Ontario Energy Board | Commission de l'énergie de l'Ontario

EB-2013-0123

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an application by E.L.K. Energy Inc. for an order approving just and reasonable rates and other charges for electricity distribution to be effective May 1, 2014.

By Delegation, Before: Lynne Anderson

DECISION and ORDER

March 13, 2014

E.L.K. Energy Inc. ("E.L.K.") filed an application with the Ontario Energy Board (the "Board") on October 25, 2013 under section 78 of the Act, seeking approval for changes to the rates that E.L.K. charges for electricity distribution, effective May 1, 2014 (the "Application").

The Application met the Board's requirements as detailed in the *Report of the Board: Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach* (the "RRFE Report") dated October 18, 2012 and the *Filing Requirements for Electricity Distribution Rate Applications* (the "Filing Requirements") dated July 17, 2013. E.L.K. selected the Price Cap Incentive Rate-Setting ("Price Cap IR") option to adjust its 2014 rates. The Price Cap IR methodology provides for a mechanistic and formulaic adjustment to distribution rates and charges in the period between cost of service applications.

E.L.K. last appeared before the Board with a full cost of service application for the 2012 rate year (the "EB-2011-0099 proceeding"). The hearing panel in the EB-2011-0099 proceeding accepted a Settlement Agreement (the "Settlement Agreement") filed by

E.L.K. and the other parties to that proceeding on May 2, 2013. The Settlement Agreement noted that certain matters would be addressed in E.L.K.'s 2014 IRM Rate Application. These matters included updating the capitalization and depreciation policies and the disposition of the remaining 2011 balances of Group 1 and Group 2 deferral and variance accounts once they had been audited by the Board's Regulatory Audit and Accounting group ("Regulatory Audit"). The Board subsequently undertook an audit of E.L.K.'s Group 1 and Group 2 deferral and variance accounts. A final audit report (the "Audit Report") was issued on December 5, 2013. On December 18, 2013, Regulatory Audit filed the Audit Report on the public record of this proceeding.

In this proceeding, E.L.K. seeks approval for changes to its depreciation rates and disposition of Group 1 and Group 2 deferral and variance accounts including account 1562 (Deferred PILs Disposition) and 1576 (Accounting Changes under CGAAP).

The Board conducted a written hearing and Board staff participated in the proceeding. No letters of comment were received.

While I have considered the entire record in this proceeding, I have made reference only to such evidence as is necessary to provide context to my findings. The following issues are addressed in this Decision and Order:

- Price Cap Index Adjustment;
- Rural or Remote Electricity Rate Protection Charge;
- Shared Tax Savings Adjustments;
- Retail Transmission Service Rates;
- Updates to Depreciation Rates and Capitalization Policy and Disposition of the Resultant Balance in Account 1576;
- Review and Disposition of Group 1 and Group 2 Deferral and Variance Account Balances; and
- Review and Disposition of Account 1562 – Deferred PILs Disposition.

There are a number of issues being considered in this proceeding that are not normally part of the Price Cap IR rate-setting mechanism outside of a cost of service application. However, in this case these issues are the direct outcome of the Settlement Agreement accepted by the Board in the EB-2011-0099 proceeding and therefore are appropriately dealt with in this proceeding.

Price Cap Index Adjustment

The Board issued the *Report on Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors* (the "Price Cap IR Report") which provides the 2014 rate adjustment parameters for distribution companies selecting either the Price Cap IR or Annual IR Index option.

Distribution rates under the Price Cap IR option are adjusted by an inflation factor, less a productivity factor and a stretch factor. The inflation factor for 2014 rates is 1.7%. Based on the total cost benchmarking model developed by Pacific Economics Group Research, LLC, the Board determined that the appropriate value for the productivity factor is zero percent. The Board also determined that the stretch factor can range from 0.0% to 0.6% for distributors selecting the Price Cap IR option, assigned based on a distributor's cost evaluation ranking. In the Price Cap IR Report, the Board assigned E.L.K. a stretch factor of 0.0%.

