

RÉMUNÉRATION DES COMPTES D'ÉCARTS

EXPERTISE DE LA FIRME CONCENTRIC ENERGY ADVISORS



Remuneration on Deferral Accounts

Prepared Direct Testimony of

James M. Coyne and

Julie F. Lieberman

On behalf of Hydro-Québec Distribution

Presented to the

Régie de l'énergie

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TABLE OF CONTENTS

| | | |
|------|---|----|
| I. | Introduction..... | 1 |
| A. | Qualifications..... | 1 |
| B. | Scope of Testimony..... | 4 |
| C. | Executive Summary..... | 5 |
| II. | Background and Definition of the Issue..... | 7 |
| III. | Regulatory and Financial Principles that Inform Conclusions | 10 |
| IV. | Specifics of HQD’s Circumstances | 22 |
| V. | Review of North American Regulatory Precedent..... | 24 |
| VI. | Response to Intervenor Evidence | 31 |

1 **I. INTRODUCTION**

2 Concentric Energy Advisors, Inc. (“Concentric”) provides this testimony on behalf
3 of Hydro-Québec Distribution (“HQD”) under two witnesses, Mr. Coyne and Ms.
4 Lieberman, who have collaborated in its preparation. The words “Concentric”,
5 “we”, and “our” are used interchangeably in the text.

6 **A. QUALIFICATIONS**

7 **Q. Please state your name, affiliation, and business address.**

8 A. My name is James M. Coyne, and I am employed by Concentric as a Senior Vice
9 President. My business address is 293 Boston Post Road West, Suite 500,
10 Marlborough, MA 01752.

11 **Q. Please describe your experience and qualifications.**

12 A. I am among Concentric’s professionals who provide expert testimony before federal,
13 state and Canadian provincial agencies on matters pertaining to economics, finance,
14 and public policy in the energy industry. Concentric provides financial, economic
15 and regulatory advisory services to clients across North America, including utility
16 companies, regulatory and public agencies, and utility sector investors. I regularly
17 advise utilities, generating companies, public bodies and private equity investors on
18 business issues pertaining to the utility industry. This work includes calculating the
19 cost of capital for the purpose of ratemaking, and providing expert testimony and
20 studies on matters pertaining to incentive regulation, rate policy, valuation, capital
21 costs, demand side management, low-income programs, fuels and power markets. In
22 addition, I work for utilities, independent developers and public bodies on issues

1 pertaining to the management and development of power generation, distribution
2 and transmission facilities.

3 I have authored numerous articles on the energy industry and filed testimony before
4 the Federal Energy Regulatory Commission and jurisdictions in Alberta, British
5 Columbia, California, Connecticut, Maine, Massachusetts, New Jersey, Nova Scotia,
6 Ontario, Québec, South Dakota, Texas, Vermont and Wisconsin. I also publish a
7 periodic report (in collaboration with the Canadian Gas Association) that compares
8 and analyzes ROEs for gas and electric utilities in Canada, and I have spoken at
9 industry and regulatory sponsored events on the topic.

10 Prior to joining Concentric, I was Senior Managing Director in the Corporate
11 Economics Practice for FTI/Lexecon, and Managing Director for Arthur
12 Andersen's Energy & Utilities Corporate Finance Practice. In those positions, I
13 provided expert testimony and advisory services on mergers, acquisitions,
14 divestitures and capital markets for clients in the energy industry. In addition to the
15 foregoing positions, I was also Managing Director for Navigant Consulting, with
16 responsibility for the firm's Financial Services practice, Director in DRI's Electric
17 and Natural Gas practices, and Senior Economist for the Massachusetts Energy
18 Facilities Siting Council, where I analyzed the supply plans and facilities proposals
19 from the state's electric and gas utilities. I also served as State Energy Economist for
20 the Maine Office of Energy Resources. I hold a B.S. in Business Administration
21 from Georgetown University and a M.S. in Resource Economics from the University
22 of New Hampshire. My qualifications are more fully detailed in the curriculum vitae.

1 **Q. Please state your name, affiliation, and business address.**

2 A. My name is Julie F. Lieberman, and I am also employed by Concentric as a Project
3 Manager. My business address is 293 Boston Post Road West, Suite 500,
4 Marlborough, MA 01752.

5 **Q. Please describe your experience and qualifications.**

6 A. I have approximately 30 years experience in the energy industry with 10 years
7 focused specifically on utility regulation. My work has included utility ratemaking,
8 risk management, regulatory policy, financial and economic analysis, business
9 valuation, due diligence and litigation support and analysis. Since joining Concentric
10 in March 2004, I have advised numerous utility and energy clients on a wide range of
11 financial and economic issues with primary concentrations in regulatory finance,
12 such as the determination of the cost of capital and capital structure for ratemaking,
13 consolidated tax savings adjustments, remuneration on deferral and variance
14 accounts, risk management, and an assessment of business, regulatory and financial
15 risk.

16 I have co-authored several articles on utility regulation and ratemaking and have
17 testified in Ontario on the topics of cost of capital and capital structure. I also have
18 co-authored two studies with Mr. Coyne that compared and analyzed ROEs for gas
19 and electric utilities in Ontario, and have made a presentation to the Canadian
20 Electricity Association on the topic of cost of capital.

21 Prior to joining Concentric, I served in the financial and risk related fields in the
22 unregulated energy trading and marketing sector. I am a licensed C.P.A. (Texas),

1 and am a FINRA licensed securities professional (Series 7, 63, and 79). I have a
2 Master's degree in Finance from Boston College, and an undergraduate degree in
3 Accounting from Indiana University. My qualifications are more fully detailed in my
4 curriculum vitae.

5 **Q. On whose behalf are you testifying?**

6 A. We are submitting this testimony on behalf of HQD, a division of Hydro-Québec,
7 Inc. ("Hydro-Québec").

8 **B. SCOPE OF TESTIMONY**

9 **Q. What is the purpose of your testimony in this proceeding?**

10 A. Our testimony presents Concentric's evidence and expert opinion concerning the
11 appropriate remuneration on deferral and variance accounts ("DVA" or "DVAs")
12 for regulated utilities and responds to the direct testimony of the AQCIE-CIFQ, the
13 ACEFQ, and the OC on this matter. Our testimony focuses on the guiding
14 regulatory principles and corporate financial principles that should be considered in
15 determining an appropriate level of return for deferral and variance accounts. We
16 have also conducted a review of North American regulatory precedent on the issue
17 of deferral account remuneration to inform our conclusions. Concentric has also
18 reviewed the past decisions and precedents established by the Régie de l'énergie (the
19 "Régie") in consideration of such matters. Concentric has relied upon its own
20 research and data sources normally used for such purposes before regulators in
21 Canada and the U.S. To gain additional information, Concentric has also

1 communicated directly with individual Canadian utilities to better understand their
2 treatment for such accounts.

3 **C. EXECUTIVE SUMMARY**

4 **Q. Please summarize the results of your analyses and your conclusions.**

5 A. Concentric’s conclusions can be summarized as follows:

- 6 1) Established legal and regulatory principles require that HQD be given an
7 opportunity to earn a fair return on its invested capital, and it is well-settled in
8 regulatory economics that investors should earn a fair return on the capital they
9 commit to utility service, inclusive of net short-term capital;¹
- 10 2) Though corporate financing principles prescribe the matching of financing terms
11 with the life of the financed asset, cost of service regulation sets rates under the
12 assumption that assets are financed with an allowed capital structure (deemed or
13 actual), i.e. a percentage of debt, preferred equity and common equity, at their
14 respective rates of return, to arrive at the weighted average cost of capital
15 (“WACC”);
- 16 3) To disregard the WACC for certain financing but to apply it for others, would r
17 double-count certain debt issuances in the cost of capital and undermines the
18 overall regulatory financing assumptions upon which rates are determined and
19 investors are compensated;

¹ Concentric understands that the Régie adheres to the “just and reasonable” standard for the setting of overall utility rates, consistent with regulatory practice elsewhere in Canada and the U.S. We refer here, specifically to the “Fair Return Standard”, emanating from the decision in *Northwestern Utilities v. City of Edmonton* (1929) [1929] S.C.R. 186 (“Northwestern”), and widely acknowledged as the legal and regulatory standard in Canada for purposes of determining the appropriate cost of capital for regulated utilities.

- 1 4) Investors consider the aggregate impact of all business risk factors on the risk of
2 the firm in establishing the required return for utility investment. Accordingly,
3 the WACC is based on the aggregate financing required to secure the firm's
4 assets and is not disaggregated for various asset classes. The risks of deferral and
5 variance accounts are aggregated with the risks of the rest of HQD's rate base;
- 6 5) A 5-year deferral account requires the same financing as a 5-year asset in rate
7 base, is subject to the same earnings stream, and accordingly should be allowed
8 to recover the same cost of capital;
- 9 6) In response to the Régie's request for a benchmarking comparison to other
10 regulatory jurisdictions, Concentric submits its analysis of Canadian and U.S.
11 regulatory treatment of deferral and variance accounts. Concentric finds that
12 although regulatory principles suggest that deferral and variance account balances
13 should earn the WACC, in practice the application of the WACC to regulatory
14 asset balances is more varied and tends to be specific to each jurisdiction and the
15 circumstances that gave rise to the deferral or variance account;
- 16 7) In response to the recommendations of intervenors to apply a 100% short (or
17 mid) term debt rate to the DVA balance, Concentric finds four fundamental
18 flaws in this argument:
- 19 • Utilities do not finance 5-year investments with 100% debt; there is
20 always an equity component;
 - 21 • Assuming so would effectively change HQD's allowed capital
22 structure, without offsetting compensation for that change;

- The DVA financing is already included in HQD's financing, and is included in the WACC at the appropriate cost; and
- If the DVA account balance is removed and financed separately, appropriate adjustments are required to the WACC, leaving ratepayers and the utility harmless; there is no net gain or loss.

Q. How is the remainder of your testimony organized?

A. The remainder of the testimony is organized as follows. Section II provides background on this proceeding and describes the issues regarding deferral account remuneration. Section III identifies the relevant regulatory and financial principles and applies them to this matter. Section IV discusses the specifics of HQD's circumstances and the deferral account treatment it has sought. Section V presents a comparison of methods of remuneration of deferral and variance accounts in Canada and the U.S. Section VI presents Concentric's perspective on issues raised in intervenor evidence.

