

**Ontario Energy  
Board**  
P.O. Box 2319  
2300 Yonge Street  
26th. Floor  
Toronto ON M4P 1E4  
Telephone: (416) 481-1967  
Facsimile: (416) 440-7656

**Commission de l'Énergie  
de l'Ontario**  
C.P. 2319  
2300, rue Yonge  
26e étage  
Toronto ON M4P 1E4  
Téléphone: (416) 481-1967  
Télécopieur: (416) 440-7656



Writer's Direct Line (416) 440-7607

November 9, 2001

**To: All Electric Distribution Utilities**

The Board has been requested to provide some clarification or direction on transition costs. The Board has given guidance on transition costs in its RP-2000-0069 Decision With Reasons, Sept 29, 2000, the Electricity Distribution Rates Handbook (Rate Handbook) and the Accounting Procedures Handbook for Electric Distribution Utilities (APH). In summary, the Board has stated:

1. the Board will initiate a review of the appropriate timing and mechanism as soon as practical following market opening;
2. the Board will apply the four criteria listed in the Rate Handbook to determine eligibility. The four eligibility criteria of causation, materiality, inability of management to control and prudence are more fully described in section 5.5.1.1 of the Rate Handbook;
3. recovery may be through Z factors "or any other means deemed appropriate as a result of the Board's review";
4. the size of the prospective rate adjustment will not be subject to a predefined limit to provide flexibility to set the rate rider with due consideration to other rate-related customer impacts;
5. the Board may adjust the class-specific rate adjustment directly based on the information provided, or may seek additional information from the utility and/or may request a review and report from the Board's Energy Returns Officer on cost eligibility and the derivation of the rate rider; and
6. where an approval is granted by the Board in the future for the disposition of a certain amount contained in the Transition Cost account 1570, the utility shall reduce the deferral account by the actual amount collected.

However, the Board has recognized in its RP-2000-0069 Decision With Reasons the cash flow pressures utilities would endure by delaying the incorporation of transition costs into initial rates. The Board acknowledges that the activities required to support market opening have turned out to be very complex, time consuming and potentially costly. The Board also recognizes that the anticipated date of market opening is now later than envisaged when this Decision was issued.

The Board has reviewed the amounts reported by electricity distributors in their trial balances of December 31, 2000 and, upon discussion with a number of the utilities, has discovered that the vast majority of expenses considered transition costs are in the development of systems projects to support the competitive market. In most instances, these are still projects in progress and, as such, are

included in construction work in progress, attracting carrying costs. Projects that are works in progress are not considered rate base items until they are put into service (even under a cost of service regulatory approach) and therefore would not receive the return associated with the utilities' deemed capital structure.

As provided for in Article 480 of the APH, completed capital projects will be recorded in the transition cost account, which also earns a return. Article 480 provides for the recovery of both a return on capital assets, and the recovery of the depreciation associated with the capital addition.

The Board realizes that, despite the fact that a return is being allowed on the transition cost account, that return is not currently reflected in rates and therefore there is a cash flow impact. The Board will therefore allow utilities to recover a portion of their transition costs in conjunction with the annual rate adjustment process.

The following guidelines shall apply to determine the transition costs limit the Board will consider for rate recovery in the annual rate adjustment process:

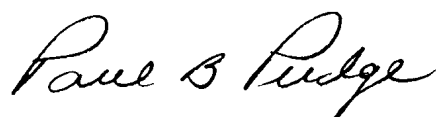
1. Recovery of transition costs will be based on amounts reported in the utility trial balance already filed with the Board, which reflect the audited financial results of the utility as at December 31, 2000. Reliance on the audited results provides increased assurance that the transition cost account (APH Account 1570) has undergone a level of independent assessment regarding utility management's representation about the costs recorded in the account. Should the utility seek rate recovery of accumulated transition costs for a later period it will need to undertake a focused audit of the balance accumulated in Account 1570 to the proposed disposition date.
2. Account 1570 is comprised of capital and non-capital sub-accounts. The Board will allow recovery of 100% of the transferred balances between the capital and non-capital sub-accounts as outlined in Article 480. In addition, the Board will also allow recovery of 20% of the balances in construction work in progress account (APH Account 1380) for specific projects which the utility would record in APH Account 1570 upon completion and assessment against the Board's Rate Handbook eligibility criteria.
3. For all other amounts recorded in the non-capital sub-accounts, the Board will reduce the recovery percentage to one third of the remaining non-capital amounts, as the Board is of the view that these items may be more contentious.

While the Board has established this recovery limit, recovery of transition costs will be reviewed in conjunction with other financial matters impacting the annual rate adjustment (e.g. Incremental MARR, PILs, IPI-X, etc.). Transition cost recovery may be deferred in whole or in part if the Board determines that the resulting rate impact on customers is undue. In addition, while the Board has allowed a partial recovery of transition costs, the Board will be reviewing all transition costs against the criteria of both the Rate Handbook and the guidance provided in Article 480 of

the APH at a later time. Inappropriately recorded amounts will be disallowed and any amounts collected resulting from this partial recovery of transition costs will reduce the recovery of these costs in future periods.

The Board will be issuing its filing guidelines for the annual rate adjustment shortly. Utilities are encouraged to hold their filings on Z-factor items until additional guidance is provided on the annual rate adjustment process.

Yours truly,

A handwritten signature in cursive script that reads "Paul B. Pudge". The signature is written in black ink and is positioned above the typed name.

Paul B. Pudge  
Board Secretary