

**Rate Base  
Issues  
Section 3.3**

# Rate Base

## Section 3.3

### Summary of Work to Date

- Reviewed the definition of distribution rate base and rate base components as to be defined in the 2006 Distribution Rate Handbook (DRH).
- Working to develop filing guidelines and definitions for all rate base components that have been identified by the OEB as 'issues'.
- Reviewed the relevancy of these identified issues to the Ontario electric distribution sector.
- Identified where these issues impact or cross over to other revenue requirements or rate design issues and groups for the 2006 EDR process.

# **Rate Base**

## **Section 3.3**

### **Summary of Work to Date (cont'd)**

- Identified where the Accounting Procedures Handbook (APH) lacks guidelines or prescriptive treatment for these issues and have recommended treatment for these issues post 2006.
- The group's work was based on the original OEB premise that a historic test year of 2004, will be the basis for setting 2006 distribution rates.

# Rate Base

## Section 3.3

### Questions of Scope

- Will the OEB sponsor an amortization study in time for the implementation into 2008 rates?
- Should the amortization rate for the computer hardware and software be adjusted as part of the 2006 EDR or considered in the depreciation study?
- Various C&DM issues - are these issues part of the process:
  - Amortization of C&DM capital assets that will not be approved in the C &DM variance accounts
  - Amortization rates for new smart meters and accelerated amortization for existing meter assets

# Rate Base

## Issue 9 - Depreciation Rates (cont'd)

### General Consensus

- That the current asset categories and amortization rates as listed in Appendix E of the current Distribution Rate Handbook will be used for the purpose of 2006 Rates
- The Ontario Energy Board should convene a working group to examine, re-evaluate and adjust amortization rates for the next rebasing period.

# **Rate Base**

## **Issue 9 - Depreciation Rates (cont'd)**

### **General Consensus (cont'd)**

- Organizations that do not follow the amortization rates as listed in the current Appendix E of the Distribution Rate Handbook should be allowed to file their own amortization schedule based on their own depreciation study which may be evaluated by the Ontario Energy Board.

# Rate Base

## Issue 9 - Depreciation Rates (cont'd)

### Unresolved issues

- Depreciation rates for hardware and software and effective implementation date of those rates.
- Early adjustment to high priority items

### Proposed path

- Evidence may be called, on reasonable life for computer hardware and software

# Rate Base

## Issue 9 - Depreciation Rates (cont'd)

### Cross Over

- Conservation & Demand Management (C&DM)
- Smart Metering



# Rate Base

## Issue 13 – Definition of Distribution Rate Base

### General Consensus

- The current definition of rate base and calculation thereof, shall be maintained for the 2006 EDR process with the following inclusions:
  - Expenditures for smart meters and C&DM capital projects not recovered through the next phase of MBRR or otherwise funded are to be included in the definition of fixed assets.

# Rate Base

## Issue 13 – Definition of Distribution Rate Base (cont'd)

### General Consensus

- Amounts paid to other LDCs for capital projects, namely Hydro One, for contributions for transformer stations and transformer assets >50 kV (LDC owned Transformer Stations) to be included in the definition of fixed assets.
- The definition of metering assets is to be clarified to include wholesale metering upgrade assets.
- Capital leases as defined by Canadian GAAP would be included as fixed assets.

# Rate Base

## Issue 13 – Definition of Distribution Rate Base (cont'd)

### Unresolved issues

- The joint use assets included in rate base should have the revenue that these assets generate be applied consistently with other revenues in determining the revenue requirement.
- If within scope, the application of 2005 MBRR funds to C & DM assets.

# Rate Base

## Issue 13 – Definition of Distribution Rate Base (cont'd)

### Cross Over

- Conservation and Demand Management (C&DM)
- Smart meter initiative
- Test Year

# Rate Base

## Issue 14 – Rate Base Measurement Date

### Summary of Discussion

In valuing of fixed assets for rate base, discussion ensued about the three different valuation approaches:

- The balance at the end of the year
- An average of the balances from the beginning of the year and end of the year
- Average monthly balance

# Rate Base

## Issue 14 – Rate Base Measurement Date (cont'd)

### Unresolved Issue

- What date should be used to determine the 2004 historical balances?