As a result, the net price cap index adjustment for E.L.K. is 1.7% (i.e. 1.7% - (0% + 0 %)). The price cap index adjustment applies to distribution rates (fixed and variable charges) uniformly across all customer classes. The price cap index adjustment does not apply to the components of delivery rates set out in the list below.

- Rate Riders;
- Rate Adders;
- Low Voltage Service Charges;
- Retail Transmission Service Rates;
- Wholesale Market Service Rate;
- Rural or Remote Electricity Rate Protection Charge;
- Standard Supply Service – Administrative Charge;
- Transformation and Primary Metering Allowances;
- Loss Factors;
- Specific Service Charges;
- microFit Charge; and
- Retail Service Charges.

Rural or Remote Electricity Rate Protection Charge

The Board issued a Decision and Rate Order (EB-2013-0396) establishing the Rural or Remote Electricity Rate Protection (“RRRP”) benefit and charge for 2014. The Board determined that the RRRP charge to be paid by all rate-regulated distributors and collected by the Independent Electricity System Operator (“IESO”) shall be increased to $0.0013 per kWh effective May 1, 2014, from the current $0.0012 per kWh. The draft Tariff of Rates and Charges flowing from this Decision and Order reflects the new RRRP charge.

Retail Transmission Service Rates

Electricity distributors are charged for transmission costs at the wholesale level and then pass on these charges to their distribution customers through the Retail Transmission Service Rates (“RTSRs”). Variance accounts are used to capture differences in the rate that a distributor pays for wholesale transmission service compared to the retail rate that the distributor is authorized to charge when billing its customers (i.e. variance Accounts 1584 and 1586).

The Board issued revision 3.0 of the *Guideline G-2008-0001 - Electricity Distribution Retail Transmission Service Rates* (the “RTSR Guideline”) which outlines the information that the Board requires electricity distributors to file to adjust their RTSRs for 2014. The RTSR Guideline requires electricity distributors to adjust their RTSRs based on a comparison of historical transmission costs adjusted for the new Uniform Transmission Rates (“UTR”) levels and the revenues generated under existing RTSRs. Similarly, embedded distributors, such as E.L.K., must adjust their RTSRs to reflect any changes to the applicable Sub-Transmission RTSRs of their host distributor(s), e.g. Hydro One Networks Inc.

The Board approved new rates for Hydro One’s Sub-Transmission class, including the applicable RTSRs, effective January 1, 2014 (EB-2013-0141), as shown in the following table.

2014 Sub-Transmission RTSRs

Network Service Rate	$3.23 per kW
<u>Connection Service Rates</u> Line Connection Service Rate Transformation Connection Service Rate	 $0.65 per kW $1.62 per kW

I find that these 2014 Sub-Transmission class RTSRs are to be incorporated into the calculation of E.L.K.'s RTSRs.

Depreciation and Capitalization Policies and Account 1576

In the Settlement Agreement accepted by the Board, there was provisional acceptance by the parties of E.L.K.'s depreciation rates and capitalization policy as set out in Exhibit 2, Tab 1, Schedule 1 of the Cost of Service Application, subject to certain adjustments. The parties acknowledged that E.L.K. was not converting to International Financial Reporting Standards in the 2012 Test Year and would remain on CGAAP until required by the Accounting Standards Board to move to IFRS. The parties noted that E.L.K. had sought to comply with the Board's letter titled "*Regulatory accounting policy direction regarding changes to depreciation expense and capitalization policies 2013*" dated July 17, 2012 but, for the purposes of settlement, the parties accepted that E.L.K. would require additional time to consider the appropriate useful lives for its distribution assets, and to determine the regulatory accounting changes for its depreciation expense and capitalization policies.

The parties agreed that E.L.K. would use deferral account 1576 (Accounting Changes Under GAAP) to record 2012 adjustments to E.L.K.'s Property Plant and Equipment ("PP&E") once the review of useful lives had been completed. Subject to the Board's approval of E.L.K.'s new depreciation rates and review of its capitalization policy, this amount would be proposed to be disposed as part of E.L.K.'s 2014 IRM rate application. In accepting the Settlement Agreement, the Board concluded that it was practical to address in this 2014 IRM application the adjustment to depreciation rates and the capitalization policy, as well as the disposition of the resultant balance in Account 1576. The Board also concluded that this would result in no harm to ratepayers.