II. BACKGROUND AND DEFINITION OF THE ISSUE

Q. Please describe the circumstances that have given rise to this proceeding.

A. This proceeding stems from consideration by the Régie in HQD's 2014-2015 Rate Application, to revisit the regulatory treatment (remuneration) on the distribution utilities' deferral and variance accounts. This is particularly important for HQD as it recently added \$380 million to its electricity pass through account in 2014, which it proposes to capitalize in its rate base in 2015 and amortize beginning in 2016 for 5 years. This brings the unamortized balance in HQD's deferral and variance accounts

1 to a total of \$679.2 million by the end of 2014; and \$826.4 million by the end of
2 2015.² Although the Régie has not established a set policy with respect to
3 remuneration on deferral and variance accounts, the Régie has historically allowed
4 the WACC on the unamortized balance. However in HQD's last rate proceeding,
5 ACEFO, an intervenor in the case, raised the issue that longer amortization periods
6 result in large payments of carrying costs by ratepayers. The ACEFO recommended
7 that the average cost of debt be used for the carrying costs on the unamortized
8 balance for the weather normalization accounts, pointing to the British Columbia
9 Utilities Commission ("BCUC") and the Ontario Energy Board ("OEB") as two
10 examples of regulatory commissions that employ this methodology.

11 In its Decision D-2014-037, the Régie announced that in its next rate case it would
12 review the return on variance accounts given their significant size. The Board also
13 instructed HQD to present an in-depth analysis on remuneration for deferral and
14 variance accounts and to perform a benchmarking survey of other jurisdictions and
15 the approaches used for remuneration of different types of variance accounts.

16 **Q. What rationale has the Régie articulated in the past with respect to its use of**
17 **the WACC for carrying costs on deferral and variance accounts?**

18 A. Although, the Régie has not adopted an across-the-board methodology for
19 determining the return on variance and deferral accounts, it has authorized the use of
20 the WACC for each of HQD's variance accounts each time a deferral or variance
21 account was proposed. These variance accounts have been authorized by the Régie

² HQD Discovery Response, R-3905-2014, HQD-15-1.5, R-4.2, p. 12

1 after a review of whether the accounts met the criteria for variance and or deferral
2 accounts, i.e. whether the costs they covered were significant, volatile, unpredictable,
3 and were beyond the distributor's control in previous rate filings.

4 This treatment reverts back to 2003, where in Decision D-2003-93, Docket R-3492-
5 2002, the Régie allowed the WACC on the newly created electricity supply and
6 transmission variance accounts. This treatment was later challenged by intervenors,
7 who took exception to the inclusion of those accounts in rate base and the associated
8 return earned at the WACC. The Commission upheld its treatment in Decision D-
9 2006-34, recalling that it had previously authorized the creation of deferral and
10 variance accounts outside of rate base with a return pegged to the WACC. It found
11 in that Decision that for such accounts to earn the WACC was customary and
12 reasonable regulatory treatment. It held that proposed return mechanisms had to be
13 considered in relation to the regulated company's capital structure and business risk.

14 **Q. Are longer-term amortizations for HQD's DVA accounts new?**

15 A. No. The weather deferral account was established in 2006 and has had 5-7 year
16 amortization in place since 2009, earning the WACC.

17 **Q. Has the Régie maintained its use of the WACC for carrying costs on deferral
18 and variance accounts?**

19 A. Yes. The Régie has found after its review that a return earned on deferral and
20 variance accounts at the WACC is consistent with past regulatory practice.
21 However, since 2013, the Régie has shown some interest in revisiting the issue of the
22 return on the various variance and deferral accounts. In its most recent decisions,

1 the Régie has asked each Gaz Metro, Gazifère and HQD to study this issue in each
2 of their respective rate applications.³

3 **III. REGULATORY AND FINANCIAL PRINCIPLES THAT INFORM CONCLUSIONS**

4 **Q. What are the primary regulatory principles that provide guidance on this**
5 **issue?**

6 A. The overarching regulatory principle relevant to this issue is the fair return standard.
7 The principles surrounding the concept of a “fair return” for a regulated company
8 were established by the Supreme Court of Canada in the *Northwestern Utilities v. City of*
9 *Edmonton* (1929) (“Northwestern”) case, where the Supreme Court found:

10 By a fair return is meant that the company will be allowed as large a
11 return on the capital invested in its enterprise (which will be net to
12 the company) as it would receive if it were investing the same amount
13 in other securities possessing an attractiveness, stability and certainty
14 equal to that of the company’s enterprise.⁴

15 As stated by Major and Priddle in 2008, this definition remains in full legal effect
16 today.⁵

17 The Fair Return Standard has been interpreted many times in both Canada and the
18 U.S. The National Energy Board (“NEB”) summarized its interpretation of the “fair
19 return standard” in its RH-2-2004 Phase II Decision and more recently reiterated

³ The relevant discussion can be found in Gaz Metro Decision D-2013-106, Gazifere Decision D-2013-191, and HQD Decision D-2014-037.

⁴ *Northwestern* at p. 186.

⁵ *The Fair Return Standard for Return on Investment by Canadian Gas Utilities: Meaning, Application, Results, Implications*, by The Honourable John C. Major, Former Justice, Supreme Court of Canada, and Roland Priddle, President, Roland Priddle Energy Consulting Inc., Former Chair of the National Energy Board, March 2008, at p. 4.

1 that interpretation in its *Trans Québec & Maritimes Pipelines Inc.* RH-1-2008 Decision,
2 at pp. 6-7.

3 The Board is of the view that the fair return standard can be
4 articulated by having reference to three particular requirements.
5 Specifically, a fair or reasonable return on capital should:

- 6 • be comparable to the return available from the application of the
7 invested capital to other enterprises of like risk (the comparable
8 investment standard);
- 9 • enable the financial integrity of the regulated enterprise to be
10 maintained (the financial integrity standard); and
- 11 • permit incremental capital to be attracted to the enterprise on
12 reasonable terms and conditions (the capital attraction
13 standard).⁶

14 **Q. Has the Régie adopted the same legal standards for application of the fair**
15 **return standard as those described above?**

16 A. Yes. The Régie embraces the same legal standards for the application of the fair
17 return standard as those put forth by the NEB, and those established through
18 Canadian law. The Régie recognizes the three primary criteria of the fair return
19 standard (i.e., the comparability standard, the financial integrity standard, and the
20 capital attraction standard) and has indicated that these should be used as a guide in
21 exercising its role with respect to fixing a reasonable rate of return.⁷ In addition, the
22 Régie has indicated that its duty is to determine a reasonable rate of return, and the

⁶ National Energy Board RH-2-2004 Reasons for Decision, TransCanada PipeLines Ltd, Phase II, April 2005, at p. 17.

⁷ Régie de l'énergie, Décision D-2009-156 (R-3690-2009), Gaz Métro, (December 7, 2009), at para [189].

1 method which it uses is at its discretion.⁸ The Régie has also recognized that, like
2 operating costs, the return allowed to the shareholder is one of the elements of the
3 regulated company's cost of service. The allowed return must, under the official
4 Act⁹ governing utility regulation, ensure that there are sufficient revenues to cover all
5 of the costs.¹⁰

6 **Q. Are there other key regulatory and financial principles that are relevant to this**
7 **issue?**

8 A. Yes, there are several. Beyond the overarching concept of the Fair Return Standard,
9 this issue also invokes an understanding of the components of the cost of service
10 revenue requirement and its derivation, including fundamental constructs such as the
11 components of rate base and the allowed return on rate base. This discussion also
12 must consider the matching principle that is fundamental to finance and regulatory
13 economics. Finally, another relevant regulatory principle to this issue is the “stand-
14 alone” principle, which we will discuss in responding to Dr. Booth's testimony.

15 **Q. Please explain the concepts of rate base and capital structure.**

16 A. According to Bonbright, a widely recognized regulatory theorist and economist, the
17 concept of rate base applies to assets committed to utility service and does not
18 involve the specific tracing of sources and uses of funds. Bonbright states: “rate
19 base is defined as the: (1) net plant in service; (2) property held for future use; (3)
20 working capital; and (4) construction work in progress (CWIP) – no AFUDC. The

⁸ Ibid., at para [195].

⁹ R.S.Q., chapter R-6.01, An Act respecting the Régie de l'énergie (“the Act”) empowers the Régie to set rates for regulated energy utilities in Québec.

¹⁰ Régie de l'énergie, Décision D-2009-156 (R-3690-2009), Gaz Métro, (December 7, 2009), at para [192].

1 capital structure simply represents the funds used to finance the rate base. The
2 sources, not the uses, of particular funds (debt, equity, deferred taxes, and other
3 capital structure components) are not easily traceable.”¹¹

4 **Q. How do you interpret Bonbright’s statement that the sources, not the uses of**
5 **particular funds are not easily traceable?**

6 A. Bonbright is referring to the composition of rate base and the funding source for
7 each asset in rate base. It would be at a minimum excessively burdensome, if not
8 impossible, to trace each asset to its source of financing, i.e. various maturities of
9 long-term debt, short-term debt, equity, etc. For this reason, a weighted average cost
10 of capital attributes the actual aggregate financing mix to all assets. Not every asset
11 requires all three components of capital for the financing, indeed the actual cost of
12 financing any given asset will most always be either higher or lower than the average,
13 but when the WACC is applied across the aggregate of all net assets of the utility, the
14 utility is provided the opportunity to exactly recover its cost of capital.

15 **Q. What does the WACC represent and how is it applied?**

16 A. The WACC is derived by from its respective pieces, debt, preferred equity and
17 common equity. The cost of debt and cost of preferred equity are directly observed
18 from the utility’s past financing; however, the cost of equity must be estimated. In
19 ratemaking, the cost of capital is the basic standard of a fair rate of return.¹²

20

¹¹ Bonbright, Daniels, & Kamerschen, Principles of Public Utility Rates, Second Edition, Public Utilities Reports, Inc. p. 237

¹² Ibid at 305.

1 **Q. What is meant by short-term capital versus long-term capital?**

2 A. The accounting classification of short-term capital refers to capital that is
3 outstanding for less than one year. Anything that is outstanding for greater than one
4 year is classified as long-term. The portion of long-term debt that is payable within
5 the upcoming year is classified as the current portion of long-term debt and is
6 considered to be a short-term or current liability. The difference between current
7 assets and current liabilities is referred to as net working capital.

