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July 19, 2019

**Sent By Electronic Mail, RESS Electronic Filing and Courier**

Ms. Kirsten Walli  
Board Secretary  
Ontario Energy Board  
27-2300 Yonge Street  
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: EPCOR Natural Gas Limited Partnership (“ENGLP”) EB-2018-0336 - Application for 2020 to 2024 Rates – Decision – Clarifications to Earnings Sharing Mechanism (“ESM”) and necessary adjustments**

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This letter is filed by ENGLP on behalf of all parties to the accepted Settlement Proposal, and is responsive to Order #4 of the Decision and Rate Order issued by the OEB on July 4, 2019 in this proceeding.

At page 4 of its Decision and Rate Order the Board stated that:

For issue 8 a), parties have agreed to an earnings sharing mechanism (ESM) based on actual regulated net income over the term 2020 to 2024, taking into account any necessary adjustments. The OEB agrees with the ESM, **but would find it helpful for future proceedings to clarify now the nature of the necessary adjustments.** The OEB asks that the parties file a letter with the OEB clarifying the types of adjustments that are expected to be made to actual net income. [Emphasis added]

The comments below serve to provide further examples of the nature of necessary adjustments which may be required to the earnings sharing account.

ENGLP notes that the regulated ROE for earnings sharing purposes will be computed consistent with the Filing Requirements for Natural Gas Distribution Applications, and the Board’s RRR 2.1.5.6 ROE Complete Filing Guide<sup>1</sup> (ROE Guide) and the detailed sample calculations provided therein. This calculation of adjusted regulatory net income and deemed ROE includes adjustments for future/deferred taxes, non-rate regulated items, adjustment to interest expense for deemed debt, and the deemed equity calculation.

The ROE Guide provides clarity regarding common adjustment items that should not be included in the calculation of achieved ROE, and is clear that necessary and appropriate adjustments in the ROE form

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<sup>1</sup> For electricity distributors.

are not exhaustive.<sup>2</sup> Necessary adjustments may take the form of adjustments that are in favour of rate payers, or adjustments which serve to exclude earnings that would not, in the normal course, be available to rate payers. The nature of, and examples of two such adjustments appear in a recent cost of service rates decision<sup>3</sup> where necessary adjustments were effected for a material change in capitalization policy, as well as a change with respect to reconciliation of the components of adjustment to tax. Taken in isolation, the adjustment to tax resulted in a net increase in revenue available for earnings sharing, and the change in capitalization policy resulted in a net decrease to revenues available for earnings sharing. To the extent possible, ENGLP would show the isolated impact of each necessary adjustment, if any, as part of its evidence in subsequent rate filings and/or when seeking disposition of the Earnings Sharing Mechanism Deferral Account (ESMDA).

For clarity, and as agreed by the parties, the entry recorded in the ESMDA is calculated annually in accordance with the formula at Issue 8(a)(3) of the accepted settlement proposal. The accounting order at Appendix H reiterates that, “[a]n entry will be made annually to record the balance of the ESMDA that is equal to the cumulative earnings to be shared, as if the balance were to be settled on the date it was recorded.” On the basis of cumulative calculation, the point above which earnings will be shared is 10.48% to account for the deadband agreed by the parties in the settlement (8.98% + 150 basis points). There is symmetry in the year-to-year calculation, but the cumulative result at the end of the period is asymmetrical. The sole figure of importance for computing earnings available for sharing to rate payers is the entry at the end of year five of the IR term.

The Board will benefit from an annual update on the entry to the ESMDA from ENGLP through RRR filings. In addition to the entry to the account, updated annually, ENGLP will provide an annual narrative, and the need for necessary adjustments, if any, and an indication from ENGLP if these adjustments may result in an entry and adjustment in the period, or alternatively, at the end of the Price Cap IR term.

In the context of custom rate setting, the Board has noted that a key objective of incentive regulation is to drive productivity improvements, and that utilities that achieve productivity improvements above what is expected are allowed to keep certain earnings above the approved ROE, with certain customer protections for excess earnings.<sup>4</sup> ENGLP fully intends to share such benefits driven by productivity improvements as set out in its earnings sharing mechanism in the settlement agreement.

ENGLP also notes that rate payers are also protected by provisions of the settlement agreement which serve to cap ENGLP’s annual Affiliate and Corporate Shared Services (C&SS) costs included in O&M costs at the lower of (a) actual costs incurred annually, or (b) the 2020 Test Year Board-approved revenue requirement as inflated by Board-prescribed inflation factors approved for use in ENGLP’s annual IRM application. These capped Affiliate and C&SS costs will be used for the purposes of calculating the utility regulated net income for the determination of cumulative ROE.<sup>5</sup>

The balance and necessary adjustments will be subject to scrutiny of interested parties in the appropriate proceeding in which disposition of the ESMDA is sought.

Please feel free to contact me if you have any questions regarding this matter.

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<sup>2</sup> RRR 2.1.5.6 ROE Complete Filing Guide, March 2016, p. 4

<sup>3</sup> EB-2018-0016, Alectra Utilities 2019 EDR Application, HRZ-Staff-17.

<sup>4</sup> Rate Handbook, p.27.

<sup>5</sup> EB-2018-0336, Settlement Proposal, filed June 10, 2019, p.27.

Sincerely,

*[Original signed by]*

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cc. All intervenors in EB-2018-0336