In the current application, E.L.K. reran the models used to support the rates set out in the Settlement Agreement to reflect the new depreciation rates. E.L.K. stated that its current capitalization policy is consistent with IFRS standards and requires no changes. The rates resulting from rerunning the models were used as the starting rates for the 2014 IRM rate application. Based on the proposed depreciation rates, E.L.K. calculated a decrease in depreciation expense of $440,991. This change in depreciation expense resulted in a change in rate base and therefore a change in the return on capital, and a change in payments in lieu of taxes. The net result calculated by E.L.K. was a reduction in the service revenue requirement of $590,964 (from $4,316,049 in the Settlement Agreement to $3,725,085).

In response to Board staff interrogatories, E.L.K. filed a completed version of appendix 2-BB (Service Life Comparison) of the *Filing Requirements for Electricity Distribution Rate Applications* and the updated models used to support the proposed starting rates.

Board staff submitted it had reviewed E.L.K.'s responses to the interrogatories and had no concerns with the depreciation rates proposed as they were all within the ranges in the Asset Depreciation Study for the Ontario Energy Board, prepared by Kinectrics Inc. and issued by the Board on July 8, 2010. Furthermore, Board staff noted that it reviewed the models related to the adjusted starting base rates for 2014 and had no concerns.

E.L.K. calculated a balance for Account 1576 to record the difference in E.L.K.'s 2012 PP&E values as a result of the accounting changes to the depreciation rates. E.L.K. is proposing to dispose of this amount over a 2-year period. The amount, taking into consideration the weighted average cost of capital ("WACC"), is a credit of $487,295 (consisting of the $440,991 change in depreciation expense plus a $46,304 return on rate base at 5.25% WACC over 2 years).

Board staff submitted that the Board, in its Decision and Order in E.L.K.'s EB-2011-0099 proceeding allowed E.L.K. to dispose of 1576 in its 2014 IRM application. Board staff noted that it appears that E.L.K. has requested a 2-year disposition period in order that account 1576 be disposed in parallel to account 1562. E.L.K. did not provide a reason and did not disagree with Board staff's submission. Board staff submitted that it had reviewed E.L.K.'s calculations and supports the disposition of account 1576 over the proposed term.

I approve the revised depreciation rates and resultant service revenue requirement of $4,316,049. While the initial evidence filed by E.L.K. had limited details on the proposed depreciation rates and how this affected the service revenue requirement, in response to interrogatories from Board staff, E.L.K. provided detailed models, including an update to all relevant appendices filed in the EB-2011-0099 proceeding. This evidence supports the revisions proposed by E.L.K.

I also approve the disposition of the $487,295 credit balance for Account 1576 over the proposed two-year period. I am approving the two-year period because this aligns with the expected timing of E.L.K.'s next cost of service application. E.L.K.'s last cost of service application was for 2012 rates, and therefore it would be expected to file its next cost of service application for 2016 rates.

While I am approving the depreciation rates, revised revenue requirement and disposition of the balance in Account 1576, I am not approving the proposed revenue-to-cost ratios. The settlement to Issue 2.4 of the Settlement Agreement states that: "the models used to support the rates set out in this proposed Settlement Agreement will be rerun to reflect the new starting rates for the 2014 IRM rate application", and E.L.K. has done this. However, E.L.K. then adjusted the revenue-to-cost ratios to bring them into the range of the Board's cost allocation policy, and there are material differences between these proposed revenue-to-cost ratios and those that were originally accepted in the Settlement Agreement. On page 35 of the Settlement Agreement, the Parties accepted the revenue-to-cost ratios for the 2012 Test Year and noted that: "no further adjustments will be required from 2014-2016 as part of this Agreement".

In the absence of a specific reference in the Settlement Agreement on how to allocate the revised revenue requirement resulting from the change to the depreciation rates, I find that the revenue-to-cost ratios from page 34 of the Settlement Agreement should be used. As part of the rate order process, E.L.K. shall revise the revenue-to-cost ratios to align with the Settlement Agreement and shall provide an update to all models affected by this revision.