8 **Q. Do regulatory principles provide guidance on the proper return for short-term**
9 **capital?**

10 A. Yes. Short-term capital can also be described as working capital, which as indicated
11 is one of the components of rate base to which the WACC is applied to arrive at the
12 utility revenue requirement. According to Bonbright,

13 “[w]orking capital as it applies to a regulated utility, can be described
14 as the average amount of capital in excess of that used to finance net
15 utility plant, (and other separately identified rate base components)
16 necessary to operate the business.

17 The working capital allowance is necessary to bridge the gap between
18 the time when costs are incurred in providing service and the time
19 the utility is paid for that service. In general, the components
20 represented are invested capital used to support inventories, petty
21 cash funds, prepayments, minimum bank balances, and costs of
22 providing services. When these funds come from investor sources
23 (debt and equity securities issued or earnings retained in the
24 business), they are legitimate investments to provide service and thus,
25 should be included in rate base. Inclusion of an allowance for
26 working capital in rate base is an appropriate method of
27 compensating investors for the cost of capital which they have
28 provided for these purposes. Since a utility’s sales price is set by the
29 Commission rather than by competition, the cost of the capital
30 needed to finance the utility’s working capital must be included in the

1 revenue requirements if the investors are to be compensated for the
2 capital they have devoted to the business.”¹³

3 Though Bonbright goes on to talk about the various means of computing working
4 capital for purposes of determining rate base, it is clear from the excerpt above that
5 short-term cash outlays for things like petty cash funds, to maintain minimum bank
6 balances, purchases for inventory, etc. are legitimate capital investments incurred to
7 provide utility service that should be allowed to earn the WACC.

8 **Q. Isn't it true that the term of financing should match the useful life of the asset,**
9 **so that a short-term asset should only earn a short-term financing rate?**

10 A. Concentric agrees that it is generally advisable to match the financing term to the life
11 of the asset being financed. As indicated previously, corporate finance principles
12 dictate that there should be such matching so that the financing costs of the asset
13 can be offset by the revenue stream generated by the asset. However, cost of service
14 ratemaking does not attempt to trace the exact source of financing to each respective
15 asset, or even attempt to distinguish tranches of financing for assets of different
16 lives, but instead applies the aggregate financing rate to all net capital of the utility.
17 In this way, the utility is able to recover all of its capital, short-term and long-term
18 without having to go through an unduly burdensome process of assigning specific
19 costs to specific assets.

20

¹³ Bonbright, Daniels, & Kamerschen, Principles of Public Utility Rates, Second Edition, Public Utilities Reports, Inc. p. 243.

1 **Q. How important is the matching principle and is the utility required to adhere**
2 **to it?**

3 A. Finance recognizes the matching principle for funding assets, but this is not the only
4 consideration in determining the appropriate financing for an asset. Financial
5 managers devote a great deal of their time to finding the right debt instrument to fit
6 their needs. Financial managers must consider how to place the debt, i.e. public or
7 private placement, collateral, call features, fixed or floating rate, covenants, etc. It is
8 not a requirement that long-term assets are exclusively financed with long-term debt,
9 but to do otherwise would expose the firm to refinancing risk subjecting the firm's
10 earnings to short-term interest rate volatility. Similarly, it is generally not advisable to
11 use long-term debt to fund short-term assets, since prevailing market rates may vary
12 significantly from the original long-term interest rate. These general principles are
13 reflected in utility ratemaking concepts, where the invested capital of the utility is
14 deemed to be funded with a mixture of debt and equity for all of the utility assets.

15 **Q. How does the impact of assigning a short-term debt cost to a large regulatory**
16 **asset balance impact the utility's ability to earn its allowed return?**

17 A. Financing a sizeable component of the company's invested capital with an assigned
18 short-term debt cost, reduces the return earned on the utility's net assets. Or said
19 another way, if you directly attribute 5-year debt to a 5-year variance account balance,
20 it would be necessary to correspondingly increase the financing costs associated with
21 the longer term assets such that the company may fully recover its cost of capital. By
22 employing the assumption that all assets are financed by the WACC, the regulator is
23 not only attributing a long-term capital rate to shorter-term assets, but also applying

1 short-term debt costs to longer-term assets. To pick and choose assets and suggest
2 they are financed with lower-cost, shorter-term debt ignores the assets at the other
3 end of the spectrum that are financed with longer-term, higher-cost debt and equity,
4 but still earn only the average cost of capital. This undermines the overall
5 assumption and mathematics that the average return applies to the aggregate invested
6 capital.

7 **Q. Can you provide a numerical example of this?**

8 A. Yes. As shown in Figure 1, we have provided an illustrative example. First, we have
9 established a base case, which assumes a utility with net rate base of \$5 billion is
10 financed with 60% debt and 40% equity. Further assume its weighted average debt
11 cost is comprised of 5-year, 10-year, 20-year and 30-year debt, averaging an aggregate
12 debt cost of 3.53%. We also assume a 10% cost of equity on 40% equity, yielding a
13 WACC of 6.12%. If the WACC of 6.12% is applied to the entire net rate base, the
14 utility will exactly recover its capital costs of \$306 million. Now assume (in Scenario
15 2), that the utility must finance an incremental \$500 million for purchased power
16 costs due to the extreme winter, and those costs are financed in accordance with the
17 matching principle and the utility's deemed capital structure. As shown in Figure 1,
18 Scenario 2, 60% of the financing is new 5-year debt (\$300 million) and 40% is
19 financed with equity (\$200 million) to maintain the deemed regulatory capital
20 structure. In this case, the utility cost of debt decreases from 3.53% to 3.39%, the
21 WACC decreases from 6.12% to 6.04%, and rate base increases from \$5 billion to
22 \$5.5 billion. The total capital costs increase by \$26 million. Now suppose (in
23 Scenario 3) that this new \$500 million regulatory asset can be exclusively financed

1 with 5-year debt (i.e. no equity). As demonstrated in the example, attributing a 5-
2 year debt rate directly to the asset will cause the utility's actual capital structure to
3 shift from its deemed capital structure to a more highly leveraged structure of 63.6%
4 debt and 36.4% equity. This shift in the capital structure will require rebalancing
5 with higher priced equity to maintain the utility's deemed equity ratio.

1

Figure 1: Example of mixing WACC and specific identification of financing

Scenario 1: Base case before financing deferral and variance account

| | <u>Cost</u> | <u>Balance</u> | <u>Weight</u> | <u>% Return</u> | <u>\$ Return</u> |
|---------------|-------------|----------------|---------------|-----------------|------------------|
| 5-year debt | 2.00% | \$ 200 | | | \$ 4 |
| 10-year debt | 3.00% | \$ 500 | | | \$ 15 |
| 20-year debt | 3.50% | \$ 1,000 | | | \$ 35 |
| 30-year debt | 4.00% | \$ 1,300 | | | \$ 52 |
| WACD | 3.53% | \$ 3,000 | 0.60 | 2.12% | \$ 106 |
| Equity | 10.00% | \$ 2,000 | 0.40 | 4.00% | \$ 200 |
| WACC | | \$ 5,000 | 1.00 | 6.12% | \$ 306 |

Scenario 2: Deferral and variance account of \$500 million financed according to deemed capital structure

| | <u>Cost</u> | <u>Balance</u> | <u>Weight</u> | <u>% Return</u> | <u>\$ Return</u> |
|---------------|-------------|----------------|---------------|-----------------|------------------|
| 5-year debt | 2.00% | \$ 500 | | | \$ 10 |
| 10-year debt | 3.00% | \$ 500 | | | \$ 15 |
| 20-year debt | 3.50% | \$ 1,000 | | | \$ 35 |
| 30-year debt | 4.00% | \$ 1,300 | | | \$ 52 |
| WACD | 3.39% | \$ 3,300 | 0.60 | 2.04% | \$ 112 |
| Equity | 10.00% | \$ 2,200 | 0.40 | 4.00% | \$ 220 |
| WACC | | \$ 5,500 | 1.00 | 6.04% | \$ 332 |

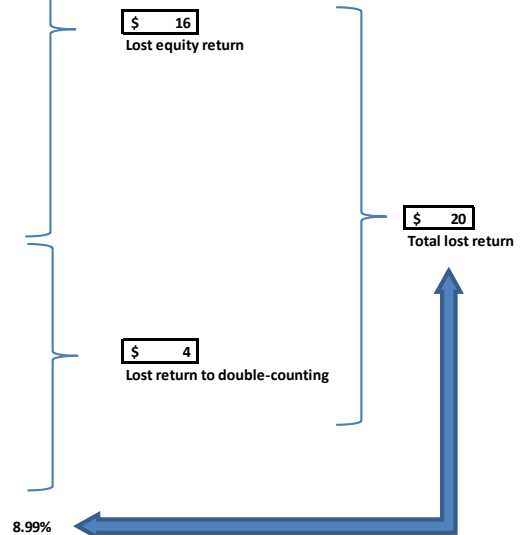
Scenario 3: Deferral and variance account of \$500 million financed 100% 5-year debt out of rate base

| | <u>Cost</u> | <u>Balance</u> | <u>Weight</u> | <u>% Return</u> | <u>\$ Return</u> |
|---------------|-------------|----------------|---------------|-----------------|------------------|
| 5-year debt | 2.00% | \$ 700 | | | \$ 14 |
| 10-year debt | 3.00% | \$ 500 | | | \$ 15 |
| 20-year debt | 3.50% | \$ 1,000 | | | \$ 35 |
| 30-year debt | 4.00% | \$ 1,300 | | | \$ 52 |
| WACD | 3.31% | \$ 3,500 | 0.64 | 2.11% | \$ 116 |
| Equity | 10.00% | \$ 2,000 | 0.36 | 3.64% | \$ 200 |
| WACC | | \$ 5,500 | 1.00 | 5.75% | \$ 316 |

Recovery:

| | | | | | |
|------------------|--------|----------|------|-------|--------|
| DVA | 2.00% | \$ 500 | | | \$ 10 |
| WACD | 3.39% | \$ 3,000 | 0.60 | 2.04% | \$ 102 |
| Equity | 10.00% | \$ 2,000 | 0.40 | 4.00% | \$ 200 |
| WACC | | \$ 5,000 | 1.00 | 6.04% | \$ 302 |
| Recovered | | | | | \$ 312 |

Scenario 3: Realized Equity Return



2

3

1 **Q. If the Regie wishes to directly assign a debt rate to the deferral and variance**
2 **account, must that debt be removed from the calculation of the WACC?**

3 A. Yes. Otherwise, the debt rate would be given too much weight in the capital
4 structure. In effect the directly-assigned debt would be double-counted, once in the
5 WACC and then again by applying it specifically to the variance account it financed.
6 As shown in Figure 1, Scenario 3, if the return is computed based on the utility's
7 actual financing and WACC (as suggested by Dr. Booth), but the DVA return is
8 based solely on the 5-year debt rate, capital costs will be under recovered by \$20
9 million (i.e. \$16 million due to the assumed lack of equity financing and \$4 million
10 due to double-counting the 5-year debt cost), lowering the realized equity return to
11 8.99%. In the example, the specific debt cost is directly attributed to the \$500
12 million balance, but the WACC (including that debt cost and assuming the 60/40
13 debt to equity ratio) of 6.04% is applied to the remainder of the assets, the utility
14 recovers \$500 million at 2% (\$10 million for the deferral and variance account); and
15 \$5 billion at a WACC of 6.04% (\$302 million return on rate base) for a total return
16 on capital of \$312 million versus the \$332 million in capital costs calculated in
17 Scenario 2, reducing the utility return by \$20 million and reducing its equity return
18 from the 10% it is authorized to 8.99% $((200-20)/2000)$.

