
Reference: (1) BR-DERS-23 (b)
(2) BR-DERS-23 (c)

Preamble: In the response to (b), DERS indicated that the actual 2004 and 2005/2006 forecast letter of credit numbers are calculated at 40 bps and are based on actual letters of credit in support of the MSA. DERS also indicated that as part of DERS' obligations to I-Tek, DERS is required to provide a letter of credit in addition to the parental guarantee.

In the response to (c), DERS indicated that its proposal to allocate the MSA credit support requirements in proportion to regulated and competitive customer count (10% threshold) was not specifically discussed in the proceeding related to Application 1302109. DERS also indicated that the methodology proposed in this Application is therefore new and will partially protect commercially sensitive information while providing a benefit to regulated customers.

Request:

- (a) With respect to the response to BR-DERS-23(b), please confirm that in Application 1302109 (p. 6-16 DRT & p. 6-14 RRT), DERS indicated that it required either a guarantee or a letter of credit to support the MSA, but not both, and please confirm that DERS' credit charges were approved on that basis.
- (b) With respect to the response to BR-DERS-23(b), please indicate the appropriate clause in the MSA or provide other documentation that supports DERS' claim that it has an obligation to I-Tek to provide a letter of credit in addition to the parental guarantee.
- (c) With respect to the response to BR-DERS-23(c), please indicate whether in DERS' proposed 10% threshold methodology, DERS proposes to determine the "actual" proportion of competitive customers on a monthly basis and to reflect any required cost allocation changes in the DRT and RRT deferral accounts on a monthly basis.

Response:

- (a) Confirmed. In Application 1302109, DERS did not indicate that it required both a parental guarantee and a letter of credit to support the MSA. However, in Written Argument dated October 11, 2003, DERS stated that in certain circumstances parental guarantees must be posted in order to obtain letters of credit – (page 17). Furthermore, in Decision 2003-106 (page 39) the Board noted that "...if the Board determines that the credit

support requirements for a particular contractual arrangement are prudent, the Board will allow the recovery of actual costs associated with the Letter of Credit and additional Parental Guarantee charges, if required to support the Letter of Credit”.

As a condition of ATCO's sale of Retail Assets to Centrica, a parental company guarantee was required in addition to a letter of credit to support the I-Tek MSA. As a result, the total cost to DERS is 40 basis points related to the letter of credit fees and an additional 40 basis points related to the parental guarantee fees.

DERS therefore views the parental guarantee and letter of credit costs to be prudent.

- (b) The appropriate clauses are in the Centrica plc Guarantee and Letter of Credit Support Agreement. Section 1(a) of this agreement refers to the Guarantee which is supported by a parental company guarantee and Section 9(a) refers to the letter of credit. The guarantee is also referred to in Sections (e) and (f) of the agreement as being a condition to the transfer of gas and electricity assets. Please refer to Attachment BR-DERS-72(b) for a copy of the Centrica plc Guarantee and Letter of Credit Support Agreement.
- (c) DERS proposes that the change in allocation factors take place prospectively with each test period and that similar third party verification of the calculation is provided.

Reference: BR-DERS-053(b)
CG-DERS-017(a)

Preamble: DERS indicated that it sought advice from the TD Bank specifically in response to the Boards directive in Decision 2003-106.

DERS understood that TD meant that before debt financing could be provided, a significant portion of the loan would need to be converted to equity or a subordinated note.

Request:

- (a) Please clarify the minimum percentage of equity (or subordinated debt) that TD requires in order to lend working capital on the terms indicated in its April 26, 2005 letter.
- (b) With respect to TD's proposal, please clarify if the quoted 85 basis points and 25 basis points are additive.
- (c) Given current interest rates, please clarify the base interest rate (such as prime rate or bankers acceptance rate) and the total interest rate that would apply to amounts drawn for working capital purposes. Please also clarify whether the 25 basis point standby fee would apply to amounts authorized but undrawn under a credit facility.
- (d) Please clarify if TD would offer the same terms if the requirement for equity or subordinated debt were replaced by a parental guarantee from Centrica plc.

Response:

- (a) In the letter dated April 26, 2005, TD stated that the intercompany loan balance shown in the latest Financial Statements, if converted to equity, or a subordinated intercompany shareholder loan, would enable TD to provide working facilities on a stand alone basis. TD did not make reference to a minimum percentage of equity in their letter. However, TD did say that they would require the subordinated loan to be converted, which implies 100% equity.
- (b) DERS has interpreted TD's proposal to imply that the Standby Fee of 25 basis points per annum would be the base charge. Any drawings on the funds would then be subject to an additional 85 basis points.
- (c) TD did not specify the base interest rate that would be charged. However, the base interest rate does not reflect the total cost to DERS as it excluded the equity component of the equation.

DERS has interpreted TD's proposal to imply that the Standby Fee of 25 basis points per annum would be the base charge and would apply to undrawn funds under the credit facility.

- (d) DERS does not know if TD would offer the same terms if the requirement for equity or subordinated debt were replaced by a parental guarantee from Centrica plc.