Review and Disposition of Group 1 and Group 2 Deferral and Variance Account Balances

The *Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative* provides that, during the IRM plan term, the distributor's Group 1 account balances will be reviewed and disposed if the preset disposition threshold of $0.001 per kWh (debit or credit) is exceeded. The onus is on the distributor to justify why any account balance in excess of the threshold should not be disposed.

In the Settlement Agreement, the parties agreed to the disposition of 50% of all Group 1 and Group 2 account balances over a 12 month period commencing on May 1, 2013. The balance, excluding accounts 1562 and 1576, was a credit of $249,477. The parties agreed that the disposition of the remaining 2011 balances would be determined after an audit review was conducted by the Board and that the results of the audit would be addressed by E.L.K. in its 2014 IRM rate adjustment application. The balances below in Table 1 reflect the outcome of the audit.

As per the outcome of the audit, E.L.K.'s 2011 actual year-end total balance for its Group 1 and Group 2 accounts, excluding accounts 1562 and 1576, is a credit of $673,546. Taking into account the 50% disposition agreed upon in the Settlement Agreement and interest from January 1, 2012 to April 30, 2014, the amount that is left owing to customers is $441,621. E.L.K. proposed to dispose of this credit amount over a one-year period.

Board staff submitted that the amounts should be disposed on a final basis.

I approve the disposition of a credit balance of $441,621 as of December 31, 2011 for the Group 1 and Group 2 accounts shown in the table below. The balances were audited by the Regulatory Audit and Accounting group of the Board, and the Audit Report was placed on the public record of this proceeding. This provides a high degree of assurance in the accuracy of the balances. These balances are to be disposed over a one-year period from May 1, 2014 to April 30, 2015.

The table that follows identifies the principal and interest amounts approved for disposition for Group 1 and Group 2 accounts.

Table 1: Group 1 Deferral and Variance Account Balances

	Account Number	Revised OEB Audited Total Account Balance to be included in 2014 IRM	50% of Principal in Disposal Per Settlement	Residual Principal Claim in 2014 IRM	Projected Interest on Residual Principal from Jan 1, 2012 to Apr 30, 2014	**Total Claim**
Group 1						
LV Variance Account	1550	($37,911)	($18,956)	($18,956)	($650)	($19,606)
RSVA - Wholesale Market Service Charge	1580	($534,305)	($263,052)	($271,253)	($9,304)	($280,557)
RSVA - Retail Transmission Network Charge	1584	($85,959)	($36,170)	($49,789)	($1,708)	($51,497)
RSVA - Retail Transmission Connection Charge	1586	($150,986)	($77,141)	($73,845)	($2,533)	($76,377)
RSVA - Power	1588	($3,334,160)	($1,611,035)	($1,723,125)	($59,103)	($1,782,229)
RSVA - Global Adjustment	1589	$3,473,945	$1,734,232	$1,739,713	$59,672	$1,799,386
Disposition and Recovery of Regulatory Balances (2011)	1595	($101,092)	($50,546)	($50,546)	($1,734)	($52,280)
Sub-Total Group 1		**($770,468)**	**($322,668)**	**($447,800)**	**($15,360)**	**($463,160)**
Group 2						
Other Regulatory Assets	1508	$128,533	$64,266	$64,267	$2,204	$66,471
Retail Cost Variance	1518	($34,290)	$0	($34,290)	($1,176)	($35,467)
Miscellaneous Deferred Debits	1525	$3,240	$1,620	$1,620	$56	$1,676
PILs and Tax Variances for 2006 and Subsequent Years, Sub-account HST / OVAT Input Tax Credits (ITCs)	1592	($561)	($281)	($281)	($10)	($290)
Special Purpose Charge Assessment Variance Account	1521	$0	$10,491	($10,491)	($360)	($10,851)
Sub-Total Group 2		**$96,922**	**$76,097**	**$20,825**	**$714**	**$21,539**
Total Group 1 and Group 2		**($673,546)**	**($246,571)**	**($426,976)**	**($14,645)**	**($441,621)**

The balance of each Group 1 and Group 2 account approved for disposition shall be transferred to the applicable principal and interest carrying charge sub-accounts of Account 1595 pursuant to the requirements specified in Article 220, Account Descriptions, of the *Accounting Procedures Handbook for Electricity Distributors*. The date of the transfer must be the same as the effective date for the associated rates, generally, the start of the rate year. E.L.K. should ensure these adjustments are included in the reporting period ending June 30, 2014 (Quarter 2).