19 **Q. Is it likely that HQD could finance a \$380 million deferral account entirely**
20 **with short-term debt?**

21 A. No. First of all, it is impossible to finance a 5-year asset balance with short-term
22 debt such as commercial paper, without exposing the utility to significant refinancing

1 risk. Furthermore, utilities finance with a mixture of debt and equity in accordance
2 with their regulatory capital structure and would not fund a balance of \$380 million
3 entirely with debt.

4 **Q. So, does Concentric recommend that HQD continue to earn the WACC on**
5 **deferral and variance accounts?**

6 A. Yes. Concentric recommends that all deferral and variance accounts be included in
7 rate base and be allowed to earn the WACC. As shown above, if the specific debt
8 costs are directly assigned to the assets they financed, and are handled outside of rate
9 base, then to be fair to the utility the WACC must be recalculated without that debt.
10 It is also unrealistic to assume that the utility would finance a \$500 million 5-year
11 asset entirely with debt. Even if the utility could find this financing, it is constrained
12 by its deemed regulatory capital structure. Applying the WACC to the aggregate net
13 assets is the most efficient and fair way to ensure that the utility recovers its weighted
14 average costs of capital. Allowing the WACC on deferral and variance account
15 balances is not suggesting that these balances should earn long-term debt rates. The
16 assets' specific financing is already reflected in the WACC. The WACC distributes
17 the actual costs of financing capital across the utility's net assets. The bottom line is
18 that using the WACC provides the matched recovery of capital costs. Deviating
19 from the use of the WACC by identifying specific assets with their costs of
20 financing, requires either specific identification of financing rates to all assets (or
21 tranches of assets) or requires a recalculation of the WACC exclusive of the specific
22 debt costs.

1 **IV. SPECIFICS OF HQD’S CIRCUMSTANCES**

2 **Q. Please describe features of HQD’s deferral account regulatory treatment that**
3 **make it unique in terms of its financing policies.**

4 A. HQD is governed under a deemed capital structure comprised of 35% equity and
5 65% debt. The debt rate may be comprised of any outstanding debt with terms
6 greater than one year in duration. With respect to the cost of debt, HQD’s parent
7 Hydro-Québec manages its debt financing programs in a comprehensive manner
8 such that there is no financing specifically for any of its operating segments or for
9 particular assets. This integrated financing policy has been in effect since D-2003-93
10 and the Régie has used Hydro-Québec’s integrated cost of debt to estimate the
11 distributor’s deemed cost of debt and the weighted average cost of capital for the
12 purposes of determining the regulatory revenue requirement. The cash requirements
13 of the Distribution division of Hydro-Québec are factored into the overall capital
14 requirement financed at the parent level.

15 **Q. What is the composition of Hydro-Québec’s embedded cost of debt?**

16 A. Hydro-Québec’s embedded debt cost incorporates its historical cost of debt and the
17 planned cost of new financing. It is comprised of borrowing terms in excess of one
18 year and includes fixed rate and floating rate debt costs that were used to finance
19 consolidated projected capital needs of all of the Hydro-Québec divisions in the
20 aggregate.

1 **Q. Has the Régie accepted that the integrated financial policy of Hydro-Québec**
2 **necessitates the use of a deemed capital structure based upon Hydro-**
3 **Québec’s average cost of debt?**

4 A. Yes. It is our understanding that the Régie had accepted the proposition that to
5 realize the benefits of integrated management and to enable Hydro-Québec to
6 recover an appropriate share of its financing costs associated with the regulated
7 divisions, a deemed capital structure should be utilized and Hydro-Québec’s average
8 cost of debt should be used. It is our understanding that the Régie accepted the use
9 of the Hydro-Québec integrated cost of debt as a proxy for HQD stand alone debt
10 because it acknowledged that Hydro-Québec manages its debt in an integrated
11 fashion and that such policies would not harm ratepayers and could potentially be
12 advantageous due to economies of scale, liquidity, and access to credit in times of
13 crisis.

14 **Q. Is it common for North American distribution utilities to receive aggregate**
15 **debt financing from their parent?**

16 A. Yes. Though many companies do their own financing, especially in the U.S. where
17 the holding company structure¹⁴ is more prevalent, there are many examples in
18 Canada of companies that follow a similar integrated financing policy. The ATCO
19 utilities (financed by their parent, Canadian Utilities), BC Hydro, Hydro One, and
20 EPCOR all follow an integrated debt policy through their parent or their
21 consolidated company.

¹⁴ The holding company structure is where the parent company is virtually a shell that owns the operating utility’s stock and generally has no operational purpose other than ownership of the operating companies.

1 **V. REVIEW OF NORTH AMERICAN REGULATORY PRECEDENT**

2 **Q. Have you surveyed North American energy utilities to determine if there is a**
3 **trend with respect to carrying costs for deferral and variance accounts?**

4 A. Yes. Concentric provided its assistance to HQD in developing a benchmark analysis
5 for the Régie. The Régie was particularly interested in how four types of variance
6 and deferral accounts were remunerated. Those accounts were, energy pass through
7 accounts, weather stabilization accounts, contribution accounts for connecting
8 projects, and energy efficiency accounts. In addition, Concentric has added a U.S.
9 perspective based on the cost of capital proxy group (utilized in our recent filing on
10 behalf of HQD and HQT), containing 6 corporate entities and 15 electric utility
11 operating companies to review how their deferral and variance accounts are
12 remunerated. Our findings are presented in Attachment A and are briefly
13 summarized in the following section.

14 **Q. What have you learned through the research you have conducted?**

15 A. We have learned that regulatory deferral and variance accounts that are amortized
16 over more than one year are nearly always allowed a return, and more often than not,
17 that return is the WACC. However, a good many regulatory commissions provide
18 carrying charges at the long-term debt rate and some even the short-term debt rate.
19 We have also observed that returns may vary by account type and the impact they
20 have on the risk profile of the company. In short, there is not strict adherence to
21 using the WACC rate on deferral and variance accounts, but the majority of
22 regulatory jurisdictions surveyed do adhere to this treatment.

1 **Q. Based on your research, did you note any trends among Canadian**
2 **jurisdictions?**

3 A. Yes, we did. Deferrals that extend beyond one year are generally allowed to earn a
4 long-term capital rate. In Alberta and Quebec, that rate is most often the WACC.
5 However, in Ontario, the Commission has provided carrying charges based on debt
6 costs that match the term of the deferral period. The utility applies annually for
7 disposition of deferral and variance accounts, so it is assumed that balances rarely
8 carry over for more than one year. British Columbia's policy on this issue is in a
9 state of flux. It had recently introduced a new policy to require a debt cost return on
10 (non-capital) deferral and variance balances, ranging from long-term and short-term
11 depending on the amortizable life of the asset. However, the gas utility in BC still
12 earns the WACC on deferral and variance accounts. In response to challenges by the
13 Fortis utilities, the BCUC will commence an in-depth review of its policies regarding
14 deferral and variance accounts. New Brunswick has currently provided a long-term
15 debt rate for a large deferral account balance on the books of New Brunswick
16 Power, but this is due to the fact that there is no equity in New Brunswick Power's
17 capital structure. In the Board's Decision in that proceeding, it indicated that it
18 would review its carrying cost methodology in the future as New Brunswick Power
19 begins to build equity in its capital structure; and its cost of equity could reasonably
20 be calculated.¹⁵

¹⁵ Decision - In the Matter of Point Lepreau Nuclear Generating Station Deferral Account and section 143.1 of the Electricity Act (March 13, 2013)

1 **Q. How have deferral and variance accounts been treated historically in British**
2 **Columbia and what is the new deferral and variance account policy?**

3 A. Historically, in British Columbia deferral accounts were included in rate base and
4 attracted the WACC. However, the BCUC has established a new policy whereby
5 the WACC only applies to the financing of capital assets. Otherwise, deferral and
6 variance account balances may earn the weighted average cost of debt (“WACD”) if
7 the balance is recovered over more than 1 year; or will earn the short-term interest
8 rate if the deferral or variance account is recovered within 1 year. Currently, this
9 policy is being challenged and has not yet been applied to the Fortis gas utility.

10 **Q. Please discuss the nature of this challenge?**

11 A: In Fortis BC’s 2012–2013 Revenue Requirements Application, the Board found that
12 “current period charges are not investments which attract a capital return, they are
13 deferred operating costs/current period expenses which, ... in the Panel’s view
14 should not attract rate base rate of return.”¹⁶ Fortis BC requested that the Decision
15 be reopened on the grounds that it was: i) inconsistent between FBC’s deferral
16 accounts, as some are financed by the WACC, some are financed by the WACD or
17 short-term interest even though they have similar characteristics; ii) inconsistency
18 with past practice (the last RRA decision was the first time the Commission
19 introduced the distinction between capital and operating expenses in deferral
20 accounts; iii) the distinction between capital and operating expenses is
21 inappropriately applied because once an item is given deferral treatment it ceases to

¹⁶ BCUC Order, FortisBC Inc., for Approval of 2012-2013 Revenue Requirements and Review of 2012 Integrated System Plan (August 15, 2012) at 115.

