



**BY EMAIL AND WEB POSTING**

**February 9, 2023**

**TO: All Licensed Electricity Distributors  
All Other Interested Parties**

**RE: Guidance on Cost Apportionment for Designated Broadband Projects**

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On April 21, 2022, [Ontario Regulation 410/22](#) (Electricity Infrastructure – Designated Broadband Projects) was filed under the *Ontario Energy Board Act, 1998*. This letter sets out Ontario Energy Board (OEB) staff's guidance on the cost apportionment in order to support the timely implementation of designated broadband projects by ensuring distributors and project proponents have clarity in regard to cost sharing.

Under section 5(7) of the Regulation, an electricity distributor is required to charge the proponent of a designated broadband project an amount to recover a contribution towards the cost of certain “make-ready” work<sup>1</sup> in accordance with a prescribed formula, unless the distributor and the proponent agree to a different apportionment of the costs. The formula comprises two components: (1) the proponent's share of the cost of replacing existing assets to accommodate the project; and (2) the proponent's share of the cost of any other work carried out by the distributor to accommodate the project, including the relocation or improvement of existing assets or the installation of new assets. Below, OEB staff provides guidance on calculating each component of the formula.

## **PART 1: REPLACING EXISTING ASSETS**

The first part of the cost apportionment formula is the calculation of the proponent's share of the costs related to any distribution assets that need to be replaced to facilitate the project. The Regulation provides that this is calculated as follows:

1. The proponent's share of the cost of replacing existing assets to accommodate the project shall be the lesser of the sum calculated using the following formula and the total cost of the replacement assets:

$$(A + B)$$

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<sup>1</sup> “Make-ready” work refers to all the necessary work required to safely accommodate the proponent's attachment of telecommunication infrastructure to a distributor's distribution poles.

in which,

“A” is the cost of any necessary early retirement of existing distribution assets in respect of the project, calculated at the remaining net book value of those assets, and

“B” is the estimated advancement cost associated with accelerating the replacement of capital assets sooner than otherwise would have been required, as a result of the project, together with any incremental costs necessary to accommodate the project that are over and above a like-for-like replacement.

**The first step is to determine the remaining net book value of the capital assets that are retired early to facilitate the project (captured in “A”).**

The remaining net book value of the replaced asset is the difference between the historical asset cost and the accumulated depreciation of that asset. A distributor is required to use the actual historical asset cost if such information is available. If the historical cost of an asset is not available, a distributor may estimate the historical asset cost and accumulated depreciation of the replaced assets.

For the historical cost of an asset, a distributor may have historically grouped assets of similar nature and depreciated these assets on a pooled basis. For the purpose of estimating the cost of a replaced asset, a distributor may estimate original asset costs, using the cost of a like-for-like asset in today’s dollars, and applying historical inflation rates (sourced from Statistics Canada, for example).

Accumulated depreciation may then be derived based on the actual/estimated historical asset cost, as well as the estimated accounting life of the asset when first placed in service.

**The second step is the estimated advancement cost (captured by “B”).**

When assets are being replaced specifically for the purpose of accommodating a designated broadband project, there may be a cost associated with accelerating the deployment of new assets sooner than otherwise would have been necessary. This is an “advancement cost.”

The estimated advancement cost is the difference between the cost of the asset today and the estimated future cost of the asset, when it would have normally been replaced in the ordinary course of business, discounted back to today’s dollars using the distributor’s weighted average cost of capital (WACC).

To calculate the estimated cost of replacing the asset in the ordinary course of business, a distributor should rely on a discounted cash flow approach, which factors in the estimated remaining useful life of the asset, the estimated future cost to replace the asset, and the appropriate discount rate, each of which are further described below:

- **Remaining useful life**

The remaining useful life of an asset does not necessarily equate to its remaining accounting life – it is an estimate based on asset condition that determine a distributor’s planned replacement date (absent undertaking this project).

- **Future replacement cost**

Once the remaining useful life of the asset is estimated, the cost of replacing the asset in a future period requires estimating what the future cost of that asset would be. To estimate the future cost of a replacement asset, a distributor may escalate the cost of the asset today by an annual inflation rate, until the year in which the distributor estimates the asset would otherwise have been replaced, based on its remaining useful life.

- **Discount rate**

As part of the discounted cash flow approach, the distributor should then account for the cost of capital associated with deploying the asset in a current, rather than future, period. To account for this, the distributor should discount (or present value) the estimated future asset cost back to current dollar terms, using the distributor’s WACC as the discounting rate.

**The third step is to calculate the incremental costs over and above a like-for-like replacement (also captured by “B”).**

To accommodate a designated broadband project, some existing assets may need to be replaced with assets of a different type (for instance, a larger pole replacing a smaller pole). In such circumstances, the difference between the actual cost of the replacement asset and a like-for-like replacement would be allocated in full to the proponent.