While TD Bank has provided an indication of the cost of debt on a stand-alone basis, that cost rate does not reflect the true overall cost of capital that would be faced by DERS. The true cost would include the opportunity cost associated with the equity, or subordinated inter-company shareholder loan that TD indicates will be necessary.

Similarly, any rate that TD might charge DERS for a working capital facility if a parental guarantee of this type were provided does not include the cost of the parental guarantee. The determination of an appropriate cost of the parental guarantee needs to recognize that the provision of such a guarantee shifts risks from DERS to the parent, Centrica, risks for which Centrica, as guarantor, would require compensation. These risks are comprised of (a) disallowances of costs beyond what is manageable, (b) timing of hearings and regulatory decisions resulting in risk of operating on interim rates with no ability to make prudent business decisions in time to mitigate such risks, (c) thin capital structure leading to extreme earnings sensitivity, and (d) large barriers to exit relative to other Centrica investments.

The total amount of compensation to Centrica required for bearing the risk of DERS should essentially remain unchanged whether provided through subordinated debt, equity or parental guarantee covering equity risk. Introducing debt into this equation increases equity risk further. The combined risk is known as the cost of capital of an enterprise. A significant amount of analysis would be required to determine DERS' cost of capital and its components using various ratios. That analysis is unnecessary, since while the cost of capital components may be carved up among debt, guarantee fee, and equity, the overall cost of capital, which is a function of the business risks of DERS, should remain relatively unchanged under different financing assumptions. Hence, what is necessary is a reasonable estimate of the overall cost of capital. In this regard, DERS would direct the Board to Attachment BR-DERS-53(f), which shows that under varying assumptions as to how DERS is financed, its overall cost of capital remains the same.

There are (1) no direct comparables for estimating the overall cost of capital of DERS on a stand-alone basis, and (2) no easy means to

estimate the separate costs of a parental guarantee covering equity risk, including the opportunity cost of the equity support, and the investors' return requirement for bearing the residual business risk. Thus, given the linkage between DERS' and ATCO Utilities' regulated businesses, the latter's overall cost of capital was determined to be a reasonable proxy for the overall stand-alone cost of capital for DERS. The rationale for so doing, as indicated in response to BR-DERS-74(g), is the regulated rate of services can be viewed as being an integral part of the distribution business.

Further, the level of business risk faced by DERS is not materially different than the delivery business; the risk mitigating effects of DERS' deferral accounts are offset by the degree of the operating leverage. DERS' high degree of operating leverage, which reflects the relatively high ratio of expenses to capital, means that small variations in costs can have a substantially negative impact on the achieved return. Reliance on the ATCO Utilities' cost of capital as the proxy for DERS' stand-alone cost of capital (similar to the Board's imputation of ENMAX's allowed cost of capital for the ENMAX RRT services) eliminates the need to undertake the difficult measurement of individual cost of capital components, such as a parent guarantee or the cost of equity support that the DERS would require.

Reference: BR-DERS-053 & BR-DERS-054

Request:

- (a) Please confirm that Ms. McShane recommended that “the generic cost of capital decision findings should be applied to DERS”. If confirmation is not provided, please provide a detailed explanation.
- (b) Please confirm that the Generic Cost of Capital Decision did not determine a cost of capital directly but rather determined the ROE as well as the equity ratio that would apply independently of the cost of debt and, in the case of the ATCO utilities, was set “as if the company had no support from its preferred shares”. If confirmation is not provided, please provide a detailed explanation.
- (c) Please confirm, that in schedule 1 of Katherine McShane Evidence, Ms. McShane applied the approved equity ratios of the ATCO distribution utilities, adjusted slightly for the presence of no-cost capital. If confirmation is not provided, please provide a detailed explanation.
- (d) Please confirm that the cost of debt to the ATCO utilities includes historic debt that was issued at an interest rate higher than that prevailing today. If confirmation is not provided, please provide a detailed explanation.
- (e) Please confirm that the cost of debt to the ATCO utilities generally reflects terms of up to 30 years. If confirmation is not provided, please provide a detailed explanation.
- (f) Please confirm that DERS did not acquire any debt from ATCO and was and is free to finance its debt at current market rates applicable to it. If confirmation is not provided, please provide a detailed explanation.
- (g) Would Ms. McShane agree that the use of the ATCO distribution equity ratios would remain appropriate if the Board were to determine an appropriate cost of debt, using an appropriate term length, to DERS, on a standalone basis, that would apply if DERS were financed based on the approved equity ratios of the ATCO distribution utilities? If Ms. McShane does not agree, please explain fully and indicate why such an approach would not flow logically from Ms. McShane's support for the use of the results from the Generic Cost of Capital.

Response:

- (a) It is confirmed that Ms. McShane recommended that “the generic cost of capital decision findings should be applied to DERS”.