1 be an operating expense; iv) the WACC reflects the company's cost of financing and
2 attempts to mirror the approved capital structure; and v) inconsistency with other
3 Fortis companies. The Commission recognized the differing treatment between
4 FBC and FEI, and though it rejected FBC's proposal to revisit its 2012-2013
5 Decision, the Commission decided that there was merit to looking into the issue
6 more broadly, and requested a future proceeding to review deferral accounts and
7 their related carrying costs.¹⁷

8 **Q. Have there been other challenges to remuneration allowed on deferral and**
9 **variance accounts in Canada?**

10 A. Yes in Alberta, intervenors challenged the remuneration on ATCO Gas's Load
11 Balancing Deferral Account. The account had historically been allowed the WACC
12 and though it had been challenged in the past, the Commission had always upheld
13 the WACC treatment. Intervenors claimed that a 3% debt cost, based on a short-
14 term debt rate, should be used on the basis that the account would not be
15 outstanding for greater than a year. ATCO Gas refuted that the account was short-
16 term and indicated that it could be outstanding for several years until the Rider
17 threshold was met, and that the WACC remained the appropriate carrying cost. The
18 AUC asked ATCO to submit an analysis of the issue by December 2013 in order to
19 determine whether the account should continue to earn the WACC, or if it should be
20 pegged to a short-term debt rate in accordance with AUC Rule 023, Rules
21 Respecting Payment of Interest.¹⁸ The AUC issued its decision on September 17,

¹⁷ FBC DOC 42180 09-15-2014 FBC 2014-18 PBR-DecisionWEB.pdf

¹⁸ AUC Decision 2013-106, ATCO Gas North Load Balancing Rate Rider (March 20, 2013) at 9.

1 2014, upholding its WACC treatment on the LBDA. The Commission recalled the
2 following suggested criteria for evaluating deferral accounts:

- 3 • Materiality of the forecast amount.
- 4 • Uncertainty regarding the accuracy and ability to forecast the
5 amount.
- 6 • Whether or not the factors affecting the forecast are beyond the
7 utility's control.
- 8 • Whether or not the utility is typically at risk with respect to the
9 forecast amount.
- 10 • The deferral account should provide a degree of protection to
11 both the company and the customers from circumstances beyond
12 their control, symmetry must exist between the costs and benefits
13 for both the company and its customers.
- 14 • Should be applied in a consistent and fair manner in both test
15 years and non-test years.

16 The AUC determined that the LBDA account continued to satisfy these criteria and
17 has continued to allow ATCO Gas to earn the WACC on its unamortized LBDA
18 balances.¹⁹ A review of the above criteria suggests that HQD's weather stabilization
19 and purchased power pass through accounts would also qualify for similar treatment.

20 **Q. Several jurisdictions seem to apply a short-term debt rate to short-term**
21 **variance accounts that will be amortized within the year. Do you agree with**
22 **this treatment?**

23 A. No. Since it is very difficult to know for sure how a utility does its financing for
24 short-term assets or operational variance accounts, the use of the WACC is a
25 reasonable approximation of the utility's financing. To the extent that such accounts
26 vary from positive to negative, customers would earn the WACC on credit balances

¹⁹ AUC Decision 2014-268 (September 17, 2014)

1 just as HQD earns the WACC on debit balances. In reviewing HQDs 2014 and
2 2015 projections for these short-term deferral and variance accounts, the outstanding
3 amounts are individually immaterial and are largely offsetting. Reviewing the history
4 of these short-term accounts, we note the accounts tend to revert back and forth
5 between positive and negative balances. It does not seem a worthwhile exercise to
6 attempt to attribute a specific financing rate to these accounts, even if it were
7 possible to identify the specific source of financing to each account.

8 **Q. Has Concentric reviewed the practices of the National regulators, i.e. the**
9 **FERC and the NEB, with respect to deferral and variance account**
10 **remuneration?**

11 A. Yes, we have. The FERC generally discourages the use of variance accounts.
12 However, when circumstances render it necessary to establish a deferral account, the
13 FERC has historically allowed the return on regulatory assets equal to the WACC or
14 an AFUDC rate, which includes an equity component.²⁰

15 **Q. What guidance has the NEB provided on this issue?**

16 A. The NEB's perspective is illuminated in its TransCanada Decision RH-003-2011,
17 where a Toll Stabilization Account (TSA) was established by the NEB to capture
18 revenue and cost variances associated with the Board's setting of Mainline tolls for
19 2014 through 2017 below the Mainline's cost of service. In that Decision, CAPP, an
20 intervenor in the proceeding, proposed that TransCanada earn interest at the short-

²⁰ Midwest Independent Transmission System Operator, Inc., Docket No. ER12-427-000 (Issued January 13, 2012); and Primary Power 131 FERC 61,106, April 13, 2010, at 35; and Central Transmission 135 FERC 61,145, May 19, 2011, at 20

1 term debt rate on the balance of its TSA account. The reasons cited by CAPP were:
2 i) that the TSA would be addressing a special non-recurring situation for the
3 Mainline, and consistent with the RH-3-86 Decision, should have carrying charges at
4 a rate that approximates the utility's probable costs of financing the deferral account;
5 ii) claimed the TSA balances were not expected to be large or deferred for a long
6 period of time, so the TSA could be financed by relatively short-term debt; iii) if the
7 TSA were to earn the return on rate base, CAPP thought it would create excessive
8 returns for shareholders because CAPP's recommended ROE already included a
9 premium for the risk related to the deferral of revenues; and iv) if the TSA carrying
10 charges equal the return on rate base, TransCanada would have less incentive to
11 minimize the TSA balance. The Commission reaffirmed that the WACC was the
12 appropriate rate for the TSA carrying charges. Specifically, the Commission's
13 rationale was articulated as follows:

14 We agree with TransCanada that the carrying charges on the TSA
15 should be the same as the rate of return on rate base, reflecting the
16 overall cost of capital of the Mainline.⁸⁰ While the allowed return on
17 rate base already takes into account the risks associated with the TSA,
18 we are not persuaded that establishing carrying charges at that level
19 would overcompensate TransCanada. Even if deferred revenues
20 include a premium for the risks of the TSA, the TSA balance is
21 exposed to the same level of cost recovery risk as the rest of the
22 Mainline's rate base and we find that TransCanada should be
23 compensated accordingly. Also, we are not prepared to assume how
24 TransCanada will finance the TSA; we deem the entirety of the
25 Mainline's financing needs to be met with a 60-40 debt-equity split,
26 rather than deeming how individual accounts are financed.²¹

²¹ Reasons for Decision, TransCanada PipeLines Limited, NOVA Gas Transmission Ltd., and Foothills Pipe Lines Ltd., RH-003-2011 (March 2013) at 235.

1 In this Decision, the NEB reaffirmed three very important points that are highly
2 instructive for this HQD proceeding: i) the WACC was determined to be the
3 appropriate interest rate even though the deferral balance was anticipated to be
4 relatively short-term in nature; ii) even though the deferral account has its own set of
5 risks it is ultimately exposed to the same risks as the rest of the Mainline's rate base;
6 and iii) the NEB recognized that to charge anything other than the WACC was
7 imposing assumptions on how the TSA account would be financed and that the only
8 reasonable assumption outside of specifically identifying each asset with its
9 respective financing is to assume that the asset is financed in accordance with its
10 deemed capital structure and the WACC.

11 **VI. RESPONSE TO INTERVENOR EVIDENCE**

12 **Q. Please summarize the testimony of Dr. Laurence Booth who has submitted**
13 **testimony on behalf of the AQCIE and CIFQ?**

14 A. Dr. Booth points out that the Régie has historically allowed the WACC on deferral
15 and variance account balances, but has adopted a case by case basis approach to
16 authorizing returns on such accounts. He also acknowledges the importance of this
17 issue given HQDs large \$380 million (at the time of his drafting) unrecovered
18 balance in its purchased power pass through account that was attributable to extreme
19 weather. Dr. Booth recognizes the importance of adherence to the fair return
20 standard where a utility should "be allowed as large a return on the capital invested in
21 the enterprise as it would receive if it were investing the same amount in other
22 securities possessing an attractiveness, stability and certainty equal to that of the

1 company's enterprise." Dr. Booth argues that the deferral/variance account is a
2 new asset of lower risk than the rest of the utility's rate base and recommends that
3 the Régie separate this asset from rate base, assigning a short-term or relatively short-
4 term debt cost to the asset. Dr. Booth recommends either lowering the overall
5 WACC of the combined entity or simply specifically assigning a debt cost return to
6 the asset. He calculates that his recommendation will produce a savings to rate
7 payers of \$68 million.

8 **Q. Please discuss the areas where you disagree with Dr. Booth.**

9 A. We fundamentally disagree with Dr. Booth's recommendation that the utility could
10 finance the variance account with relatively short-term debt and no equity. As the
11 example in Figure 1 shows, Dr. Booth's recommendation would not allow the utility
12 to recover its just and reasonable capital costs; and it is highly unlikely that the entire
13 deferral and variance balance would be financed entirely with debt. In addition, we
14 disagree on the following positions taken by Dr. Booth: that the risk of recovering
15 balances through deferral account amortization is any less than the risk of recovering
16 the balance of assets in the HQD's rate base through depreciation; that long-term
17 variance accounts are "new" for HQD (as it has amortized the balance in its weather
18 stabilization account over 5 years since 2009); that use of the WACC in any way
19 contradicts the matching principle; that short-term debt or commercial paper could
20 be used to finance a \$380 million, 6-year asset; and finally, we find that Dr. Booth's
21 recommendation to finance the DVA entirely with debt ignores the fact that HQD is
22 constrained by a regulatory capital structure.

1 **Q. Dr. Booth states that the WACC is generally inappropriate for remuneration**
2 **on deferral and variance accounts due to the presumed lower risk of the**
3 **accounts. Do you find merit to this point of view?**

4 A. No. Dr. Booth spends a great deal of his testimony discussing the reduction of risk
5 associated with protective Canadian regulation. Concentric agrees that protective
6 regulation reduces risk. However, the risk associated with deferral accounts is
7 already considered and factored into the debt costs and equity return of the utility,
8 and accordingly is already factored into the WACC. Because deferral accounts
9 generally reduce the risk profile of the utility, lenders and investors look favorably on
10 the protection that deferral accounts provide and may provide capital more readily to
11 the utility knowing that their earnings stream is protected. Both rating agencies and
12 equity analysts carefully review the level of risk mitigation that resides with the utility
13 and factor it into their investment decisions. If the utility were able to obtain very
14 cheap capital to finance a specific deferral account, it would still be appropriate to
15 use the WACC since the WACC would reflect the cost of obtaining that cheap
16 capital in its computation. By using the WACC, we are not assigning costs to assets
17 over and above what was incurred for utility financing, we are merely spreading the
18 cost of actual capital costs incurred across utility assets, some initially financed at
19 lower rates and some at higher rates. Dr. Booth acknowledges that the WACC
20 reflects all the risks that a utility is faced with. However, he goes on to attempt to
21 differentiate the risk of the deferral and variance account from that of the larger
22 enterprise.