For an illustrative example of how a distributor would allocate to proponents the costs associated with replacing assets to accommodate a project, refer to Example for Part 1 (Replacing Existing Assets).

### **EXAMPLE FOR PART 1 (REPLACING EXISTING ASSETS)**

A project requires a distributor to replace an existing 35ft, 35-year-old pole with a new 45ft pole. The actual cost of the 45ft pole is \$10,000.

**A** = remaining net book value of 35ft pole = historical asset cost - accumulated depreciation of that asset

- If the distributor does not have a record of the actual cost of this pole, it should estimate this cost based on its current installation cost and publicly available historical inflation rates. For example, if the cost to the distributor of a 35ft pole is

\$8,000 in 2022, the estimated historical cost of this pole, after accounting for the effects of inflation, would be \$ 3,600<sup>2</sup> in 1987.

- If the distributor, based on useful lives assumed for these assets in the past, estimates that the original useful life of this pole was 50 years, the straight-line depreciation rate would be 2% annually (or 1/50 per year). The accumulated depreciation of the pole, as at the beginning of 2022, is therefore estimated to be \$2,520.<sup>3</sup>

$$A = \$3,600 - \$2,520 = \$1,080$$

**B = estimated advancement cost + incremental costs over and above a like-for-like replacement.**

- **Advancement Cost**

As mentioned under “A”, the useful life of this 35-year pole was originally estimated to be 50 years, leaving it with a remaining accounting life of 15 years. However, as mentioned earlier, the estimate of the remaining useful life is based on an assessment of the asset’s current condition. In this case, the pole’s condition was recently assessed as giving it a remaining useful life of 20 years, five years more than the originally planned replacement date.

The estimated cost of replacing the pole in 20 years, in the ordinary course of business, requires inflating today’s cost of the pole by 20 years. This results in a projected asset cost of \$11,888.<sup>4</sup>

Deploying the asset today requires an investment in capital that otherwise would have been deferred to a future period. Accordingly, to appropriately compare the projected cost of the replacement pole in the future with the actual cost of the pole today, the future cost must be discounted back to today, using the distributor’s WACC. Assuming a 5% WACC, the future cost of the replacement asset in today’s terms is \$4,480.<sup>5</sup>

Therefore, **the advancement cost is:**

$$\$8,000 \text{ (price of pole today) less } \$4,480 \text{ (future cost of the pole in today's terms) = } \$3,520^6$$

<sup>2</sup> This number is calculated using the inflation calculator published by Bank of Canada <https://www.bankofcanada.ca/rates/related/inflation-calculator/>

<sup>3</sup> Note that the half-year rule requires that only one half of a year’s depreciation is recorded in the year an asset is originally placed in service. For the purposes of this example, the half-year rule is being ignored.

<sup>4</sup>  $\$8,000 \times (1.02)^{20}$

<sup>5</sup>  $\$11,888 / (1.05)^{20}$

<sup>6</sup> For the purposes of this illustrative example, the impacts of taxes have been excluded. The discounted cash flows associated with income taxes (for example, the present value of a CCA tax shield on new assets placed in service, terminal losses associated with the early retirement of existing assets, etc.), should be incorporated into the calculation of the advancement cost calculation.

- **Incremental costs over and above a like-for-like replacement:**

In addition to the advancement charge, in this example, there is an incremental amount to calculate to account for the difference between the upgraded, more costly, asset (a 45ft pole) and the existing asset (a 35ft pole), which is allocated in full to the proponent: \$10,000 pole less \$8,000 pole = \$2,000

$$B = \$3,520 + \$2,000 = \$5,520$$

**The Regulation stipulates that the proponent's share is the lesser of A+B and the total cost of the replacement assets. In this case, A+B = \$1,080 + \$5,520 = \$6,600, and the actual cost of the new pole is \$10,000, so the cost to be allocated to the proponent is \$6,600.**

## **PART 2: ANY OTHER WORK**

The second part of the cost apportionment formula is to determine the costs of any other work that is necessary to accommodate the project. Specifically, the Regulation states: "The proponent's share of the cost of any other work carried out by the licensed distributor to accommodate the project, including the relocation or improvement of existing assets or the installation of new assets, shall be the incremental costs associated with that work."

The incremental costs for this additional work incurred by the distributor are to be allocated in full to the proponent. Incremental costs are those associated with work that has no benefit for electricity customers and would only be undertaken for the purpose of facilitating the designated broadband project. The costs under this section may include those associated with the relocation or improvement of existing assets, the installation of any new assets, or any other additional costs directly attributable to accommodating the project, such as pole reframing, guy/conductor re-tensioning and incremental easement requirements.

The costs that would be incurred by the distributor in the absence of the designated broadband project should not be allocated to the proponent.

Any questions regarding this letter should be sent to [IndustryRelations@oeb.ca](mailto:IndustryRelations@oeb.ca).

Sincerely,

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Consumer Protection & Industry Performance