account
Variance or Deferral Accounts for spending plans pre-approved by the Board

Category #2 Accounts

For this category of accounts, the Board has not previously approved the costs that have been recorded and therefore a more detailed review of balances may be required.

Accounts of this type would include:

1508 Other Regulatory Assets
1518 RCVA – Retail
1525 Miscellaneous Deferred Debits
1548 RCVA – Service Transaction Request
1570 Qualifying Transition Costs
1571 Pre-Market Opening Energy Variances
1572 Extraordinary Event Costs
1592 PILs and Tax Variances for 2006 and Subsequent Years
2425 Other Deferred Credits

It should be noted that of the list of accounts above, the only accounts in active use by most distributors (i.e. new entries being made to principal balances) are Accounts 1518 and 1548. Occasionally, a distributor will apply for a Z factor as permitted under IRM and will use account 1572. It is appropriate for the Board to have a thorough review of entries to these accounts. The other accounts in this category typically apply to circumstances that arose in the past, and some distributors have already cleared these balances.

Category #3 Accounts

This category would relate to accounts that do not need to be cleared, are the subject of a specific proceeding of the Board, or are so specific in nature to a particular distributor that the level of review must be determined on a case by case basis.

Accounts of this type would include:

1555 Smart Meter Capital and Recovery Offset
1556 Smart Meter Operation, Maintenance and Administration
1562 Deferred Payment-In-Lieu of Taxes ("PILs")
1563 Contra Account – Deferred PILs
1565 Conservation and Demand Management Expenditures and Recoveries
1566 Conservation and Demand Management Contra Account
1574 Deferred Rate Impact Amounts

Distributors are in various stages of completion of their Smart Meter projects and as such Accounts 1555 and 1556 are also in different stages. Some distributors had costs approved as part of the Smart Meter proceeding but have not cleared balances in these accounts, whereas others have already cleared balances to a particular date. Some distributors have not yet had Smart Meter costs approved. Where costs have already been approved by the Board, the clearance of balances should be treated the same as Category #1 accounts. There may also be different accounting approaches with respect to these accounts that will need to be considered. On this basis, it is appropriate to include Accounts 1555 and 1556 in Category #3 such that the Board will consider the disposition of balances on a case by case basis.

For Accounts 1562 and 1563, the Board has launched a special proceeding to determine the appropriate process and procedures for clearing balances. These accounts must therefore be considered separately.

Accounts 1565 and 1566 are essentially tracking accounts related to a distributor's commitment to undertaking CDM programs funded from the 3rd tranche of its market adjusted revenue requirement ("MARR"). While the Board may wish to review the circumstances in which a distributor has not completed their 3rd tranche spending, there are no amounts to clear.

Typically, entries to Account 1574 are related to amounts approved by the Board for recovery from customers that will be charged in a future period. This would typically be to mitigate rate impacts. The Board typically approves the rates for that future period at the same time as approving the amount to be recorded in Account 1574. On that basis, the account balance would clear when the approved rates are implemented. No further review would be required and therefore this account would not be included with other variance and deferral accounts to be cleared.

Threshold Mechanism Used for Disposition

<u>Purpose of Threshold</u>

Board staff has proposed "*the use of preset disposition thresholds during the IR plan*". While the CLD is recommending that accounts be categorized based on the scope and depth of the Board's review when balances are cleared (e.g. prudence review), this does not preclude the use of thresholds. Typically, the thresholds will be used as a trigger mechanism that distributors will use to determine if an application will be filed to clear account balances.

The CLD agrees with Board staff that distributors self-indentify when a disposition is triggered. Distributors generally want account balances to be cleared as soon as possible. However, they must have the flexibility of either filing an application for the disposition of account balances, or to provide a rationale why the disposition (or a portion of the disposition) should be deferred to a later period. This rationale might include an explanation of timing differences in the account balances that will self-clear, a plan to coordinate the disposition with other rate adjustments or other utility specific circumstances. The CLD notes that the Board permits the use of the billed accounting method instead of the accrual method for recording the RSVA accounts. Although none of the CLD members use the billed method, this would create some timing issues between costs and revenues that would have to be considered. Furthermore, the $RSVA_{power}$ global adjustment sub-account has inherent timing differences that must be considered before balances are cleared. It is therefore recommended that the threshold only be used as a trigger for a distributor to review balances and propose whether disposition is required or not. Thresholds should not be used to clear balances on an automatic basis because the distributor should review whether any accounts have balances that will self-clear in time or whether there are other circumstances that warrant deferring an application.

The Board staff proposal to establish a threshold based on dollars per kilowatt-hour ($ /kWh) to prompt the clearing of balances is appropriate. However, it is important to distinguish between the threshold used to trigger an application to clear balances and the threshold used to determine if rate mitigation is required. For the purposes of determining if rate mitigation is required, the CLD recommends that the Board retain the approach set out in the 2006 Electricity Distribution Rate Handbook that a rate mitigation proposal is required if the total bill impact to any customer class exceeds 10%, and not establish new $/kWh thresholds.