1 **Q. Do you agree with Dr. Booth that deferral and variance accounts should be**
2 **treated as lower risk for capital recovery purposes?**

3 A. No we do not. The required return that the utility earns is based on the aggregate
4 risks of the firm and is not determined on an account by account level. The utility is
5 investing in the enterprise and not a specific account. Dr. Booth's testimony cites a
6 quote by Dr. Paul Carpenter where he states that "[w]hen investors buy a share of
7 stock, they are buying a share of a long-term earnings stream of the company."²²
8 They are not picking selected accounts to finance. Dr. Booth seems to differentiate
9 cost recovery through "normal depreciation" as eligible to earn the WACC in rate
10 base, but cost recovery for a deferred 5-year regulatory asset, is determined to be
11 special, low-risk, and not eligible to earn the WACC. We see absolutely no basis for
12 Dr. Booth's distinction. As mentioned earlier in this testimony, the NEB found in
13 the TransCanada Mainline case that the risks associated with deferral and variance
14 accounts are exposed to the same risks of cost recovery as the rest of the utility's rate
15 base. In that case, the NEB stated "[e]ven if deferred revenues include a premium
16 for the risks of the TSA, the TSA balance is exposed to the same level of cost
17 recovery risk as the rest of the Mainline's rate base."²³ As Dr Booth states in his
18 testimony, the WACC "reflects all the risks that a utility is faced with."²⁴ Ultimately,
19 lenders and investors are concerned with cost recovery and earnings and generally do
20 not provide financing for specific account balances.

²² Direct Evidence of Dr. Laurence Booth on behalf of AQCIE/CIFQ, at. 8.

²³ Reasons for Decision, TransCanada PipeLines Limited, NOVA Gas Transmission Ltd., and Foothills Pipe Lines Ltd., RH-003-2011 (March 2013) at 235.

²⁴ Direct Evidence of Dr. Laurence Booth on behalf of AQCIE/CIFQ, at 10.

1 **Q. Does Dr. Booth consider the perspective of lenders and investors in his**
2 **evidence?**

3 A: No. He does not address how lenders and investors would view the existence of
4 large deferral account balances nor does he discuss how those accounts would be
5 financed differently from a newly acquired, 5-year rate-base asset by HQD. We see
6 no basis to differentiate the two 5-year assets by what is considered “normal” or
7 “special” by the regulator. It is only the investor’s perspective that is relevant to this
8 issue. As Dr. Booth states in his testimony, investors are interested in the earnings
9 stream of the utility.²⁵ There is no basis to find that one asset can be distinguished by
10 investors according to their earnings stream. Both assets would provide ratable cost
11 recovery over their respective lives and neither would be more assured of recovery
12 than the other. Both assets would require the same financing over the same term.
13 No distinction is warranted.

14 **Q. Dr. Booth states in his IR response to HQD that the \$380 million variance**
15 **account balance was not necessary to provide utility service.²⁶ Do you agree?**

16 A: No. Dr. Booth states that he believes that the deferral accounts did not result from
17 and were not necessary to provide utility service. However, the costs that were
18 captured and deferred in those balances were power costs directly attributable to
19 providing power to customers over the past winter. Without question, the costs
20 captured in the purchased power pass through variance account were costs incurred
21 in providing utility service. The fact that these costs were deferred to smooth the

²⁵ Direct Evidence of Dr. Laurence Booth on behalf of AQCIE/CIFQ, at. 8.

²⁶ Dr. Booth responses to HQD interrogatory 8.b. (November 20, 2014)

1 impact on ratepayers does not change the original use for which the costs were
2 incurred.

3 **Q. Dr. Booth seems to be saying that if HQD is allowed remuneration at the**
4 **WACC that it would be a violation of the matching principle. Do you agree?**

5 A. No. The matching principle applies to how assets are financed, which as discussed
6 previously, is not the same as how rates are set. It is our understanding that Hydro-
7 Québec generally adheres to the matching principle by aggregating its cash flow
8 requirements and financing on that basis. It is our understanding that the Régie has
9 determined that this is the most efficient way for Hydro-Québec or HQD to carry
10 out its financing. For rate-setting purposes, however, all of the debt costs are
11 averaged and are applied (in conjunction with the equity return) to the net assets of
12 the utility. The fact that debt costs are averaged for ratesetting and applied to assets
13 by way of the WACC, by no means indicates that debt financing terms were not
14 matched against the lives and risks of the assets they financed. In addition, use of
15 the WACC does not upset the actual debt financing costs and respective maturities
16 obtained to finance specific assets, which were matched to the aggregate cash flow
17 requirements of HQD. The matching principle and the application of the WACC
18 are not mutually exclusive and in fact that WACC maintains the matching
19 relationship by weighting debt costs in accordance with their respective outstanding
20 principal balances.

21 **Q. Does HQD's WACC include relatively short-term debt costs, such as 5-year**
22 **floating rate debt?**

1 A. Yes it does. The financing of variance account balances are integrated into the cash
2 flow needs of HQD and financed by Hydro-Québec in accordance with its
3 integrated debt policy. Indeed, HQD recently borrowed \$1 billion with a 5-year
4 maturity and floating interest rate.

5 **Q. Dr. Booth recommends that “normal” deferral accounts are financed at a rate**
6 **of 25 basis points over the commercial paper rate. Is Concentric in favor of**
7 **this recommendation?**

8 A: Concentric is not in favor of this recommendation. As indicated earlier in this
9 testimony, it is very difficult to specifically identify financing for individual assets
10 especially when those assets are created from utility operations. The money that is
11 used to finance short-term assets may come from retained earnings, short-term debt
12 or even long-term debt. In HQD’s case, the short-term deferral balances do seem to
13 revert between positive and negative and remunerate both the utility and its
14 ratepayers equally. Further, the balances are small and offsetting relative to the larger
15 long-term deferral accounts. Concentric sees no reason to depart from the current
16 practice of remunerating these assets with the WACC. As we have seen with the two
17 large deferrals HQD carries on its books, what appears to be a short-term deferral
18 account could grow to a level exceeding that which can be recovered from ratepayers
19 in a single year. Large variance balances that are deferred beyond one year require
20 financing; and short-term capital does not meet these financing needs.

21 **Q. Do you also wish to respond to the testimony of ACEFQ?**

22 A. Yes.

1 **Q. Please summarize the testimony of ACEFQ?**

2 A. ACEFQ provides a historical perspective on the purchased power pass through
3 account and claims that because customers bear the risk for these accounts, the
4 utility should not be allowed to profit from any supply related accounts. The
5 ACEFQ challenges whether balances that arise from variance accounts can truly be
6 considered investments and argues that deferred operating expenses are not the same
7 as capital expenditures that result in a return on capital. ACEFQ also takes
8 exception to HQDs average debt cost which it claims is higher than it should be due
9 to the integrated financing policy of Hydro-Québec and the different risk profiles of
10 the generation division as opposed to the distribution and transmission division; and
11 that the risks of deferral and variance accounts are lower still. ACEFQ concludes
12 that HQDs stand alone financing costs for deferral and variance accounts would be
13 much lower than the integrated debt cost of Hydro-Québec; and that the WACC
14 would therefore be a poor estimator of the interest rate applicable to the purchased
15 power pass through account. ACEFQ also claims that HQD benefits from the
16 stand-alone principle in its ROE proceedings, but that in regards to the rate of return
17 on DVAs, HQD relies on the integrated management of Hydro-Québec's funding.
18 Finally, ACEFQ recommends that the Régie sets the rate of return on the power
19 pass through account at the short-term debt rate.

20 **Q. Do you agree that because deferral and variance accounts transfer risk to**
21 **customers that the utility should not be allowed to profit on costs associated**
22 **with the accounts?**

1 A. No. As discussed previously in this testimony, the risk reduction associated with
2 deferral and variance accounts is already reflected in its various costs of capital. It's
3 protective effects are considered by lenders and equity investors in setting a return
4 that compensates for the risks of making loans or investing capital in the enterprise.
5 The shareholder should be allowed the same return as that which it could
6 alternatively pursue with a competing investment of similar risk. Shareholders do
7 not invest in specific accounts but make investments in the aggregate earnings
8 stream of the enterprise. The deferral and variance account is integral to the risk of
9 the firm and would not be considered separately by investors. Risks were considered
10 in determining the debt costs and the WACC and do not need to be considered
11 again in deferral and variance accounts remuneration.

12 **Q. ACEFQ states that a deferral account relating to operating expenses cannot**
13 **be considered an investment. Do you agree?**

14 A. No. Deferral and variance accounts are investments just as any five-year rate base
15 asset may be considered an investment. The fact that it is not included in rate base,
16 doesn't make it any less of an investment. Concentric agrees that utilities do not
17 earn a return on operating costs. Those charges are recovered in the revenue
18 requirement in the period they are incurred. However, if recovery of operating
19 expenses is deferred to future periods, those costs cease to be current operating
20 expenses and instead become regulatory assets of the utility. Those assets cannot be
21 financed with short-term debt and must be financed exactly the same way that other
22 assets are financed, i.e. such as computers or vehicles. Concentric does not accept

1 that the capital commitment associated with deferral and variance accounts is
2 significantly different from other rate base investments that attract the WACC.

3 **Q. ACEFQ takes exception to HQDs average debt cost which it claims is higher**
4 **than it should be due to the integrated financing policy of Hydro-Québec and**
5 **the different risk profiles of the generation division as opposed to the**
6 **distribution. Do you see evidence of this?**

7 A. No. ACEFQ concludes that HQDs stand alone financing costs for deferral and
8 variance accounts would be much lower than the integrated debt cost of Hydro-
9 Québec. They also argue that HQD opportunistically employs the stand-alone
10 principle for purposes of determining its ROE, but claims to be subject to an
11 integrated financing policy when it comes to its debt costs. The Régie has long-
12 accepted the integrated financing costs of Hydro-Québec as a proxy for HQD debt
13 costs, and further it is Concentric's understanding that the matter of how HQD
14 determines its debt costs is not an issue in this proceeding. Concentric, however,
15 sees no evidence that HQDs debt profile is disproportionately long. The average
16 maturity of HQD's long-term debt is 18 to 19 years and the average life of HQD's
17 assets is 27 years. This suggests that there is a mix of short-term and long-term debt
18 in its portfolio and that debt costs are not disproportionately long-term.