I note that E.L.K. did not file its balances for the Group 1 accounts as at December 31, 2012 per the Board's Filing Requirements. The Board's policy is to dispose of balances in Group 1 accounts in IRM applications if a preset disposition threshold of $0.001 per kWh is exceeded. There is no information on the record on which to determine if the disposition threshold has been exceeded. E.L.K. proposed to seek disposition of the 2012 balances as part of its 2015 IRM application.

While it is important to review and dispose of balances in a timely manner, it is also important that those balances are accurate. In reviewing the Audit Report placed on the record of this proceeding, I note that there are numerous corrective actions required by E.L.K's, and that E.L.K. had agreed to a management action plan that would address these issues by June 30, 2014. I therefore accept E.L.K.'s proposal not to dispose of the 2012 Group 1 balances in this proceeding.

Review and Disposition of Account 1562 – Deferred PILs Disposition

In the Settlement Agreement, parties agreed that E.L.K. would pay customers 50% of the stated balance in account 1562 over a 36-month period commencing on the effective date of the rate order. At the time of the Settlement Agreement, the balance was a credit of $751,938. The parties requested that E.L.K. be allowed the proper time to review and analyze all activity in this account and subsequently to undergo a regulatory audit of this account by the Board. The parties agreed that the results would be addressed by E.L.K. in its 2014 IRM rate application.

The Audit Report confirmed the credit balance of $751,938. E.L.K. is proposing that the remaining amount, a credit of $387,674 (50% of the balance plus interest), be disposed over a 2-year period in order to have this account fully addressed prior to its next cost of service application.

Board staff submitted that it had reviewed the balance in account 1562 and had no issue with E.L.K.'s request to dispose of the balance over the remaining 2-year period as the request is in line with the Settlement Agreement approved by the Board. Furthermore, Board staff submitted that the balance should be disposed on a final basis.

I approve the disposition of the remaining credit amount of $387,674 over a two-year period. The balance was audited by the Regulatory Audit and Accounting group of the Board. A two-year disposition period will align this disposition with the original 50% disposition period of 36 months commencing May 1, 2013 set out in the Settlement Agreement accepted by the Board.

IMPLEMENTATION

I have made findings in this Decision and Order which change the 2014 distribution rates from those proposed by E.L.K.

I expect E.L.K. to file a draft Rate Order, including a proposed Tariff of Rates and Charges and all relevant calculations showing the impact of this Decision and Order on E.L.K.'s determination of the final rates. Supporting documentation shall include, but not be limited to, filing a completed version of the 2014 IRM Rate Generator model.

A Rate Order will be issued after the steps set out below are completed.

THE BOARD ORDERS THAT:

1. E.L.K. shall file with the Board, and shall also forward to intervenors, a draft Rate Order that includes revised models in Microsoft Excel format and a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision by March 27, 2014.

2. Board staff shall file any comments on the draft Rate Order including the revised models and proposed rates with the Board and forward to E.L.K. within 7 days of the date of filing of the draft Rate Order.

3. E.L.K. shall file with the Board responses to any comments on its draft Rate Order including the revised models and proposed rates within 4 days of the date of receipt of Board Staff comments.

All filings to the Board must quote file number **EB-2013-0123,** be made through the Board's web portal at https://www.pes.ontarioenergyboard.ca/eservice/ and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.ontarioenergyboard.ca. If the web portal is not available parties may email their document to BoardSec@ontarioenergyboard.ca. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 2 paper copies.

DATED at Toronto, March 13, 2014

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary