Power Stream

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February 14, 2005

Mr. John Zych
Board Secretary
Ontario Energy Board
2300 Yonge Street
26th Floor, Box 2319
Toronto, Ontario
M4P 1E4

Dear Mr. Zych:

Re: RP-2004-0188 – Procedural Order No. 5
PowerStream Inc. Argument-in-Chief on the
OEB 2006 Electricity Distribution Rate Handbook

In accordance with Procedural Order No. 5, PowerStream Inc ("PowerStream") is pleased to submit to the Ontario Energy Board ("OEB") its argument-in-chief on the 2006 electricity distribution rate handbook ("2006 EDRH"). The attached submission is structured by chapter and section of the second draft handbook.

In regard to the process to date, compressed timelines have not given enough time to complete a thorough argument and comment effectively. The oral hearing of RP-2004-0188 concluded on February 4, 2005 and argument is due six business days later on February 14th. While PowerStream would ideally have liked to provide the Board with a comprehensive argument on all the issues outlined in the draft 2006 EDRH and the Associated Rate Adjustment Model, these time constraints have limited our comments to those that are of critical concern to PowerStream. The compressed timelines provided in this proceeding have caused PowerStream to prepare an individual submission rather than contributing to a combined submission with those who have like views. This is unfortunate since it would have resulted in a more streamlined regulatory process and a better overall result.

In addition, PowerStream respectfully submits the process has not given stakeholders a reasonable and fair opportunity to fully understand the myriad of issues and make their views and issues known. Typically in a proceeding such as this one, when an oral hearing is conducted by the OEB to address issues of all interested stakeholders arising from a draft code or handbook, the draft code or handbook is written. Through the oral hearing process different positions of various stakeholders are heard by the OEB. The OEB considers these positions and provides a final decision on the issue. These final decisions are incorporated into the final approved code or handbook.

In the case of RP-2004-0188, the process generally used to review issues arising from the draft 2006 EDRH in an oral hearing was not followed in this proceeding. It is PowerStream's understanding that the intent of the oral hearing was to hear evidence with respect to the contested issues of the draft

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EDRH. However, a draft was not available at the time issues were determined to be addressed in the oral hearing. The issues addressed in the oral hearing were determined as follows:

- On July 6, 2004, the OEB began the process of developing the 2006 EDRH to be used in filing rate applications for the 2006 year.

- On August 12, 2004, in response to submissions received subsequent to the July meeting, the OEB issued a revised preliminary list of issues to be discussed at an Issues Conference in early September 2004.

- The OEB hosted an Issues Conference on September 8 and 9, 2004. At this conference, working groups were formed to develop proposals and draft material for incorporation into the draft 2006 EDRH.

- The OEB indicated that they would prefer as many issues as possible be dealt with through the working group consensus-building process. However, it indicated that certain issues may not be resolved in that manner. The OEB needed to determine what issues would be decided through a hearing process in order to complete the Handbook. The OEB proposed to accomplish this objective through two events: 1) a meeting of all stakeholders; and 2) an Issues Day before the Board.

- On October 25 and 26 a stakeholder meeting was held to discuss the results of working group efforts to date and to allow parties an opportunity to organize themselves for an orderly presentation of issues of scope and of process on Issues Day. At this stakeholder meeting the working groups presented summaries of their work to date and identified unresolved issues.

- On Issues Day, November 1, 2 and 3, 2004 representatives of the working groups presented a description of the issues they considered and their plan for resolution of unresolved issues. Stakeholders were given the opportunity to make their concerns known to the OEB regarding questions of scope and the path proposed for unresolved issues. The outcome of Issues Day was to define the issues to be addressed in the oral hearing.

- On December 13, 2004 the first draft of the 2006 EDRH was provided to stakeholders and a second draft was provided on January 10, 2005.

- On January 17, 2005 the oral hearing for the 2006 EDRH began.

The governance structure for the working group process included each working group reporting up to the executive working group with their proposed recommendations. PowerStream participated on five working groups and invested a great deal of time after the Issues Conference in September 2004 to assist in developing the draft 2006 EDRH. It was our experience that there were a number of issues that were resolved in the working group consensus-building process but were overturned at the

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executive level. As a result, issues resolved at the working group appeared as unresolved issues in the draft 2006 EDRH with various alternative solutions to the issue. Since these issues were not defined as unresolved on Issues Day, participants understood that they would not be an issue to be addressed in the oral hearing. Consequently, such issues could only be addressed in these submissions due on February 11, 2005.

