Response of the Coalition of Large Distributors to the Evidence of the Vulnerable Energy Consumer's Coalition Re; the Appropriate Interest Rate for Work in Progress and Deferral Accounts

1.0 Background

On Day 1 of Issues Day in the 2006 Electricity Distribution Rates proceeding, RP-2004-0188 held on November 1, 2004, the Board ruled:

> "With respect to item number 2 and deferral accounts, the Board will hear evidence on this item, the appropriate interest rate for work in progress and deferral accounts. But we do caution the parties that the Board does not anticipate that this evidence will open up the larger questions in the financial parameters section."

The Vulnerable Energy Consumer's Coalition (VECC) chose to lead evidence on this issue and retained the services of Mr. M. Greg Matwichuk, a partner with the firm of Steven Johnson Chartered Accountants of Calgary, Alberta.

This reply evidence has been prepared by the Coalition of Large Distributors (CLD) to comment on the recommendations put forth by VECC for determining the appropriate interest rate for interest improving construction work in progress (CWIP) and deferral accounts.

The CLD members include Hydro One Distribution, Toronto Hydro, Hamilton Hydro, Powerstream, Hydro Ottawa, Veridian Connections Inc. and Enersource Mississauga.

2.0 CLD Response to VECC Recommendations

The CLD largely supports the recommendations of VECC as presented in the written evidence of Mr. Matwichuk.

2.1 Construction Work In Progress

VECC recommends the use of an Allowance For Funds Used During Construction (AFUDC) using the Weighted Average Cost Of Capital (WACC), or Interest During Construction (IDC) using a long-term debt cost for the interest improvement of CWIP balances.

> "Given the regulatory principles, history and generally accepted regulatory practice, the appropriate carrying charge for CWIP would be AFUDC (using rate of return on rate base) in the case of utility whose capital structure includes an equity component and IDC for a utility that is essentially financed by debt. Short term debt rates are not typically employed in the context construction assets. Based on my analysis, I recommend Alternative 3." (Q17, Page 17)

The CLD agrees with VECC's recommendation of Alternative 3 for interest improvement of CWIP balances. The capitalization rate used by a utility should reflect the actual financing costs being incurred. The most appropriate rate for calculating the interest capitalized on CWIP is the company's WACC. Investments are made with the expectation that prudently incurred costs related to these investments will be recovered from the time incurred and throughout such assets' service lives.

2.2 Deferral Accounts

VECC has developed a "Size-Related Debt Rate Formula" and suggests this could be a basis for interest improvement of the majority of deferral account balances. In the case where deferral account balances are greater than 10% of a utility's rate base VECC is suggesting the application of a 5 to 10 year deemed debt rate or WACC.

The CLD supports the use of a shorter-term debt rate for the interest improvement of deferral accounts in those cases where an annual clearing and recovery mechanism has been established, as is the case with the gas utilities in Ontario. The CLD encourages the Board to establish a more timely process that will result in the recovery of deferral account balances on a more frequent basis.

Where a deferral account is of a longer-term nature, generally more than one year, the CLD continues to believe a longer-term rate is more applicable for interest improvement.