19 **Q. Please summarize the testimony of the OC**

20 A. The OC recognizes the current practice of the WACC being applied to all of HQD's
21 deferral and variance account balances, and the Régie's consistent approval of this
22 practice in the past. Drawing upon Concentric's evidence of practices in Canada and

1 the U.S., citations to decisions in BC and Ontario, and the “matching principle”, the
2 OC concludes that using the Distributor’s cost of debt would be more appropriate.
3 The OC supports this position based on the nature of the DVA balances being
4 identifiable, and the carrying costs being “essentially short-term”.

5 **Q. Please comment on the basis of the OC’s recommendation**

6 A. The OC’s position is based primarily on select precedents (BC and Ontario), and its
7 interpretation of the “matching principle”.

8 **Q. Do you believe the regulatory precedents have been appropriately interpreted**
9 **for HQD?**

10 A. No. As discussed earlier, a broader view of the precedents researched by Concentric
11 point to the WACC as the more common approach adopted by regulators for DVA
12 balances, especially those amortized over one year. In Canada, while the BC and
13 Ontario commissions have turned to debt rates, the Alberta commission reinforced
14 the use of the WACC. The precedents are not completely one-sided on this matter,
15 but do suggest greater reliance on the WACC.

16 **Q. Do you believe the “matching principle” has been appropriately interpreted**
17 **by the OC for HQD?**

18 A. No. As discussed earlier, and addressed in response to IRs²⁷, Concentric agrees that
19 it is generally advisable to match the financing term to the life of the asset being
20 financed. However, in utility regulation for rate-setting purposes, utility assets are
21 assumed to be financed in accordance with a deemed capital structure, i.e. a

²⁷ See Concentric responses to AQCIE/CIFQ 1.5 and 1.10.

1 percentage allocation of debt, preferred equity and common equity. It is further
2 assumed for regulatory purposes that all assets are financed at the WACC. Rates are
3 set such that prudently acquired assets will be financed in accordance with the
4 deemed capital structure at the allowed rate of return. The deemed capital structure
5 is designed to approximate how the utility is actually financed (or how the regulator
6 wants to see the utility financed.) Within the utility's range of investments, are those
7 of varying asset lives and risks. To pick and choose assets and suggest they had
8 been/or should be financed with lower-cost debt ignores the assets at the other end
9 of the spectrum that are financed with longer term higher cost debt, but still earn
10 only the WACC. Furthermore, at both ends of the spectrum, debt must be
11 accompanied by an equity component. Even low risk utilities finance with both debt
12 and equity. A deemed capital structure and WACC is designed to compensate the
13 utility and investors for the complete basket of risks across all capital assets in rate
14 base. This is fair to ratepayers and allows the utility a reasonable opportunity to
15 earn its allowed return. The OC's recommendation would not adequately
16 compensate HQD for its DVA carrying costs.

17 **Q. Does this conclude your testimony?**

18 A. Yes.

Concentric Evidence - R-3905-2014, Attachment A
Canadian Utilities

| Regulatory Board | Regulated Company | List of Applicable DVA | DVA amongst IR's 4 types (Weather, DSM, Purchased Gas, Contributions) | Included in Rate Base? | Recovery Period | Carrying Cost | Comments | Source |
|-------------------------------------|-------------------|---|--|----------------------------------|--|---|---|---|
| Régie de l'énergie | Gaz Métropolitain | 1) Weather and wind stabilization account 2) Energy supply account 3) EEP Expenditures and Subsidies 4) Energy Efficiency Incentives | 1) Weather stabilization account 2) Energy supply account 3) and 4) Demand side Management (DSM)/Energy Efficiency account | 1) Yes 2) No 3) and 4) Yes | 1) 1 to 5 years 2) within 12 months 3) and 4) 1 year | 1) Weighted Average Cost of Capital (WACC) 2) WACC 3) and 4) WACC | | - Gaz Métro - 2013 Annual Financial statements on September 30, 2013, Note 5, pages 19-22 - Correspondence with key company personnel |
| | Gazifère | 1) Weather stabilization deferral account 2) DSM variance account 3) Purchased gas variance | 1) Weather stabilization account 2) DSM account 3) Energy supply account | 1) Yes 2) No 3) Yes | 1) 5 years 2) 1 year 3) 1 year | 1) No return 2) WACC 3) No return | | - Documents B-0013 and B-0016 Gazifère Regulatory Book Closing on December 31, 2013, Docket R-3884-2014 - Decision D-2012-163, para 53 - Decision D-2008-144, p 19 - Correspondence with key company personnel |
| Alberta Utilities Commission | AltaGas | Deferred Cost of Gas | Energy supply account | No | Monthly | No return | | - AltaGas - Consolidated Financial Statements 2013, pages 30-32 - AltaGas Utilities Inc. - 2013 Rule 005, Financial Statement, Note 7, page 17 - AUC Decision 2001-75, 4.4.2, page 66 |
| | ATCO Gas | 1) Rider L, Load Balancing Deferral Account (LBDA) 2) Rider W, Weather Deferral Account | 1) Energy Supply 2) Weather Stabilization | 1) No 2) No | 1) Varies. Typically 2 to 3 months 2) 1 Year | 1) WACC 2) WACC | - The load balancing deferral account relates to the physical operation of the gas distribution system. This is not an energy supply account in the conventional sense. | - ATCO - MD&A march 2014, page 20 - AUC Decision 2014-268 - AUC Decision 2014-263 - AUC ATCO 2013 Rule 005 - Correspondence with key company personnel |
| | FortisAB | Rider E - Special Facilities Charge | Contribution for new customer connections | Yes | Life of the agreement | WACC | - Costs associated with special facilities constructed on customer property are recovered through special facilities rate, and facilities are treated as utility property and are included in rate base. - ATCO Electric has a similar Rider E tariff. | - AUC Decision 2011-176 - Fortis Alberta Tariff (October 1, 2014) - Correspondence with key company personnel |
| | EPCOR | None | None | N/A | N/A | N/A | | - Correspondence with key company personnel |
| | ENMAX | None | None | N/A | N/A | N/A | | - Correspondence with key company personnel |

Concentric Evidence - R-3905-2014, Attachment A
Canadian Utilities

| Regulatory Board | Regulated Company | List of Applicable DVA | DVA amongst IR's 4 types (Weather, DSM, Purchased Gas, Contributions) | Included in Rate Base? | Recovery Period | Carrying Cost | Comments | Source |
|---------------------------------------|-------------------|---|--|-------------------------------------|---|---|---|---|
| British Columbia Utilities Commission | BC Hydro | 1) Non-heritage deferral account (variance account) 2) Heritage deferral account (variance account) 3) Trade income deferral account (variance account) 4) DSM deferral account (deferral account) | 1) Weather Stabilization 2) and 3) Energy supply accounts 4) DSM account | 1) No 2) and 3) No 4) Yes | 1), 2), and 3) Heritage Deferral Account, Non-Heritage Deferral Account, Trade Income Deferral Account recovered through Deferral Account Rate Rider (DARR) - has historically provided recovery over 10 years but in 2015-2016 RRA, was increased to 20 year recovery period. 4) DSM 15 years | 1), 2) and 3) HDA, NHDA, TIDA : Weighted average cost of debt 4) DSM : No return earned before asset goes into service (DSM expenditures generally go into service in the year of expenditure) - once in service unamortized balance earns the WACC. | | - BC Hydro - Annual Report 2014, pages 55-56; 87-91 - BC Hydro F2015-2016 RRA, Appendix C, Schedule 8.0, page 38 - BC Hydro F2015-20216 RRA, Appendix H, page 55 - Order G-77-12A, page 5 - Correspondence with key company personnel |
| | Fortis BC | 1) Commodity Cost Reconciliation Account (gas variance account); Midstream Cost Reconciliation Account (gas variance account) 2) Power Purchase Expense variance account (electric) 3) EEC Deferral Account (gas) 4) Revenue Stabilization Adjustment Mechanism (gas variance account) | 1) Energy supply account (Gas) 2) Energy supply (Electric) 3) DSM account (Gas) 4) Weather Stabilization (Gas only) | 1) Yes 2) No 3) Yes 4) Yes | 1) 1 - 2 years 2) 1 year 3) 10 years 4) 2 years | 1) WACC 2) Short-term Debt Return 3) WACC 4) WACC | Historically, the majority of FBC (Electric) deferral accounts were included in rate base and attracted the WACC. FBC Order G-110-12 established a new policy for the electric utility whereby the WACC only applies to the financing of capital assets. Otherwise, WACC for DVA recovered > 1 year and Short term Interest Rate < 1 year. For FEI (Gas) regulatory deferrals continue to attract the WACC. | - FortisBC - Consolidated Financial Statements December 31, 2013, pages 16-18 - FortisBC Exhibit B-9 - Responses to Celgar IR No.2, Question 21.0, Page 43 - G-44-12, pp. 151, 183 - G-110-12, pp. 105, 115 - Correspondence with key company personnel |
| Ontario Energy Board | Hydro One | None | None | N/A | N/A | N/A | N/A | - Hydro One - 2013 Consolidated Financial statements, Note 11, pages 22-25 |