# Rate Base

## Issue 14 – Rate Base Measurement Date (cont'd)

### Alternatives

- Historical year end balances
  - As rates will not be implemented until 2006, the assets purchased or constructed in 2004 will be in full use and in rate base for over a year from the close of fiscal 2004. Therefore the LDC should be allowed to calculate the 2006 rates using the full amount of the 2004 year-end balances

# Rate Base

## Issue 14 – Rate Base Measurement Date (cont'd)

### Alternatives (con't)

#### Historical year end balances (cont'd)

- Using year-end amounts would be easier to calculate and more transparent in an audit function and is also consistent with the original Rate Handbook.
- Using a yearly average may not be reflective of when the asset was placed in service, which in some cases, benefits some and hinders others. Therefore consistency and fairness would dictate that year balances would be used.



# Rate Base

## Issue 14 – Rate Base Measurement Date (cont'd)

### Alternatives (cont'd)

- Yearly Average balances
  - The argument for using average balance is that when rates are based on a year when the asset is placed in service, the LDC should not receive rates based on assets that have not been in use for the full year.

# Rate Base

## Issue 14 – Rate Base Measurement Date

### Proposed Path for this Issue

- Evidence

### Cross Over

- Test Year - Timing difference between calendar year and rate year may be an issue.
- Prudence Review of 2004 balances see 3.1

# Rate Base

## Issue 16 – Capitalizing Expenses

### General Consensus

- No change in capitalization policy for 2006, but electricity distributors should implement full cost accounting by 2008;
- The definition should be further defined and a companion guide produced to provide more guidance and consistency among LDC's in allocating overhead.
- The APH should also be amended to include reference to the new CICA section 3110 on Asset Retirement Obligations.
- A description of a LDC expense capitalization policy must be filed.

# Rate Base

## Issue 16 – Capitalizing Expenses

### Unresolved issues

- What interest rate should be used for interest capitalization?
- Type and amount of disclosure of an LDC's capitalization policy needed.

### Proposed Path for this Issue

- Interest rate – Evidence
- Type of disclosure – further discussion and argument

### Cross Over

- Distribution expenses and effect on Comparators and Cohorts
- Test year

# Rate Base

## Issue 17 – Capital expenditures

### Summary of Discussion

- The practicality regarding an in-depth review of capital projects was discussed and thought to be too broad due to resource constraints and the number of electricity distributors (90+).
- Capital project review could be approached by way of filing rules. File a trend line and brief analysis of line items. Ability to question trend line needs to be in place. All of these factors would be within the scope of a materiality level
- Discussion about a general materiality limit or level. This could be used to flag where an LDC would have to provide further analysis and summaries. For example, if 2004 figures greater than 25% compared to past, an explanation would be required.

# **Rate Base**

## **Issue 17 – Capital expenditures**

### **Summary of Discussion (cont'd)**

- Prudence Review
  - Scope and detail

# **Rate Base**

## **Issue 17 – Capital expenditures**

### **Consensus**

**Three years of historical capital expenditures should be filed.**

### **Unresolved issues**

- Definition of the material variance threshold.
- Level of detail in filing requirements for 2002, 2003 and 2004 capital projects data, including what explanation must be provided for variances.

### **Proposed Path for these Issues**

- Further discussion at the working group level

# **Rate Base**

## **Issue 18 – Contributed Capital**

### **General Consensus**

- The Status Quo should remain in effect.



# **Rate Base**

## **Issue 19 – No Cost Capital**

### **General Consensus**

- No Cost Capital is a non-issue in Ontario.

# Rate Base

## Issue 20 - Treatment of Capital Gains & Losses

### Unresolved Issues

- How should capital gains and losses be shared between the ratepayers, and the shareholder, if at all?
- Alternatives discussed included shareholder keeping 100% of gain or loss, ratepayer keeping 100% of gain or loss, or a sharing of gains or losses between ratepayers and shareholders.
- Materiality threshold.

### Proposed Path for this Issue

- Evidence