

2006 Electricity Distribution Rates

Distribution Expenses

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Gaps in Accounting Treatment

Issue of Scope

- Should the development of prescriptive accounting treatment for expenses incurred in 2006 and beyond, be developed as part of the 2006 EDR process for implementation into 2008 rates?
 - Some expenses do not currently have prescriptive accounting treatment
 - Wide range of treatment between LDCs

Issue 10 – Affiliate Transactions (AT) and Shared Services (SS)

Discussions/background

- maintaining confidentiality of affiliate's competitive information
- review of ARC compliance in 2006 EDR process
- wide range in nature and amounts of ATs and SSs used by LDCs

Issue 10 – Affiliate Transactions (AT) and Shared Services (SS)

Proposed consensus

- Minimum filing requirements for AT
 - identify all affiliates
 - summary of nature of activities provided by each affiliate
 - annual aggregate value (\$) of each affiliate's services
 - process used to determine basis for transfer pricing (e.g. cost vs. market pricing)
 - method used to determine prices (e.g. cost based, cost allocation, market based, tendering process)

Issue 10 – Affiliate Transactions (AT) and Shared Services (SS)

Proposed Consensus

- Minimum filing requirements for SS
 - types of services (e.g. finance services, IT, office space)
 - annual value (\$) by service
 - rationale and summary of cost allocators for each service (e.g. square footage, computers, headcount)
 - use APH Article 340 as reference for allocators

Issue 10 – Affiliate Transactions (AT) and Shared Services (SS)

Unresolved:

- What should the additional filing requirements be for review of AT and SS (e.g. Service agreements and contracts)

Proposed path:

- Submission/argument before the board

Issue 10 – Affiliate Transactions (AT) and Shared Services (SS)

Issue of Scope

- To what extent must ARC compliance be determined as part of 2006 rate setting process to determine reasonableness of expenses?

Issue 11- Low Voltage and Wheeling Costs

Discussion/background

- Hydro one has an approved shared DS charge
- Future specific DS, shared line and specific line charges
- Expenses related to recouping of assets from host
- Include expenses in account 5017

Issue 11- Low Voltage and Wheeling Costs

Unresolved:

The following filing requirements

- Amounts billed to an embedded LDC by its host LDC for Shared DS, Specific DS, Shared Line, Specific Line charges to be included in Account 5017
- Such amount shall include amounts for:
 - recouping regulatory assets from host LDC; and
 - amounts for rates to be charged by a host LDC in 2006 and beyond for Shared DS, Specific DS, Shared Line, Specific Line

Issue 11- Low Voltage and Wheeling Costs

Proposed path:

- Working group needs to consider rules resulting from proceeding on regulatory assets and any future government directives

Issue 21 - Definition of Distribution Expenses

Discussion/background

- Updates to the current definitions of distribution activities and list of distribution expenses in the USoA
- Changes in distribution expenses definitions related to changes in rate base definitions
- Minimum filing requirements for distribution expenses

Issue 21 - Definition of Distribution Expenses

Proposed consensus

- Continue with definitions in DRH Appendix D, part I
 - Guidelines for Determining distribution or “wires only” activities and assets
- Discontinue DRH Appendix D, part II
 - Rate base calculation – initial filing
- Update DRH Appendix D, part III, table B.2
 - Add accounts 5014 and 5015 – transformer equipment

Issue 21 - Definition of Distribution Expenses

Recommended filing requirements:

- Utilities should file 3 years of historical data (i.e. 2004, 2003 and 2002) for high level groupings of distribution expenses

Unresolved issues:

- Level of account groupings

Proposed path:

- Further discussions in working group, possible argument before Board

Issue 22 – Benefits and Pensions Matters

Discussion/background

- Should review be on period expenses only or on choice and performance of pension plan
- Some utilities administer their own pension plans and may have unique expenses or associated risks
- Cash vs. Accrual basis for recording pension and post-retirement benefits costs

Issue 22 – Benefits and Pensions Matters

Proposed consensus

Filing requirements for pensions

- Three years of historical information (2004, 2003 and 2002) on amounts paid for pension premiums and adjustments
- LDCs who do not use OMERS must provide key policy information (e.g. Cash versus accrual valuation, “smoothing” methods, summary of performance)

Issue 22 – Benefits and Pensions Matters

Unresolved:

- Filing requirements on non-OMERS plans not available to all employees

Proposed Path:

- Further discussions in working group

Issue 22 – Benefits and Pensions Matters

Proposed consensus

Filing requirements for post retirement benefits

- Information on current accounting treatment (e.g. Cash vs. Accrual, review of period frequencies) of benefits as well as on treatment of one-time expenses and on past changes in accounting policies (e.G. Move from cash to accrual)
- Information on treatment changes in actuarial value in post retirement benefits

Issue 24 – Review of Insurance Expense

Discussion/background

- Third party insurance premiums
- Utility's reserves related to self insurance

Issue 24 – Review of Insurance Expense

Proposed consensus

Filing requirements:

LDCs using third party insurance should provide:

- 3 years of historical costs;
- high level information on number of insurers;
- types of insurance purchased;
- Premium costs by insurer

Issue 24 – Review of Insurance Expense

Filing requirements (cont.)