For example, at the October 25 and 26, 2004 stakeholder meeting PowerStream raised the issue of including in rate base new transformers stations in service for 2006 that would be readily known, identifiable, quantifiable and verifiable. PowerStream was given the impression at the stakeholder meeting that this issue could be resolved at the working group level and would not need to be raised as an issue on Issues Day. As a result, PowerStream did not raise this issue at Issues Day. After Issues Day, the working groups reconvened and PowerStream participated on the working group to address the 2006 transformer issue. It was PowerStream's understanding that this issue was resolved at the working group and a transformer station built in 2006 would be included in the rate base assuming a LDC could provide sufficient evidence. However, when the issue was taken up to the executive level it was overturned and became an unresolved issue as outlined on page 18 of the draft 2006 EDRH. If PowerStream would have known the 2006 transformer station would remain as an unresolved issue in the draft 2006 EDRH it would have raised the 2006 transformer station as an issue at Issues Day to be addressed in the oral hearing.

PowerStream recognizes that the RP-2004-0188 process is moving forward and the situation outlined above cannot be rectified in this proceeding. However, PowerStream would appreciate it if the OEB would improve the process in any future proceedings to ensure this circumstance does not continue.

We would be pleased to provide any further information that you may require relative to this submission. Please call Paula Conboy, Directory of Regulatory and Government Affairs at (905) 417-6992 if further information is required.

Yours truly,

for

Brian Bentz
President and CEO
PowerStream Inc.

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RP-2004-0188

PowerStream Inc.

Ontario Energy Board
2006 Electricity Distribution
Rate Handbook

Argument-in-Chief Respecting Draft 2
Issued on January 10, 2005

February 14, 2005

PowerStream Inc. Argument-in-Chief

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PowerStream Inc. Argument-in-Chief
On the Ontario Energy Board
2006 Electricity Distribution Rate Handbook
Issued on January 10, 2005

The Ontario Energy Board ("OEB") has invited all participants in the RP-2004-0188 proceeding to file written submissions on issues relating to the rate handbook following the structure outlined in Procedure Order No. 4. Per this order, PowerStream Inc. ("PowerStream") has structured its comments by chapter and section of the second draft of the handbook ("EDRH"). PowerStream has limited its comments to those that are of critical concern to Corporation rather than providing comprehensive argument on all the issues outlined in the draft 2006 EDRH.

Chapter 3: Test year and adjustments

3.0 Test Year and Adjustments

1. PowerStream supports Alternative 2 whereby a LDC is not obligated to disclose material events expected to occur in 2006. A LDC filing based on a historical test year is unable to adjust for regular business inflationary costs for 2006. Labour costs, or costs for contract services will be at the 2004 costs levels in the calculation of revenue requirement. The inflation on these costs are quite material but the LDC has chosen to forgo the associated revenue requirement limit the cumbersome and cost burdensome forward test year application. For PowerStream labour related costs make up 65% of the total OM & A expenses. In this regard, these cost pressure are quite material to the LDC's revenue requirement as are material additions to the rate base in 2005 and 2006 that generally will not be allowed in 2006 rates. In this regard on a Tier 1 or Tier 2 application, LDCs should not be required to disclose material items expected for

2006. If a LDC has chosen to forgo recovery of many material cost pressures to avoid the cost associated with a forward application, it should not be required to disclose other material changes. Should the Board decide to impose this requirement it should also allow LDC's to adjust their revenue requirement for material items such as labour contract costs, which are fixed and negotiated well before 2006 rate implementation.

3.2 Test Year Adjustments

2. Allowable test year adjustments to rate base should include new transformer stations and directly-associated assets with an in-service date of 2006 (i.e. Alternative 1). These are material adjustments that are readily known, identifiable, quantifiable and verifiable. These types of additions to rate base are planned over two years in advance of the in-service date. The construction period on this type of addition will also span over a two-year period. Most of the additions to rate base (i.e. feeders from the station) will be in-service prior to the in-service date of the station itself. These assets are built to provide not only additional capacity to serve customers but also reliability of service. The nature of the planning and the decision to build these material assets subsequently insures that the targeted in-service date will be realized in the year intended. Exclusion of these material adjustments may encourage system planning based on re-base years rather than reliability and system optimization.

