May 21, 2010

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St., Suite 2700
Toronto, ON, M4P 1E4

RE: **EB-2010-0178 - Depreciation Study for Electricity Distributors**

Dear Ms. Walli:

On April 30, 2010, the Ontario Energy Board (the "Board") released a draft report by Kinectrics Inc. ("Kinectrics") called Asset Amortization Study for the Ontario Energy Board (the "Study") and invited comments from electricity distributors on the draft report. Following are the comments of the Coalition of Large Distributors ("CLD") which is comprised of Enersource Hydro Mississauga, Horizon Utilities Corporation, Hydro Ottawa, PowerStream, Toronto Hydro-Electric System Limited, and Veridian Connections.

Nature of the Study as a Tool

The CLD notes that the Board described this Study as a tool for distributors in determining the service lives of assets under International Financial Reporting Standards ("IFRS") but that each distributor must still evaluate their specific circumstances. Kinectrics also noted that the purpose of the Study was to assist distributors, but that each distributor "must still evaluate whether the total service lives set out in this Report are completely applicable to their own utility". However, the conclusion of the report states "the selected useful lives are not expected to be substantially different from the Typical Useful Lives ("TULs") provided in this Report unless it can be demonstrated that a utility operates under an exceptional set of circumstances." Further, it is noted on page 14 of the Study that "the selected amortization period should stay within the prescribed range". The test should not be whether the utility operates under an 'exceptional' set of circumstances, but rather whether utility-specific information is sound and better represents the expected useful life of assets in its system. The CLD believes that the final report should exclude these comments. It is critically important that it is understood by all parties that the Study is just one tool to assist distributors and that it is not meant to replace professional judgment and responsibility of the distributor to review and determine the appropriateness of its depreciation methodologies, including estimated useful lives, as required under IFRS.

Useful Lives

For the CLD, identified asset components fall within the proposed ranges for most of the components, and for those that fall outside the range there is a good rationale. However, the general concern is that the Study's development of the useful lives seems to focus mostly on the "technical" lives, which would be defined as when an asset would

be expected to fail if it was left in service. The technical lives would be longer than the actual useful lives for two key reasons.

First, while there is an attempt to include external factors, Kinectrics notes that information on the cause of end of life for assets is limited. On that basis, there must be qualitative judgment used to determine the effect of local and external factors (e.g. technological changes, other construction activities, new regulations etc.). These factors could be quite different in an urban service area with a lot of construction activity. The occurrence of these local and external factors becomes more probable the longer the life of the asset. With many of the assets having a TUL of longer than 50 years, the likelihood of an external factor hastening the failure of an asset increases significantly.

Second, many distributors have been developing comprehensive asset management plans ("AMPs"). These programs are designed to evaluate asset conditions and to develop asset replacement plans based on the probability and impact of plant failures. One likely result of implementing an AMP is that distributors will replace many assets before they fail. This practice effectively shortens the TUL of an asset but improves the distributor's service quality to customers and generally reduces its overall costs because replacing an asset in an emergency condition is usually more costly. The extent to which the use of comprehensive AMPs has been factored into the TULs is not clear. Those taking a more proactive approach to asset management may have a lower TUL than in the Study, or fall outside of some of the identified ranges, and should not be discouraged from effective management of assets as the result of having to justify variations from this Study. In other proceedings, the Board has been critical of reactive 'run-to-failure' asset management practices and therefore submits that the AMPs be considered in the determination of the TULs for the reasons described above.

The Study provides initial ranges of useful lives. However, IFRS requires an annual review of estimated useful lives and it is not clear how the identified ranges will be utilized by distributors beyond year one.

As a final note on the useful lives, there are two instances within the Study in which the minimum useful life of a component is the same as the TUL (i.e. 3. Fully Dressed Steel Poles and 15. Station DC System –Charger). The mathematical formula used by Kinectrics may have resulted in such values, but it is intuitively incorrect that the minimum and typical values would be the same.