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- (b) It is confirmed that the Generic Cost of Capital Decision did not determine a cost of capital directly but rather determined the ROE as well as the equity ratio that would apply independently of the cost of debt and, in the case of the ATCO utilities, was set “as if the company had no support from its preferred shares”.
- (c) It is confirmed that in schedule 1 of Kathleen McShane Evidence, Ms. McShane applied the approved equity ratios of the ATCO distribution utilities, adjusted slightly for the presence of no-cost capital.
- (d) It is confirmed that the cost of debt to the ATCO utilities includes historic debt that was issued at an interest rate higher than that prevailing today.
- (e) It is confirmed that the cost of debt to the ATCO utilities generally reflects terms of up to 30 years.
- (f) It is confirmed that DERS did not acquire any debt from ATCO. However, under the current corporate structure DERS is not “free to finance its debt at current market rates available to it”, because, as noted in Ms. McShane’s testimony,

“DERS is effectively a division of Direct Energy Marketing Limited (DEML), which, in turn, is an indirect wholly-owned subsidiary of Centrica plc. Neither DERS nor DEML accesses the capital markets on a stand-alone basis. Instead, they obtain their financing requirements from Centrica, who assesses DERS a ‘use of capital’ charge of 10% for inter-company advances.”

In other words, while there is nothing legally restricting DERS (as a division of DEML) or DEML (as a subsidiary of Centrica) from raising capital, Centrica plc has chosen not to arrange it’s financing in this manner.

- (g) As indicated in Ms. McShane’s testimony, a key rationale for assigning the ATCO Utilities’ cost of capital to the RRT and DRT functions is because there is no separate RRT or DRT business; the services effectively can be viewed as an integral part of the distribution business. In principle, an alternative to attributing the ATCO Utilities’ embedded cost of debt to DERS would be to assume that the utility business could be refinanced *de novo*. A hypothetical current cost of debt could be estimated that would reflect the average term to maturity that a utility would prudently attempt to achieve in order to minimize its refinancing risk. An average term to maturity of 15 years would be reasonable, which is representative of a typical traditional utility. However, if the utility business could be refinanced *de novo*, the overall cost of capital would be reflective of the

risk inherent in the business. While the cost of debt is currently lower than ATCO's embedded debt, the risk of the business is unchanged. Therefore, the overall cost of capital of the business would remain unchanged as depicted in the various scenarios outlined in Attachment BR-DERS 54(f).

Reference: BR-DERS-051, BR-DERS-053 & BR-DERS-054

Preamble: The Board wishes to understand the considerations in deciding between short-term and long-term debt for DERS' working capital purposes, assuming DERS was a standalone entity.

Request:

- (a) Would DERS agree that seasonal variations above the annual minimum level of working capital should be financed by short-term debt? If the answer is no, please provide a detailed explanation.
- (b) Please provide the annual minimum 2005 forecast amount of working capital for DERS either on a daily closing balance basis or monthly closing value basis (or both).
- (c) Would DERS agree that the use of long-term (such as beyond 5 years) debt for working capital could be risky considering that customers are free to choose other suppliers? If the answer is no, please provide a detailed explanation.
- (d) Please confirm that in a regulated context it is customers and not DERS that would bear the risk of interest rate fluctuations as long as the debt term is at least as long as the test period. If confirmation is not provided, please provide a detailed explanation.
- (e) Please provide the factors that should be considered in selecting the term for DERS debt and recommend an appropriate term length. If a portion of the debt would be short-term, while another portion would be long-term, please provide details and a weighted average.

Response:

- (a) Assuming DERS could finance itself on a stand alone basis, the concept that seasonal variations above the annual minimum level of working capital could be financed by short-term debt is valid in principle. However, this does not lead to the conclusion that the total cost of capital associated with DERS' rate base (which is primarily working capital) would be equivalent to the short term financing cost. Please refer to BR-DERS-73(d).
- (b) For the 2005 monthly forecast amounts of working capital please refer to Attachment BR-DERS-75(b).
- (c) DERS agrees that there is a risk that customers will move to another supplier. However, this risk exists in all industries and in all companies

and does not necessarily deem that the use of long term debt to be inappropriate.

- (d) DERS agrees that the regulatory model allows utilities to recover their actual embedded cost of debt and that the risk of interest rate fluctuations is borne by customers as long as the debt term is at least as long as the test period. For utilities that actually issue debt on a stand-alone basis, the risks of under-recovery of actual debt costs are limited to (1) differences between the forecast short-term rate included in the revenue requirement and actual short-term rates incurred, and (2) any difference between a forecast and actual new long-term issue between the time the issue is completed and the actual cost of debt is included in the revenue requirement. In DERS' case, if the Board imputes an interest rate, the risk of over- or under-recovery of that rate is effectively hypothetical, since DERS' will not actually issue any debt. However, DERS does bear the risk that it will not recover the actual cost of capital that it is charged by its parent.
- (e) For the factors that should be considered in selecting the term for DERS debt and an appropriate term length, please refer to BR-DERS-74(g). For convenience it has been inserted below:

“As indicated in Ms. McShane’s testimony, a key rationale for assigning the ATCO Utilities’ cost of capital to the RRT and DRT functions is because there is no separate RRT or DRT business; the services effectively can be viewed as an integral part of the distribution business. In principle, an alternative to attributing the ATCO Utilities’ embedded cost of debt to DERS would be to assume that the utility business could be refinanced *de novo*. A hypothetical current cost of debt could be estimated that would reflect the average term to maturity that a utility would prudently attempt to achieve in order to minimize its refinancing risk. An average term to maturity of 15 years would be reasonable, which is representative of a typical traditional utility. However, if the utility business could be refinanced *de novo*, the overall cost of capital would be reflective of the risk inherent in the business. While the cost of debt is currently lower than ATCO’s embedded debt, the risk of the business is unchanged. Therefore, the overall cost of capital of the business would remain unchanged as depicted in the various scenarios outlined in Attachment BR-DERS 54(f). “

As noted in that response, the key rationale for relying on the allowed common equity ratios and return on equity that were determined in the Generic Cost of Capital proceeding is the premise that the RRT and DRT

services are effectively a part of the distribution function, and would be viewed as similarly financed.