Chapter 4 Rate Base

4.1 Definition of Rate Base

3. PowerStream submits it is appropriate to file the detail outlined in Schedule 4-1 of Appendix B. For PowerStream, distribution capital growth programs make up

around 50% of the total capital program. These projects involve cost allocation to various general ledgers and examining a particular general ledger item in isolation could appear to distort the prudence of these costs in a year over year comparison. Major categories of capital expenditures better reflect the nature of the capital programs and reduce the necessity for detailed explanation of differences in line by line general ledger amounts, which are interdependent on one another. In addition capital work is approved on a project by project basis and these projects do not necessarily map to individual general ledger items.

4. In PowerStream's opinion the year-end net fixed asset base is the relevant measurement date in a Tier 1 & Tier 2 application. For LDC's with material growth patterns the asset base at the end of the year for 2004 is already understated from a forecast 2006 level, which would be derived using a forward test year. Valuing the rate base at year-end is more appropriate and fair, given that this value will be used to set rates for future periods.

4.2 Amortization Rates

5. PowerStream is concerned with the lack of discussion on amortization expense included in the Handbook. In PowerStream's view, the 2006 EDRH does not clearly define how amortization expenses will be included in the distribution revenue requirement. The distribution revenue requirement must include amortization expenses. For a historic test year, this could be the amortization expenses from 2004 or the amortization expenses that will occur in 2006 for 2004 assets. This distinction is important. A LDC that adds a major capital asset in 2004 will apply the half rate rule to the asset as required by Generally Accepted Accounting Principles (GAAP) and will record 50% of the annual amortization in 2004 but will incur 100% of the annual amortization in 2006 for this 2004 asset.

If a 2004 asset has been permitted in the rate base, the full annual amortization should also be permitted.

4.3 Capital Investments

4.3.1 Non IT related

6. PowerStream supports the materiality threshold proposed in Alternative 2. Materiality thresholds are set to assist Board staff in their test of prudence on costs as well as determining the applicability of various capital programs in rates. For Tier 1 or 2 applications these programs have already been put in place and the costs have already been incurred. Management assesses capital projects on various business criteria in order to determine if the programs are required for various service capacity or reliability reasons. Further the LDC's Board of Directors also scrutinizes these programs for integrity prior to approval for spending. Since these programs are generally cash funded by the LDC they make every effort to incur these costs prudently and as efficiently as possible. Setting low materiality thresholds (as proposed in Alternative 1 the lower of % of net fixed assets or $ value) will require LDCs to explain in detail a large number of projects in their 2004 capital programs. This not only burdens LDCs with additional filing requirements but also slows down the application evaluation process unnecessarily.

4.4 Interest on Deferral Accounts and CWIP

7. Consistent with other CLD members, PowerStream recommends the adoption of Alternative 1 as the use of a utility's embedded cost of debt provides the proper

assignment of carrying costs to the deferral account balances as actually experienced by an applicant.

8. As a general principle, for deferral accounts of a longer-term nature, which the OEB as recently as its Regulatory Asset Decision defined as "generally more than one year" (RP-2004-0117/0118/0100/0069/0064 Page 25, Paragraph 3.0.17), a longer-term interest rate should apply.

9. In this hearing the OEB recognized that the period of time from the incurring of costs to full recovery would stretch over several years and allowed the use of a long-term debt rate. The Board ruled that with the exception of Hydro One, the deemed long-term debt rate in the existing Handbook should apply in the case of Toronto Hydro, Enersource Mississauga and London Hydro. Hydro One was to use its last approved long-term debt rate. (Page 18, 2.0.29)

10. As noted at Page 3 of Exhibit B.7, for deferral accounts that will be recovered on an annual basis, PowerStream would support the use of a shorter-term debt rate. For such accounts, PowerStream would support the methodology used by the OEB to determine the 5.75 per cent approved for Conservation and Demand Management (CDM) and the Ontario Energy Board's costs.

The VECC Proposal Respecting Deferral Accounts

11. PowerStream recommends the OEB outright reject the VECC proposal. Not only is it contrary to the OEB's recent Regulatory Asset Decision and its recent gas utility Decisions it is also not reflective of regulatory practices in other Canadian jurisdictions.