- LDCs that self-insure should provide high level information on:
 - Evaluation plan; And,
 - Accounting treatment for reserves.

Unresolved:

- Whether changes in reserves can be treated as expense

Proposed path:

- Further discussion in working group

Issue 25 – Bad Debt Expense

Discussion/background

- Separate reporting of bankruptcy from bad debt expenses
- Bankruptcy as on-going component of bad debt

Issue 25 – Bad Debt Expense

Proposed consensus

Filing requirements:

- Bad debt recorded for three historical years (2004, 2003 and 2002) in 2004, including bankruptcies, to be reported segregated by customer class
- Disclose single bankruptcies exceeding current materiality for z-factors (i.e. 0.25% of net assets)

Issue 25 – Bad Debt Expense

Unresolved Issue:

- What timing is used to write-off bad debt: year it is provided for or year it is written off.

Issue 26 – Total Compensation

Discussion/background

- Level of disclosure for meaningful regulatory review vs. privacy of individuals' wages
- Difficulty establishing filing categories that fit all LDCs with varying levels of employees
- Disclosure threshold (e.g. individuals > \$100,000)

Issue 26 – Total Compensation

Proposed consensus

- Compensation issues related to affiliate transactions are adequately reviewed under the filing requirements for affiliate transactions
- LDCs need to confirm existence of and adherence to documented LDC compensation policy

Issue 26 – Total Compensation

Filling requirements:

- Provide for each category : Executive, Management, Non-unionized, Unionized
 - Average yearly wage
 - Average yearly incentive
 - Average yearly benefits
 - Number of FTEs in category
- Where there are ≤ 3 FTE's/category, aggregate staff with most closely related category, continue to aggregate to ensure that no category contains ≤ 3 FTE's/category

Issue 26 – Total Compensation

Wage – earnings including overtime, excluding incentives and benefits

Incentive – amounts paid as prescribed corporate incentive

Benefits – employee benefits related to compensation

Executive – e.g. CEO, COO, VP's, Directors

Management – e.g. operational, middle, supervisory

Non-Unionized – positions not part of bargaining units

Unionized – positions included in bargaining units

Issue 26 – Total Compensation

Unresolved:

- Should overtime amounts be included in wages?
- Filing requirements for LDCs with < 3 employees
- Should “unionized” category be broken down by bargaining unit?
- Disclosure of compensation for staff earning > \$100,000
- Disclosure/eligibility for recovery of performance plan
- Need for filing of information on contract staff
- Need definition of “contract” employees
- For LDCs with affiliates what portion should be reported: total compensation or only the portion paid by LDC?

Proposed Path:

- Further discussion in working group

Issue 27 – IT Expenses

Discussion/background

- IT project overruns in gas distribution industry
- Wide variety of treatment of IT expenses by LDCs

Issue 27 – IT Expenses

Proposed consensus

- Most useful review of IT expenditures is capital investment rather than expenses and should be undertaken as rate base consideration
- Lack of formal account definition in USoA makes separate IT expense filing difficult and likely of no comparative value across LDCs
- Prescriptive accounting treatment should be developed for future years

Issue 28 – Advertising, Entertainment/travel, Charitable and Political Contribution, Employee Dues, Research & Development

Discussion/background

- Allocation between ratepayers and shareholders
- Uniqueness precludes generic treatment
- Expectation of public utilities as community supporters
- E/T recorded across many accounts
- Use of general principles in absence of values

Issue 28 – Advertising, Entertainment/travel, Charitable and Political Contribution, Employee Dues, Research & Development

Proposed consensus

Implementation of following policies:

- Advertising
 - Advertising expenses incurred for sole purpose of promoting corporate branding or image are not recoverable in distribution rates and are a cost to be borne by the shareholder

Issue 28 – Entertainment/travel etc.

Policies (cont.)

- Entertainment/Travel
 - Staff entertainment and travel expenses (i.e. employee business expenses) must be approved by LDC management and must be based on a documented and consistently applied corporate policy

Issue 28 – Entertainment/travel etc.

- Unresolved:
 - Whether disallowed portion of entertainment expenses filed in LDC's tax return could be used as proxy of 1/2 of level of this expense in the absence of distinct accounts.
 - Should LDCs file policy on E/T, including staff development and training?
 - Should LDCs be required to required to file information on excluded items
- Proposed Path:
 - Further discussion in working group

Issue 28 –Political Contribution etc.

Policies (cont.)

- Political Contributions
 - Political contributions are cash donations to political parties and are a cost to be borne by the shareholder and not recoverable in distribution rates.

Issue 28 –Employee Dues etc.

Policies (cont.)

- Employee Dues
 - Fees or dues for annual recreational or social club memberships are not recoverable in distribution rates (e.g. golfing, tennis, sailing).

Issue 28 –Research & Development etc.

Policies (cont.)

- Research and Development
 - Prudently incurred distribution related research and development expenditures intended to benefit the ratepayers are recoverable in distribution rates

Issue 28 –Charitable Contribution etc.

Charitable Contributions

- Unresolved:
 - Should charitable contributions be recoverable in rates?
- Proposed Path:
 - Further discussion in working group