To fulfill this request DERS will assume that a typical gas utility capital structure has approximately 5%-10% short-term debt, while the typical electric utility capital structure has zero - (this is based on the actual capital structures of selected Canadian gas and electric utilities at the end of 2004). For simplicity, DERS therefore propose to use 5% for short-term debt for the RRT and DRT.

Given the above comments and assuming ATCO's common equity ratio, DERS would propose the following capital structure:

	<u>RRT</u>	<u>DRT</u>
Short-term debt	5.0%	5.0%
15-year debt	58%	57%
Common Equity	37%	38%

Reference: BR-DERS-054

Request:

- (a) Please confirm that the embedded debt cost of the ATCO utilities is unrelated to the debt cost that DERS would face. If confirmation is not provided, please provide a detailed explanation.
- (b) Please provide an estimated debt cost for 2005 for DERS in the following format, assuming that DERS is a standalone entity with the noted equity ratios and that the generic cost of capital ROE is applicable to each equity ratio.

5 Year Debt

Equity Ratio	35%	40%	45%	50%	60%
Government of Canada					
Estimated Spread					
Total Interest yield					

10 Year Debt

Equity Ratio	35%	40%	45%	50%	60%
Government of Canada					
Estimated Spread					
Total Interest yield					

Long-term Debt (Consistent with term of Bank of Canada Long-term benchmark)

Equity Ratio	35%	40%	45%	50%	60%
Government of Canada					
Estimated Spread					
Total Interest yield					

Response:

- (a) It is confirmed that the embedded debt cost of the ATCO utilities is unrelated to the debt cost that DERS would face. However, ATCO utilities' overall cost of capital is related as it represents a good proxy for

the overall cost of capital that DERS would face. Relying on the generic cost of capital decision provides a means to be consistent with other regulated retail entities (as outlined in Ms McShanes' evidence) and a pragmatic solution to questions concerning the cost of equity or the cost of parental company support.

- (b) Without undertaking a formal and costly credit rating process, DERS is unable to respond. However, DERS' proposed return on rate base was based on the premise that the RRT and DRT services are an integral part of the distribution function, and thus have a similar cost of capital. The logical extension of that premise would be that, at the same allowed capital structure and return on equity, the cost of debt would be similar to that of an investment grade distribution utility.

TD Securities regularly publishes new issue corporate spreads for various utilities.

As of August 12, 2005, the average indicated spreads (in basis points) for Canadian utility issues rated A(low) or higher by DBRS for various terms were as follows:

<u>5 Years</u>	<u>10 Years</u>	<u>30 Years</u>
37	64	104

These spreads would apply to common equity ratios in the range of approximately 35% to 40%, which reflects the approximate range of allowed common equity ratios. Presumably, the spread would be somewhat lower at higher common equity ratios in Canada; precisely how much lower would entail discussion with investment bankers. It should also be noted that DEML does not have a stand alone credit rating and that if DEML's stand alone rating was less than A(low) the indicated spreads would likely be higher.

The average actual yields to date (January 1-August 18) in 2005 of the corresponding term Canada bonds have been:

<u>5 Years</u>	<u>10 Years</u>	<u>30 Years</u>
3.5%	4.1%	4.6%

Using the TD indicated spreads, the resulting current costs of debt for an A rated utility would be approximately:

<u>5 Years</u>	<u>10 Years</u>	<u>30 Years</u>
3.9%	4.75%	5.65%

Reference: (1) BR-DERS-71
(2) Decision 2003-106, p. 43

Preamble: DERS indicated that its audited statements were finalized and filed with the Board on June 27, 2005.

In Decision 2003-106, it was noted that DERS stated that the “due to parent” shown on its balance sheet was the working capital.

Request:

- (a) Please indicate where working capital and interest expense, related to the working capital, are included in the DERS audited financial statements and please indicate the respective amounts. If these items are not included in the financial statements, please provide a full explanation.
- (b) With respect to inter-company liabilities, please indicate whether, in addition to accounts payable owed by DERS to other DEML business units, DERS also has or could have accounts payable owing to DEML itself. If the answer is no, please provide a full explanation.
- (c) With respect to inter-company liabilities, please indicate whether DERS has or could have accounts payable owing to entities in the Centrica family outside of DEML. If the answer is no, please provide a full explanation.
- (d) With respect to work performed by DEML on behalf of DERS, please indicate where the related labour expense is included in the DERS audited financial statements. If this item is not included in the financial statements, please provide a full explanation.
- (e) Please provide the audited financial statements of DEML as of December 31, 2004.

Response:

- (a) Working capital return is reflected in the audited financial statements as part of the net income figure in the statement of operations and deficit. Please see below the amounts reflected therein. DERS does not directly incur interest charges, as such; these charges are not reflected in the financial statements. Rather, working capital costs are charged to DERS and other DEML business units as a corporate capital charge below the net income line as outlined below.

	<u>DRT</u>	<u>RRT</u>	<u>Total</u>
Working Capital Return	805.5	310.8	1,116.3
Disallowed Costs & Non-deferral item variance from approved rates	(2,719.0)	(1,261.6)	(3,980.6)
Tax	696.9	345.8	1,042.7
Net Income (deficit)	(1,216.6)	(605.0)	(1,821.6)
Corporate Charge (10%)	(947.6)	(365.6)	(1,313.3)
Net Income after Corporate Charge	(2,164.2)	(970.6)	(3,134.8)

As demonstrated, DERS earned a negative return in 2004 due to variances in non-deferral items, disallowed costs and the difference between the corporate charge rate and the allowed return on working capital.

- (b) Confirmed, DERS has inter-company accounts payable to DEML related to corporate allocations, other charges incurred by corporate on behalf of DERS and commodity procurement costs of goods sold.
- (c) No, DERS did not have any transactions to other Centrica entities outside of DEML.
- (d) With respect to work performed by DEML on behalf of DERS, the related labour expense is included as part of gas and electricity supply costs (related to EMG salaries for Procurement & Portfolio Management) and as part of the General and Administrative costs (related to corporate salary allocations).
- (e) With the exception of DERS, audited financial statements are only prepared at the Centrica level. Consequently, there are no audited financial statements for DEML.

Reference: (1) BR-DERS-051

Preamble: DERS indicated that in order to annualize working capital requirements in 2004, the seasonal fluctuations need to be taken into account. DERS submitted that this was accomplished by adding the 2004 approved forecast amounts for January through April to the actual working capital amounts from May through December, 2004

Request:

- (a) For January through April 2004, please provide the forecast amount of working capital for DERS on a monthly closing value basis.
- (b) For May to December 2004, please provide the actual amount of working capital for DERS on monthly closing value basis.

Response:

- (a) For the January through April 2004, forecast amounts of working capital please refer to Attachment BR-DERS-78.
- (b) For the May through December 2004, actual amounts of working capital please refer to Attachment BR-DERS-78.

Reference: (1) BR-DERS-053(f)

Request:

- (a) Please confirm that the Centrica Charging for Credit Policy and Centrica plc parental company guarantee of 40 bps are being used for the credit support requirements of the MSA. If confirmation is not provided, please provide a detailed explanation.
- (b) Please confirm that the magnitude of credit support required for the forecast DRT and RRT working capital requirements in 2005, assuming working capital was obtained from the Toronto Dominion Bank for example, would be less than the magnitude of credit support requirements of the MSA. If confirmation is not provided, please provide a detailed explanation.
- (c) Please confirm that the Centrica Charging for Credit Policy and Centrica plc parental company guarantee of 40 bps could be used to provide credit support requirements if working capital was obtained from the Toronto Dominion Bank. If confirmation is not provided, please provide a detailed explanation.

Response:

- (a) It is confirmed that the Centrica Charging for Credit Policy and Centrica plc parental company guarantee of 40 bps are being used for the credit support requirements of the MSA.
- (b) Not confirmed. The cost of the credit support related to the working capital requirements in 2005, is greater than the cost of the credit support related to the MSA.

The credit support for the MSA is tied to the likelihood of default whereas credit support covering all equity risks is outside corporate control.

- (c) DERS is unable to confirm that the Centrica Charging for Credit Policy and Centrica plc parental company guarantee of 40 bps could be used to provide credit support requirements if working capital was obtained from the Toronto Dominion Bank.

It should be noted, that the TD Banks approach to funding working capital does not address the broader issue of the full cost of capital to attribute to the unique firm. While their approach provided a reasonable indication of the cost of debt to finance working capital, it has not provided any indication as to the cost of equity or parental company support which would be required to obtain such debt financing.

Reference: (1) BR-DERS-8(c) & (d)

Preamble: DERS indicated that in order to develop the normalized monthly usage per customer for each class of the DRT, DERS used actual gas consumption from April 2003, through September 2004.

DERS indicated that in order to develop the normalized hourly usage per customer for each class of the RRT, DERS used January 2004 through August 2004 final settlement data and September 2004 through December 2004 interim settlement data.

Request:

- (a) Please provide the reasons why DERS selected the particular time periods for the noted historical data which was used to develop the noted forecasts for the DRT and RRT respectively.
- (b) Please indicate the reasons why the time period for the historical data used for forecasting purposes noted in the preamble is different for the DRT and RRT.

Response:

- (a) DRT - To develop the normalized monthly usage per customer for each class for the DRT, DERS used actual gas consumption from April 2003, through September 2004. These time periods were utilized for the following reasons:
 - When DERS purchased the Regulated business, ATCO Gas supplied historical data back to April 2003.
 - Due to system limitations of the current DRT load forecasting program, DERS was unable to load data after September 2004 and generate results.