Componentization

The CLD is concerned that there will be an expectation that each distributor have all of the asset components included in the Study. While there is some commonality, the level of componentization is highly dependent on how a distributor replaces its assets. For instance, if a pole is being replaced, it may be a cost efficient approach to replace the cross arms for the pole at the same time. Therefore, a distributor taking this approach would have no need to separate the poles and cross arms into different components. However, in the Study, not only are these assets identified as separate components, the cross arms have been identified as having a different TUL than the poles. It does not seem reasonable to expect that when a 60 year old concrete pole is being replaced, a 60 year old steel cross arm would be relocated to the new pole for another 10 years, or that a 40 year old wood cross arm would be replaced on a wood pole and 5 years later

the wood pole would be replaced. The useful lives and componentization must match the asset management practices of the distributor.

Another important consideration for componentization of assets is materiality. Within Ontario, the size of distributors ranges from those with a net property plant and equipment of under $1 million to over $4 billion. From an accounting perspective, it is the impact on depreciation expense that primarily drives the componentization of assets. Materiality is based on professional judgement and is reviewed by management. The distributor may determine that the impact of potential componentization of the asset on depreciation expense is not significant and therefore not necessary to separate the asset into components.

Finally, the Study has assigned assets to parent groupings based on overhead and underground classifications. A distributor may have grouped its assets more by the functionality of the assets. For instance, transformers could be grouped together rather than separated into overhead and underground parent groupings. This grouping should be at the discretion of distributors.

Given the relative size and asset management practices of distributors along with different system configurations, the Board should recognize that the number and type of asset components will vary between distributors for numerous reasons.

Useful Life of Minor Assets

On page 17 of the Study, Table F-2 includes a summary of the useful life of minor assets. The note below this table states, “Table 2 contains assets that were not studied in detail in this analysis and represent recommended ranges based on the experience of Ontario LDCs interviewed”. The CLD submits that if there is no detailed supporting analysis for this table, it should be excluded from the Study. The CLD also notes that it is inappropriate to constrain the selection of service lives because distributors may have different types of assets which have different retirement histories, are subject to differing factors leading to retirement, and may have varying accounts and asset componentization structures.

Adoption Date for IFRS

One important factor that needs to be corrected within the Study is the IFRS adoption date. As noted in the Executive Summary of the Study, IFRS is effective January 1, 2011. However, page 1 of the Study also notes that distributors will adopt IFRS “beginning in 2010”. This gets to the heart of the outstanding issue to be addressed. While financial statements for 2010 will still be completed under Canadian Generally Accepted Accounting Principles (“CGAAP”), the financial statements for 2011, which will be prepared under IFRS, must present comparatives for 2010. Hence, the statement should be corrected. This will result in differences between the 2010 opening and closing asset and accumulated depreciation balances shown in the 2010 financial statements and the 2011 financial statements. How these differences will be treated for the purposes of determining future rate bases and cost of service is still unclear.

Depreciation versus Amortization

Another point is one of terminology. The Study is called an amortization study. Amortization is more typically defined as the apportionment of the cost of an *intangible* asset as an operating cost over an asset's estimated useful life. Depreciation is a similar apportionment of costs, but for *tangible* assets. The Study focuses on determining common groups of tangible assets, identifying the most common components, and ascribing a typical range for the useful life of these components. As such, the CLD is of the opinion that the Study should be called a depreciation study, and references to amortization changed to depreciation throughout the document.

Other

The CLD notes that there were discrepancies in the Study between "Summary of Component Assets, Table F-1 Service Life Factors" and the supporting technical analysis for some of asset components (e.g. Section 7 – Overhead Integral, Switches, Section 17 – Station Independent Breakers, Section 31 – Secondary Cables – Direct Buried, etc). In addition, there were both typographical and grammatical errors noted throughout the report. It is recommended that these discrepancies and errors be rectified in the final report through a final proof reading by Kinectrics.

Conclusion

Based on the comments above, the CLD believes that the Study provides useful information and is a good tool for distributors to compare the results from their own analysis of asset useful lives. However, the Board needs to consider that there are other factors that will influence TULs, such as external factors and the proactive initiatives taken by asset management teams, all of which will influence a distributor's results. The numbers and types of asset components across distributors may be more difficult to compare because these will be based on the specific asset management practices and the relative size of each distributor and varying system configurations.

Thank you for this opportunity to provide comments on the Study. The CLD considers this to have been a worthwhile exercise provided that the Board does not consider the results prescriptive.

Yours truly,

Original signed by

Lynne Anderson
Chief Regulatory Officer
Hydro Ottawa

On behalf of the CLD