12. When asked to provide an example of a regulator that imposed such a rate (Prime less 175 basis points) for deferral accounts VECC's witness, Mr. Matwichuk, was unable to readily provide an actual example but undertook to do so. In fact, Mr. Matwichuk admits that his proposal is not an attempt to suggest that the actual rate selected by the OEB should be hard and fast as his evidence suggests. (Volume 3, TR 140). PowerStream therefore submits that the Board should disregard VECC's submitted framework and keep with established regulatory principles.

Construction Work-in-Progress (CWIP)

13. For applying interest to CWIP account balances PowerStream recommends the adoption of Alternative 1. PowerStream submits the capitalization rate used by a utility should reflect the actual financing costs being incurred to finance the asset. The utility's embedded cost of debt best reflects a matching of the way in which the assets under construction will be permanently financed.

Chapter 5 Cost of Capital

5.2 Debt Rate

14. PowerStream supports Alternative 2 which considers the embedded cost of debt LDCs have with their parent company. (lesser of deemed at time of debt issuance vs. actual debt rate)

5.4 Working Capital Allowance

5.4.1 Introduction

15. PowerStream understands that the mechanistic adjustment to the cost of capital calculation does not reflect the additional risk that LDCs have had to shoulder as a result of their exposure to the entire electricity market settlement costs. In addition the Regulated Price Plan, once implemented, will place additional working capital pressures on LDCs. An update to the 15% of historical COP and other power supply expenses would be appropriate in this case. Although this still forms part of a Tier 1 or 2 applications it would be appropriate to use the methodology illustrated in Alternative 2. (adjustment based on forecast rates from an approved power authority (IESO)). As well, no reduction to working capital for security deposits should be made since these funds do not form part of the Distributor's general cash reserves for payment of monthly business activities. These total values are to be available for refund within the deposit policy criteria.

Chapter 6 Distribution Expenses

6.0 Introduction

16. PowerStream proposes that the appropriate level of detail for distribution expenses be based on a grouped trial balance as outlined in the 2006 EDR Model (i.e. Alternative 2). There is a direct relation between operation & maintenance expenses and capital program spending. Both capital and operation & maintenance programs are evaluated in periods of intensive capital additions or extensive maintenance requirements. Therefore, year over year review of individual general ledger items in isolation may produce skewed results in a year where PowerStream was more capital intensive in spending than another or vice versa. This detailed reporting would create more regulatory burden to provide explanations for the prudent and practical business practices of a LDC. This in turn would be reflected through increased rates to ratepayers through increased regulatory costs. We propose that the aggregated level of year over year

comparison will give rise to indications of variances which, if material, could result in more scrutiny for prudence.

6.2 Detailed Reporting for Specific Distribution Expenses

6.2.2 Bad Debt Expense

17. Since the cost of capital was adjusted mechanistically the added risk exposure of LDC since 1999 has not been considered. PowerStream believes that consistent with a review on the cost of capital formula, an updated risk assessment will be undertaken by the OEB in 2007. Until such a review and assessment are undertaken the bad debt expense should be included as recoverable in revenue requirement. In addition, changes to the security deposit policy, effective July 2004 and fully implemented in the 1st quarter of 2005, will increase the LDC's risk exposure, which in turn will increase the allowances for bad debt in the future. Therefore, all bad debts for 2004 should be included as allowable for the calculation of revenue requirement.

6.2.4 Advertising, Political Contributions, Employee Dues, Charitable Donations, Meals/Travel and Business Entertainment, Research & Development

Charitable donations

18. PowerStream proposes that this type of expense be recoverable but capped at a % of revenue or % of net income threshold for all LDCs. This will facilitate comparability amongst the Distribution sector and allow some level of donations, which will benefit the ratepayers in the community.

6.2.5 Employee Compensation

2. Minimum Filing Requirements

19. PowerStream proposes that the minimum filing requirements for employee compensation fulfills the level of scrutiny required in order to determine prudence and no additional filing requirements are necessary. As a means of comparability and to review the reasonableness of these expenses, the average yearly compensation per employee by category will accomplish this requirement. Furthermore, LDCs must have this information available for scrutiny on a salary band basis to all interest parties in order to comply with the Municipal Freedom of Information and Protection of Privacy Act.