RRT – To develop the normalized hourly usage per customer for each class for the RRT, DERS used January 2004 through August 2004 final settlement data and September 2004 through December 2004 interim settlement data. These time periods were utilized for the following reason:

- The DERS' RRT load forecasting program uses the highest quality settlement data, interim and final, for the last 12 months, to calculate usage per customer. At the time the forecast was

created, the aforementioned usage data covering Jan. 2004 to Dec. 2004, was the best quality of actuals available.

DERS would like to reiterate the fact that for the purposes of this application any variance in forecast volumes or customer counts will be captured by the deferral accounts.

(b) Please refer to BR-DERS-80(a).

Reference: (1) BR-DERS-47

Preamble: DERS indicated that the Mercer Total Compensation Survey for the Petroleum Industry (“MTCS”) provides a large, comprehensive and relevant dataset of compensation information for the western Canadian energy industry but some jobs within DEML cannot be matched to benchmark jobs in MTCS. Rather than exclude these DEML jobs from the analysis, data was gathered from other Mercer surveys where matching benchmarks jobs could be found.

Request:

- (a) Please identify the jobs within DEML that cannot be matched to benchmark jobs in MTCS and please describe DERS’ understanding of the reasons why these jobs are not performed in the western Canadian energy industry.

Response:

- (a) The Mercer Total Compensation Survey for the Petroleum Industry (“MTCS”) provides a large, comprehensive and relevant dataset of compensation information for the western Canadian energy industry. However, seven jobs within DEML cannot be matched to benchmark jobs in MTCS. The following lists the positions that were matched to benchmark jobs within either the 2004 Mercer Executive, Management and Professional Compensation Survey (“EMP”) or the 2004 Mercer Call Centre Survey (“Call”):

DEML Position	Mercer Survey Source
VP Marketing Western Region	EMP
Manager Brand Communications	EMP
Manager Customer Management	EMP
Marketing Analyst	EMP
Director Customer Operations	Call
Manager Service Delivery	Call
Business Analyst – Enrollment	Call

These positions may to some degree be found in other Western Canadian energy companies operating primarily in the power and gas distribution business where interaction with a large retail base requires strong brand management, customer service and call centre capabilities. However, these positions and the required skill sets are not covered in MTCS. Accordingly, the EMP and the Call survey provide better matches based on job descriptions and more comparable organizations from which DEML may attract employees and to which DEML may lose employees.

Reference: (1) BR-DERS-48

Preamble: DERS indicated that to a large extent, the interest of DERS' customers and DEML's shareholder are aligned because shareholder value is an amalgam of many long-term performance targets such as employee engagement, enhanced customer care and cost effectiveness. DERS submitted that achievement of these targets will benefit both customers and DEML's shareholder and that failure to achieve the targets will generate deteriorating customer service and declining contributions to shareholder value.

Request:

- (a) Without identifying any specific numerical targets, please describe all executive goals or performance targets that are associated with the long-term incentive components, which DERS proposes to include in the DRT and RRT revenue requirements.
- (b) For each goal or performance target identified in (a), please describe in detail how such goal or target benefits customers.

Response:

- (a) The Long Term Incentive Scheme (LTIS) is a program designed to attract and retain top talent at the Senior Management and Executive levels. The performance targets associated with the long term incentive components is the Total Shareholder Return (TSR) position of Centrica plc shares compared to the other 99 companies in the comparator group of the FTSE100. Full payout of the LTIS occurs if the company's share price performance is within the top quartile of the TSR.
- (b) Ultimately the LTIS is an incentive program designed to keep the executives engaged in achieving strong business performance which ultimately contributes to strong customer satisfaction, world class customer care and shareholder value. LTIS programs are one component of the total compensation package that ensures competitiveness in the market place compared to peer groups. By ensuring that DEML can be competitive in the industry and have a competitive total compensation package, DEML will add value to the customer base by being in a position to attract and retain the top talent in the industry. Please also refer to CG-DERS-49.

Reference: (1) BR-DERS-58
(2) Application, Table 5-V, Total FTE Counts DRT and RRT
(3) Decision 2003-106, p. 92

Preamble: DERS indicated that the additional 2.1 FTEs over approved levels were required to support the regulated business throughout 2004. DERS indicated that a complete DRT and RRT staffing table detailing all allocation and FTE changes by position was shown in Attachment BR-DERS-058(a) and DERS noted that the table only shows year end FTE numbers and the corresponding year over year changes. DERS also indicated that the 2.1 FTE average increase would result from performing the analysis in the attachment on a monthly basis.

In Decision 2003-106, the Board accepted DERS' forecast of the number of FTEs for the DRT and RRT which were 21.04 (4.90 energy & 16.14 non-energy) and 7.72 (non-energy) respectively.

Request:

- (a) With respect to the DRT and RRT 2004 forecasts of FTEs, which were accepted by the Board, does DERS consider these forecasts to be average year numbers or year end numbers? Please provide a detailed explanation.
- (b) With respect to Attachment BR-DERS-058(a), please explain why DERS used year end numbers instead of average year numbers.