Approach to Applying the Threshold

The CLD is recommending that only one threshold be set for any application to clear variance and deferral account balances as part of an IRM rate application. The Board staff's proposal is to consider each category of accounts in isolation of the other categories. With this proposal, there could be circumstances in which a distributor meets the threshold for one group of accounts that are in an asset position but not for another group that is in a liability position. By clearing these accounts together, there would be a smoothing effect to the rate adjustments.

The CLD therefore recommends that when a distributor self-identifies that a disposition has been triggered and an application is filed as part of an IRM rate application, this would always include the Category #1 accounts, but could also include Category #2 and/or Category #3 accounts, with comprehensive evidence. IRM rate applications are typically filed in November for a May 1st effective date. If Category #2 and/or Category #3 accounts are included it is appropriate for the application to be filed two months earlier to give the Board sufficient time to review balances.

No threshold would be used for cost of service rate applications because it would be typical practice that all balances would be cleared. However, if the net balances are not material enough to result in at least the fourth decimal place for a rate rider ($0.0001/kWh or $0.0001/kW), it may not be an effective use of regulatory resources to clear these balances.

It is understood that the clearance of account balances as part of the quarterly review should meet a higher threshold so that this would only occur when balances reach a level that could materially affect the financial condition of the distributor. The CLD recommends that this review be extended to all Category #1 accounts not just Account 1588, because experience has shown that several of the other accounts can accumulate significant balances.

Magnitude of Threshold

Knowing that requirements for rate mitigation are in place if required, the Board should consider the materiality of account balances on the distributor when setting a threshold that will trigger a distributor's application for disposition of balances. In determining this threshold, the CLD examined the 2008 year-end results for each company. The impact of the different threshold levels was compared to the net income of each company. The results are shown in the table that follows.

2008 Actual Results	**Enersource**	**Horizon**[1]	**Hydro Ottawa**	**PowerStream**[2]	**Toronto Hydro**	**Veridian**
Annual MWh Sales	8,096,000	5,301,494	7,562,000	6,828,655	25,139,059	2,501,314
Net Income $000	18,034	14,914	21,788	17,802	76,134	6,649
Distribution Revenue $000	109,979	86,961	134,227	114,074	452,995	42,769
$0.01/kWh Threshold $000	80,960	53,014	75,620	68,286	251,390	25,013
Threshold ratio to net income	448.9%	355.5%	347.1%	383.6%	330.2%	376.2%
$0.005/kWh Threshold $000	40,480	26,507	37,810	34,143	125,695	12,506
Threshold ratio to net income	224.5%	177.7%	173.5%	191.8%	165.1%	188.1%
$0.002/kWh Threshold $000	16,192	10,602	15,124	13,657	50,278	5,002
Threshold ratio to net income	89.8%	71.1%	69.4%	76.7%	66.0%	75.2%
$0.001/kWh Threshold $000	8,096	5,301	7,562	6,828	25,139	2,501
Threshold ratio to net income	44.9%	35.5%	34.7%	38.4%	33.0%	37.6%

As can be seen in the above table, a threshold level of $0.001/kWh represents accumulated balances in the order of magnitude of 33 to 45% of net income, a material amount to any distributor.

One of the thresholds proposed by Board staff is $0.01/kWh. As can be seen from the table above, balances pertaining to this threshold are so significant (more than 300% of net income) it could place a distributor in severe financial distress. In Board staff's analysis, two distributors would have reached this threshold of $0.01/kWh based on 2007 results. It is difficult to understand how any distributor that is following the Board's prescribed accounting could have

[1] Does not include wholesale market participant throughputs.

[2] PowerStream exclusive of Barrie Hydro.

balances of this magnitude. To illustrate this magnitude, the 2004 balance of regulatory assets for which Hydro Ottawa received final approval as part of the Phase 2 Regulatory Asset proceeding was $36.4 million, and this had to be recovered over four years. This is roughly one-half of the threshold level proposed by Board staff.

Based on this analysis the CLD is proposing the following thresholds:

1. As part of an IRM rate application – Threshold of $0.001/kWh

2. As part of the quarter review of account balances – Threshold of $0.005/kWh for all Category #1 accounts.

3. As part of a cost of service rate application – No Threshold, but the net balances should be material enough to result in a rate rider within the fourth decimal place of a rate to e.g. $0.0001/kWh or $0.0001/kW.

Cost Allocation Methodology

The selected allocation factor for each particular variance and deferral account must be the same across all classes and should be selected based on how the costs were incurred. The CLD has reviewed Table 4 on Page 30 and Table 5 on Page 31 of the Board Staff Discussion Paper. These tables appear to have mixed up the allocation factors with the billing determinants. The allocation factor for all RSVA accounts and for all classes has been kWh, and this should be maintained. In other words, the total amount to be disposed of for RSVA accounts is allocated to all of the classes based on kWh (not kW). In determining the rate rider for each class, the billing determinant will be kWh or kW depending on the customer class.