3. Incentive plans

20. PowerStream believes that incentive plans should be allowable distribution expenses since these incentives (at all staff levels) promote increased productivity and initiative and are paid on meeting specific goals and targets. Although this may translate into incremental returns for the Shareholder it also provides increased quality of service and lower costs going forward to ratepayers. Incentives for staff create positive environments for increased quality of service through increased response time and initiatives which assist in better system reliability. A LDC's initiative to move to incentive plan compensation also limits the amount of the base salary component for employee compensation. It places more risk on the incentive portion of the expense and entitlement is only paid if performance is met. Discouraging inclusion of this expense from the eligibility in the recovery through rates may shift compensation back to base salary and effectively increase rates to the end users.

6.2.7 Distribution Expenses Paid to Affiliates

21. PowerStream proposes that the additional filing requirements are unnecessary to determine a Distributor's compliance to the ARC. In disclosing the minimum filing requirements the Distributor must file the nature, methodology, monetary value and basis for pricing the transactions with each affiliate. This information will assist the OEB in determining compliance to the ARC at which time the OEB can determine if further information on actual costs of the affiliate is required on an individual basis for further scrutiny.

Chapter 7 Taxes/PILs

7.1.1 General Principles Underlying the 2006 Tax Calculation

22. PowerStream supports the methodology proposed by the partial true up in Alternative 1. This limits the potential swings in rates, which may be caused by the full true up methodology. There is continual catch up whether increases or decreases in future rates for activity and earnings of the previous rate years. The partial true up methodology provides the customers with better rate transparency and stability. The partial true up also mitigates the risks of the shareholders if events outside of the Corporation control materialize. If there are changes in any tax rates/law/assessments losses could be incurred if tax rates were increased with no true up mechanisms. These increases would be unrecoverable during a rate year with no true up mechanisms. Conversely, ratepayers are protected if tax rates are lowered under the partial true up.

23. PowerStream supports the evidence filed by Toronto Hydro during the oral hearing and their submissions respecting this issue.

7.1.2.2 Non-recoverable and disallowed expenses

24. Consistent with other members of the Coalition of Large Distributors, it is PowerStream's position that the tax benefits associated with any disallowed OEB expenditures should go to the benefit of the applicant's shareholder. The costs associated with disallowed expenditures are borne by the shareholder and under the established principle of "benefits follow costs" any related tax savings should therefore accrue to the shareholder. Costs associated with the disallowed expenditures are not reflected in the rates of the distributor, so the ratepayers should not be entitled to any tax savings associated with these expenditures. To do so would lower the allowed return available to the shareholder approved by the OEB and would violate established regulatory principles.

25. The underlying assumption with respect to this issue of tax savings associated with disallowed expenses is that an applicant would continue to make these expenditures even with the full knowledge that no recovery in rates will be allowed and that any tax savings would flow to the ratepayer. Few if any prudently managed organizations would continue to make such expenditures on a go forward basis. There wouldn't be any incentive and thus the tax savings the School Energy Coalition is trying to obtain for customers would generally not be there.

Chapter 14 Comparators & Cohorts

26. PowerStream supports the use of comparators and cohorts as a screening tool only. In addition, filing information prior to the preparation of the 2006 rate application in order to understand which cohort PowerStream will be assigned to would be beneficial in preparing the rate application. In particular, if PowerStream had the potential to be an outlier and be under a higher level of scrutiny the reasons for being an outlier could be addressed in the application.

27. PowerStream supports Alternative 2 in regards to distribution of the comparators and cohorts analysis. PowerStream is concerned the initial analysis will be based on data that may still be compromised and inconsistent to a degree and if released to the public may result in misleading conclusions that could be harmful.

Conservation and Demand Management

28. PowerStream is committed to initiatives that will enable Conservation and Demand Management (CDM). The company is still ramping up its programs and determining how savings will be tracked and measured. This experience allow PowerStream to have more informed comments on LRAM and SSM models in future proceedings.

29. PowerStream generally supports the submissions of Hydro One Networks Inc. and Toronto Hydro–Electric System Limited in this area.

30 PowerStream agrees on the necessity for revenue protection, and timely recovery of CDM expenditures. However, the timeline for the 2006 EDR has been very short for such an important topic as CDM and therefore, PowerStream hopes that any decisions made will be considered preliminary and will be revisited when distributors are required to re-base distribution rates in 2008.

Respectfully Submitted

John Glicksman

John Glicksman

Executive Vice President and Chief Financial Officer

PowerStream Inc.