Response:

- (a) In the FTE forecast prepared for the 2004 DRT and RRT application, DERS considers that the average numbers and year end numbers of FTEs are the same. When the forecast was developed, DERS believed that a full staff complement would be in place at the time of transition, and there would be no vacancies from month to month.
- (b) Attachment BR-DERS-53(a) was provided to illustrate FTE changes as a result of changes in existing allocations, change in allocation drivers, or new FTEs. DERS submits that for this purpose the year end numbers are suitable because they represent a snapshot of each position and the appropriate allocation. Attachment BR-DERS-83(b) has been provided to show average FTE numbers for 2004-2006.

Reference: (1) BR-DERS-10
(2) Application 1361950

Preamble: In Application 1361950 (DERS letter dated December 10, 2004), DERS used July to October 2004 data to annualize call centre costs for 2004 and claimed that actual customer assistance call data for May and June 2004 data was not valid because customers did not receive their first DERS bills until sometime in June 2004. Later in its Argument with respect to Application 1361950, DERS submitted that it was still appropriate to consider actual results in the determination of the fair market value of its overall customer care cost per customer, but DERS argued that it was appropriate for the Board to consider the call volume forecasts provided by DERS in Application 1399611 which were based on forecasts of actual experience to the end of 2004. In the current Application (1399611), DERS presented actual 2004 annualized costs using a factor of 7 months for all customer care service components including the call centre portion. DERS took the actual costs from May to December 2004 (8 months) and divided them by 7 and then multiplied this result by 12 to annualize the customer care costs.

Request:

- (a) Please explain the reasons why in Application 1361950 DERS did not consider it valid to include June 2004 customer assistance call data for annualization purposes but in Application 1399611, DERS used June 2004 customer call data in order to derive annualized results for 2004.

Response:

- (a) For illustrative purposes in this Application, DERS annualized the total I-Tek costs by dividing by 7 and multiplied them by 12. DERS could have annualized these costs component by component. For example, customer assistance services could have been annualized by using only 6 months of actuals, whereas the billing components could have utilized 7 months of costs. As a result of the methodology used, the 2004 annualized cost numbers are understated. DERS would like to reiterate that these annualized costs were only provided in this Application for illustrative purposes.

In developing the 2005 and 2006 volume drivers, the 12 month annualized costs were not utilized, instead 6 months of actual call volumes (July – December) were used to develop the full year volume driver forecasts. DERS believes that this approach is consistent with the approach taken in Application 1361950.

Reference: (1) BR-DERS-18

Preamble: DERS did not provide an adequate response to (c). When asked to describe what DERS meant by “normal levels” with respect to credit and collection activities for all customer classes, DERS indicated that it based the 2005 and 2006 forecast costs on expected “Normal Levels” of credit and collection activity. DERS also indicated that the actual 2004 credit and collection costs were not representative of “Normal Levels”.

In response to (d), DERS indicated that it has a number of industry and process improvement initiatives that will require further reporting and that some time and material costs are for projects related to compliance with changes to ATCO Gas and ATCO Electric’s Terms and Conditions, business practices and tariffs.

Request:

- (a) With respect to “normal levels” of credit and collection activities for all customer classes, please describe “normal levels”.
- (b) Please identify the noted changes to ATCO Gas and ATCO Electric’ Terms and Conditions, business practices and tariffs or identify the Board Decisions that approved such changes.

Response:

- (a) It is difficult to define 'Normal Levels' of credit and collections activities. 'Normal Levels' of credit and collection activities are dependent on many factors including, but not limited to, market price, general economic health of the region, time of year, rebate programs, etc.

As an example, when market prices increase, customer bills typically increase. Customers on fixed or low incomes may have difficulty paying their bills or in some cases there is an inability to pay. This in turn increases DERS accounts receivables and collection activity. Collections activities are also impacted by the weather. For example during unseasonably cold summers or winters, customers will have increased natural gas consumption. As a result, total usage increases resulting in higher natural gas bills. Once again customer on low or fixed incomes will have difficulties, thereby increasing DERS accounts receivables and collection activities.

In 2004, DERS collection activity was lower than 'normal' due to the transition from ATCO Gas and ATCO Electric as well as the rapid onset of

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- the winter moratorium post transition. Customers transitioning from ATCO Gas and ATCO Electric to DERS started with zero account balances and did not receive initial bills until the June/July time frame. While preliminary collections were initiated on accounts in arrears, cut off for non-payment activities were curtailed mainly due to the implementation of the winter moratorium. DERS also worked proactively with customers to ensure any issues related to misdirected payments as a result of the transition were resolved prior to the initiation of collection activity.
- (b) DERS is required to respond to changes in ATCO Gas' and ATCO Electric's Terms and Conditions, business practices, and tariffs. For example, the approval of an ATCO Gas and/or ATCO Electric rate rider impacts the DERS bill which requires DERS to make system changes. Any changes to the distributor's tariffs also require DERS to re-evaluate and potentially change the estimation parameters used to determine estimated distribution charges on customer's bills. Changes in information provided to ATCO Gas regarding CONP orders or process changes to energize a site has required DERS to enhance and change internal process and business parameters in order to accommodate such changes.