For Account 1508, Table 4 makes reference to specific Hydro One accounts. It should be noted that the Board has approved disposition of Account 1508 for other distributors (unrelated to Hydro One) using distribution revenue as the allocation factor including OEB Cost Assessments and Pension Contributions. It is appropriate to continue to use distribution revenue as the allocation factor for this account.

For Account 1525, it should be clarified that the balance was allocated to each class of customer that received rebate cheques based on the number of customers in that class. In other words, it was assumed that all customers within a class either received rebates or did not. This is different from the Board staff's description that implies that some customers within a class received rebates whereas other customers in the same class did not.

As noted by Board staff, the allocation factors for Accounts 1574 and 2425 would have to be determined based on the nature of the extraordinary event or deferred credit.

Other than these corrections and clarifications, the CLD concurs with Board staff that the same allocation factors be maintained because they are consistent with principle that allocation factors be set based on how costs were incurred.

Rate Rider Derivation

In most cases the CLD supports the Board staff proposal to use a volumetric rate rider because the most material balances have typically been with respect to RSVAs that accumulate based on volume. This is also a simple approach. However, if an account balance has been accumulated based on fixed charges, it is appropriate to clear the balance through a fixed charge rate rider. This is the case with the Smart Meter variance accounts. Furthermore, a one-year default disposition period, as described by Board staff, is appropriate.

Timelines

Based on the CLD's proposal, typical timelines could be as shown in the following table. It should be noted that distributors must have the option of proposing alternative timelines to suit their specific circumstances. Factors distributors will consider include the timing of the next cost of service rate application, the magnitude of balances, the expectation of other rate adjustments to consider combined rate impacts, the expectation of future entries to the accounts being cleared to consider if there may be unnecessary fluctuations in rates, the expected time required for the Board's processes based on the complexity of the account to be cleared, and other utility specific considerations.

For cost of service applications, the CLD notes the Board staff's assumption that the effective date for rates will typically be May 1. It is expected that many distributors will seek effective dates of January 1 in the future to align with fiscal periods.

	RRR Data	**Application Filing Date**	**Effective Date of Rates**
IRM Application Category #1 Accounts only	Most recent trial balance filed April 30	November 1	May 1 or as proposed by distributor
IRM Application Category #1 plus Category #2 and/or Category #3 Accounts	Most recent trial balance filed April 30	September 1 for the variance and deferral accounts[3]	May 1 or as proposed by distributor
Quarterly balances for all Category #1 Accounts	RRR Quarterly balance filed April 30 July 31 October 31 January 31	 June 15 September 15 December 15 March 15	 August 1 November 1 March 1[4] May 1 or as proposed by distributor
Cost of Service Application	As proposed by distributor	As proposed by distributor	As proposed by distributor

[3] The remainder of the IRM application would remain due at the normal time period, typically around November 1.

[4] February 1 is not recommended as an effective date because many distributors may seek January 1 effective dates as part of cost of service rate applications.

Filing Requirements

The CLD has concerns with the Board staff proposal that distributors file a *"statement by the distributor's external auditor certifying that the information filed is consistent with the Board's accounting requirements and procedures in the Accounting Procedures Handbook and any other accounting procedures the Board may approve from time to time"*. This is a departure from past practice and will result in significant additional costs to distributors.

In the CLD's view, the regulatory trial balance that has been filed with the Board as part of the Reporting and Record-Keeping requirements includes the balances in variance and deferral accounts and can be readily reconciled to the audited financial accounting trial balance. On that basis, no additional external audit certification or assurance of the variance and deferral accounts should be required. This reconciliation could be supplemented with detailed explanations to support the reconciliation where warranted. This will be consistent with the Board's approvals as part of the Phase 2 Recovery of Regulatory Assets. The CLD sees no reason to change the existing practice. The CLD is concerned that this requirement for an external audit will lengthen the timelines needed to clear balances and unnecessarily increase costs.

However, if the Board determines that some form of third party review is required, a distributor should be permitted to select the appropriate party to undertake this review and not be required to sole-source this contract to their external auditors. Factors in the distributor's selection of the reviewing party would include the cost, the timeliness of the review and the expertise in regulatory accounting.

The CLD also questions the value added from a certification from the company's CEO, but the administrative time to produce this is not significant.

The other proposed filing requirements are reasonable.

Procedural Matters

The CLD has proposed certain changes to the Board staff proposal. In making these recommendations, details have been provided to help explain concerns with the current proposal and the rationale for the CLD's proposal. Board staff may find it helpful to convene a stakeholder session to explore these issues in further detail.

Thank you for the opportunity to comment. Three paper copies, along with an electronic version accompany this submission.

Yours truly,

Original Signed By

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(On behalf of the Coalition of Large Distributors)