Concentric Evidence - R-3905-2014, Attachment A
Canadian Utilities

| Regulatory Board | Regulated Company | List of Applicable DVA | DVA amongst IR's 4 types (Weather, DSM, Purchased Gas, Contributions) | Included in Rate Base? | Recovery Period | Carrying Cost | Comments | Source |
|---|-------------------|---|---|---|--|--|---|---|
| | Enbridge | 1) Purchased Gas Variance Account 2) Unaccounted for Gas Variance Account 3) Storage and Transportation Deferral Account 4) Lost Revenue Adjustment Mechanism Variance Account 5) Demand Side Management Deferral Account | 1), 2) and 3) Energy supply account 4) and 5) DSM Deferral | 1) No 2) No 3) No 4) No 5) No | 1), 2) and 3) Quarterly 4) and 5) Apply for disposition annually, subject to OEB approval | 1), 2) and 3) 90-day interest rate 4) and 5) 1 year interest rate | 90-day short term interest rate plus a corporate spread for accounts that are adjusted quarterly, i.e. PGVA; Use one-year short term interest rate plus corporate spread for regulatory accounts that are not adjusted quarterly. | - Enbridge 2013 Annual Financial Statement, Note 5, pages 14-16 - Letter to all gas and electric utilities re.: Approval of Accounting Interest Rates Methodology for Regulatory Accounts Board File No. EB-2006-0117 (November 28, 2006) - OEB Accounting Order EB-2012-0459, EGDI (August 22, 2014) - Correspondence with key company personnel |
| New Brunswick Energy and Utilities Board | NB Power | None | None | N/A | N/A | N/A | | - Decision - In the Matter of Point Lepreau Nuclear Generating Station Deferral Account and section 143.1 of the Electricity Act (March 13, 2013) NB Power Consolidated Financial Statements, Note 4, pages 7-9 and Note 14, page 25 - Correspondence with key company personnel |
| National Energy Board | TCPL | 1) Long-term Adjustment account (deferral) 2) Toll Stabilization Adjustment (deferral) | 1) and 2) Revenue Stabilization | 1) Yes 2) No | 1) Life of transmission system 2) 4 years | 1) WACC 2) WACC | - Deferral accounts cited, pertain to stabilization of revenues inclusive of weather related variances. - Board stated in Order "Also, we are not prepared to assume how TransCanada will finance the TSA; we deem the entirety of the Mainline's financing needs to be met with a 60-40 debt-equity split, rather than deeming how individual accounts are financed." | - TCPL - 2013 MD&A and Consolidated Statements, Note 9, pages 118-121 - Business and Services Restructuring and Mainline 2012-2013 Tolls Application, Part C: Business and Services Restructuring Proposal, Section 7.0: Toll Design, page 46. - Reasons for Decision, TransCanada PipeLines Limited, NOVA Gas Transmission Ltd., and Foothills Pipe Lines Ltd. RH-003-2011, March 2013 |

Concentric Evidence - R-3905-2014, Attachment A
U.S. Proxy Utilities

| Regulatory Board | Regulated Company | List of Applicable DVA | DVA amongst IR's 4 types (Weather, DSM, Purchased Gas, Contributions) | Included in Rate Base? | Recovery Period | Carrying Cost | Comments | Source |
|---|------------------------------------|---|---|----------------------------|--|--|--|--|
| Alabama Public Service Commission | Alabama Power | Deferral and Variance Accounts - Generally | Deferral and Variance Accounts - Generally | Yes | Generally one year | WACC, unless otherwise stated | | - Southern Company 2013 10-K |
| Public Utilities Commission of Colorado | Public Service Company of Colorado | 1) Expenditures for renewable resources and environmental expenditures 2) Energy rider 3) DSM rider 4) Capacity cost rider 5) Renewable energy rider 6) Transmission cost rider 7) Other deferral and variance accounts not recoverable within the year | 1), 3) and 5) Energy efficiency/DSM/ renewable energy 2) and 4) Energy supply 6) Transmission costs 7) Other long-term DVAs | 1) - 6) No 7) Yes | 1) - 6) within 1 year 7) greater than 1 year | 1) - 6) No return 7) WACC | | - Decision No. C12-0494, PUC of CO, Docket No. 11AL-947E, Order Approving Settlement Agreement, May 9, 2012, Adopted Date: April 26, 2012 at 17. - PSCO 2013 10-K at 80. |
| Connecticut Public Utilities Regulatory Authority | Connecticut Light and Power | 1) Storm fund balance 2) Derivative accounts to purchase energy and energy related products | 1) Storm fund balance 2) Energy supply | 1) No/Yes 2) No | 1) 6 years 2) Contract specific | 1) A portion at 5-year constant maturity Treasury 1.30%, the remainder allowed in rate base and amortized over the life of the plant 2) No return | | - NU 2013 10-K at 117-118 - CT PURA Order, Docket No. 13-03-23, Petition of Connecticut Light and Power for Approval to Recover Its 2011-2012 Major Storm Costs (March 12, 2014) |
| Florida Public Service Commission | Florida Power and Light Company | 1) Fuel and purchased power recovery 2) DSM / Energy Efficiency 3) Interchange costs 4) Construction related to nuclear and solar generating facilities 5) Conservation and environmental deferral accounts | 1) Energy Supply 2) DSM / Energy Efficiency 3) Interchange costs 4) Construction related to nuclear and solar generating facilities 5) Conservation and environmental deferral accounts | 1) - 5) Yes on certain DVA | 1) - 5) Not disclosed, but recovery is assumed to be at least annual | 1) - 5) WACC on certain DVA, or other return set by the Commission | | - FPL 2013 10-K at 81. |
| | Gulf Power | 1) Fuel and purchased power recovery 2) Revenue recovery 3) DSM / Energy Efficiency | 1) Energy Supply 2) Revenue recovery 3) DSM / Energy Efficiency | 1) - 3) Yes | 1) - 3) Generally annually | 1) - 3) WACC | Net regulatory assets are subject to Commission approved cost of capital | - Southern Company 2013 10-K - Gulf Power Stipulation and Settlement Agreement, Docket No. 130 140-EJ (November 22, 2013) at 3 - Smith Exhibit RCS-2, Schedule A p. 1 of 1 Staff Revenue Requirements Witness, Docket 36989, at 9 of the .pdf (October 2013) |

Concentric Evidence - R-3905-2014, Attachment A
U.S. Proxy Utilities

| Regulatory Board | Regulated Company | List of Applicable DVA | DVA amongst IR's 4 types (Weather, DSM, Purchased Gas, Contributions) | Included in Rate Base? | Recovery Period | Carrying Cost | Comments | Source |
|---|--|---|--|--------------------------|--|---|--|--|
| Georgia Public Service Commission | Georgia Power | 1) Fuel and purchased power recovery 2) Revenue recovery 3) DSM / Energy Efficiency | 1) Energy Supply 2) Revenue recovery 3) DSM / Energy Efficiency | 1) - 3) Yes | 1) - 3) Generally annually | 1) - 3) WACC | Net regulatory assets are subject to Commission approved cost of capital | - Southern Company 2013 10-K - Smith Testimony, Staff Revenue Requirements Witness, Docket 36989, at 17 and 26 (October 22, 2013) - Exhibit RCS-2, Schedule B p. 1 of 4, Docket No. 36989 (October 22, 2013) |
| Massachusetts Department of Public Utilities | NSTAR Electric | 1) Revenue decoupling 2) Storm Fund 3) Derivative accounts to purchase energy and energy related products | 1) Weather Stabilization 2) Storm Fund 3) Energy supply account | 1) No 2) Yes 3) No | 1) Semi-annual 2) 5 years 3) Contract specific | 1) Customer deposit rate (set at the prime rate of interest) 2) WACC 3) No return | | - MA DPU, National Grid Decoupling Order, November 30, 2009, at 88, 205, 208 - NU 2013 10-K at 117-118 |
| | Western Massachusetts Electric Company (WMECO) | 1) Revenue decoupling 2) Storm Fund 3) Derivative accounts to purchase energy and energy related products | 1) Weather Stabilization 2) Storm Fund 3) Energy supply account | 1) No 2) Yes 3) No | 1) Semi-annual 2) 5 years 3) Contract specific | 1) Customer deposit rate (set at the prime rate of interest) 2) WACC 3) No return | | - MA DPU, National Grid Decoupling Order, November 30, 2009, at 88, 205, 208 - NU 2013 10-K at 117-118 |
| Minnesota Public Utilities Commission | Northern States Power Company of Minnesota | Deferral and Variance Accounts - Generally | Deferral and Variance Accounts - Generally | Yes | Generally one year | WACC | | - NSP-MN 2013 10-K, at 94-95 - MPUC Order, NSP-MN Docket No. E-002/GR-12-961 (September 3, 2013) at 39. |
| Mississippi Public Service Commission | Mississippi Power | Deferral and Variance Accounts - Generally | Deferral and Variance Accounts - Generally | Yes | Generally one year | WACC, unless otherwise stated | | - Southern Company 2013 10-K |
| New Hampshire Public Utilities Commission | Public Service New Hampshire | 1) Deferral and variance accounts generally 2) Storm fund balance 3) Derivative accounts to purchase energy and energy related products | 1) Deferral and variance accounts generally 2) Storm fund balance 3) Energy supply | 1) Yes 2) No 3) No | 1) Not disclosed 2) 7 years 3) Contract specific | 1) WACC 2) Fixed rate of 4.5% 3) No return | | - PSNH Witness Baumann Exhibit, Docket No. DE-09-035, Schedule 3, p. 1 of 2 - PSNH Order Approving Settlement, June 2010 at 10. - NU 2013 10-K at 117-118 |

Concentric Evidence - R-3905-2014, Attachment A
U.S. Proxy Utilities

| Regulatory Board | Regulated Company | List of Applicable DVA | DVA amongst IR's 4 types (Weather, DSM, Purchased Gas, Contributions) | Included in Rate Base? | Recovery Period | Carrying Cost | Comments | Source |
|---|--|---|---|------------------------|--------------------------------------|---|---|---|
| New York Public Service Commission | Consolidated Edison Company of New York (CECONY) | Deferral and Variance Accounts - Generally | Deferral and Variance Accounts - Generally | No | Not disclosed | Unless otherwise specified in Commission Order, deferral and variance accounts earn the , at the Other Customer-Provided Capital Rate, set by formula annually based on long term debt rate | At the time of Concentric's research, Other Customer-Provided Capital Rate was 3%. | - ConEd 2013 10-K - Memo dated, November 14, 2013, Subject Case 13-M-0463 - Customer Deposits Interest Rates Effective January 1, 2014 |
| Public Utilities Comission of Texas | Southwestern Public Service Company | 1) Expenditures for renewable resources and environmental expenditures 2) Other deferral and variance accounts - generally | 1) Energy efficiency/DSM/ renewable energy 2) Other DVAs | 1) No 2) Yes | 1) Not disclosed 2) Not disclosed | 1) No return 2) WACC | | - SPS 2013 10-K at 68 |
| Public Service Commission of Wisconsin | Wisconsin Electric Power Company | Deferral and variance accounts - generally | Deferral and variance accounts - generally | No | Not disclosed | Mostly short-term debt cost though certain assets earn no return | | - We-Energies 2013 10-K at 54, 73, and 75 |
| | Northern States Power Company of Wisconsin | 1) Power purchase recovery 2) Deferral and Variance Accounts - Generally | 1)Energy supply 2) Deferral and Variance Accounts - Generally | No | Not disclosed | 1) No return 2) Mostly short-term debt cost | Generally enviornmental remediation projects do not earn a return, but NSP-WI was granted a 3% return on the clean up of the Ashland site due to its magnitude. | - NSP-WI 2013 10-K at 41, 65, and 70 |