Reference: (1) BR-DERS-15

Preamble: DERS indicated that the majority of costs (other than customer care) have been allocated on the basis of sites before consolidation as these costs are directly attributable to sites. DERS submitted that the primary driver for working capital, labour, other admin costs, corporate costs, education and awareness costs, hearing costs and the EUB assessment was the number of sites served.

Request:

- (a) For each item noted in the preamble (working capital, labour, other admin costs, corporate costs, education and awareness costs, hearing costs and the EUB assessment), please explain the reasons why DERS considers that the number of sites served is the primary driver for such costs.
- (b) For each item noted in the preamble (working capital, labour, other admin costs, corporate costs, education and awareness costs, hearing costs and the EUB assessment), please identify other drivers for such costs and outline the reasons why DERS does not consider it appropriate to allocate such costs based on these other identified drivers.

Response:

(a)

Cost Category	Rationale for allocating cost on sites
Working Capital	<ul style="list-style-type: none"> • Working Capital requirements consist of several items which includes distribution tariff, general admin expense, capital base, deposits, budget payment plan, and amortization expense all of which have different cost drivers. • The rate class percentage share of distribution costs, capital base, BPP and Deposits are shown on Attachment BR-DERS-86(a). A weighted average of these percentages results in rate class percentages similar to the site allocator, therefore allocating based on sites is appropriate.

Cost Category	Rationale for allocating cost on sites
General Admin (Includes: Labour, Other Admin and Corporate Costs)	<ul style="list-style-type: none"> • These costs are fixed and are not necessarily dependant on number of sites or load. • DERS submits that it is appropriate to allocate on sites as these costs are required to support all customers who receive DRT and RRT service.
Education and Awareness Costs	<ul style="list-style-type: none"> • Customer education and energy awareness programs are to educate customers on industry restructuring, choices, and how the regulated rates are set. • These programs are targeted and benefit all DRT and RRT sites and have therefore been allocated by sites.
Hearing Costs	<ul style="list-style-type: none"> • These costs relate to the costs incurred for this Application to set non-energy administration rates. • Considering a large proportion of DERS costs included in this application are driven by sites, DERS believes it is appropriate that hearing costs be allocated on the basis of sites.
EUB Assessment	<ul style="list-style-type: none"> • EUB Assessment is allocated to DERS on the basis of revenue and customers. • Similar to the reason above for allocating Hearing costs, the EUB Assessment has been allocated on sites.

- (b) The costs items described above could have been allocated on the basis of total revenue, non-energy revenue, load, or consolidated bills. DERS submits that allocating these costs on sites is appropriate for the reasons stated above. Considering that the largest single component of DERS' revenue requirement, the base billing fee, is determined at the site level (base billing fee is approximately 36% of the RRT revenue requirement and 42% of the DRT revenue requirement) DERS submits that its rates

would only be minimally impacted by changes to allocations of these costs.

Reference: (1) BR-DERS-17

Preamble: DERS indicated that it was able to track some, but not all, individual customer care cost items by the specific rate classes. DERS indicated that call centre costs cannot be tracked by rate class and will continue to be allocated on a statement account basis. DERS also indicated that it was DERS' intention to track the necessary cost drivers by rate class.

Request:

- (a) Please identify all individual customer care cost items that DERS can not currently track by specific rate class.
- (b) Please provide further elaboration with respect to DERS' noted intention to track the necessary cost drivers by rate class.
- (c) If DERS cannot currently track all individual customer care cost items by rate class, please indicate how DERS plans on allocating actual customer care costs in the deferral accounts to each rate class.

Response:

- (a) All I-Tek costs are invoiced to DERS DRT or RRT and are not segregated by rate class. In order to develop any of the costs by rate class, the cost drivers must be utilized. Currently the items listed in Attachment 4 (a) of the Application that cannot be tracked by rate class are as follows: The list below accounts for approximately 33% of the total 2005 I-Tek costs. The remaining 67% mainly consist of the base billing charges which are directly attributable to rate class.

- Cost of Rebills (line 8)
- Cost of additional single sided pages (line 9)
- Total call center charges (line 17)
- Walk-in Services (line 20)
- Credit Calls & Inquiries (line 23)
- Letter printing (line 24)
- Agent (time and Materials) (line 25)
- Price Schedule Value Changes (line 28)
- Memo Statements (line 29)
- Time and Materials (line 34)
- Collection (Postage and Paper) (line 38 and line 45)
- Return Envelopes (line 42)
- Long Distance Phone Charges (line 46)

- (b) DERS intends to track the specific cost drivers to be able to derive the actual I-Tek costs by rate class. By taking the cost drivers and the unit rates, DERS can determine the cost by rate class. Currently there is no ability to track and report on call volumes by rate class, and in some instances the nature of the cost does not lend them to be tracked by rate class. For example, time and material costs are projects that are typically performed on all rate classes. Price values changes are typically done for all rate classes whereas DERS is invoiced one fee.
- (c) DERS would not propose to allocate each deferral item separately to rate class but rather determine the total deferral balance. The total deferral balance would take into account all deferral costs items and the revenue deferral. DERS would then determine the appropriate allocation of the total deferral balance to rate class and take into consideration specific treatment relating to the streetlight rate class.