EB-2019-0029

E.L.K. Energy Inc.

Application for electricity distribution rates effective May 1, 2020

Final Submissions of VECC
February 6, 2020

E.L.K. Energy Inc. (E.L.K.) filed an incentive rate-setting mechanism (IRM) application with the Ontario Energy Board (OEB) seeking approval for changes to its electricity distribution rates to be effective May 1, 2020. The application was filed on November 4, 2019, under section 78 of the *Ontario Energy Board Act*, *1998*, S.O. 1998, c. 15, (Schedule B).

VECC was granted intervenor status in E.L.K.'s application regarding E.L.K.'s proposed 2020 rate increase in the context of its 2018 earnings. In 2018, E.L.K. earned 739 basis points above the target ROE that was the basis upon which rates were established.

For the reasons discussed below, VECC submits the OEB should not approve E.L.K.'s proposed Annual IR increase of 1.4% for 2020.[1] In VECC's view, E.L.K. has not substantiated the increase.

Background

E.L.K. has a history of underspending and over-earning. E.L.K. over-earned first in 2009 and 2010, then in 2014 and again in 2018 as discussed below.

<u>2009 & 2010 Over-Earnings</u>

E.L.K. rebased in 2006, followed by five years of Incentive Rate-setting.[2] Then in 2011, E.L.K. was required by the OEB to file its 2012 rate application on a CoS basis[3] in part due to the OEB's review of financial information that showed E.L.K. over-earned in 2009 and 2010; 16% or an increase of 700 basis points in each of 2009 and 2010 compared to a deemed rate of 9.00% in base rates. Following a review of its 2010 Financial Statements, E.L.K. subsequently corrected the 2010 return on equity from 16% to 8.32%, and noted the 2011 return on equity was 4.07%.[4]

<u>2014 Over-Earnings</u>

In 2016, E.L.K. sought to defer the scheduled rebasing of its rates beyond the 2016 rate year. The OEB granted E.L.K.'s request and rescheduled rebasing for the 2017 rate year, allowing

[1] Staff-1 (f)
[2] 2007 - 2011
[3] EB-2011-0099 OEB Letter dated July 18, 2011
[4] EB-2011-0099 OEB Decision and Procedural Order No. 2 dated May 29, 2012 Appendix A

E.L.K. to seek a rate increase for 2016 rates based on a Price Cap Incentive Rate-setting application (Price Cap IR).[5]

As part of the 2016 rate application proceeding, over-earnings in 2014 was an issue. Following an OEB Audit and Performance Assessment, OEB staff concluded that E.L.K.'s regulatory ROE in 2014 measured 19.22%, 1,010 basis points above the target ROE of 9.12% that was the basis upon which its rates were established.[6]

Given the level of returns earned by E.L.K. in 2014, the OEB considered whether an amendment to E.L.K.'s rate plan in 2016 was warranted, in order to ensure that customers pay distribution rates that better reflect the value of the service provided to them.

The OEB concluded that there was sufficient evidence to conclude that the 2014 over-earning was not expected to persist as it was primarily related to the change in capitalization policy and extension of asset lives and a change in capitalization policy is not expected in 2016. The OEB approved a Price Cap IR increase in 2016.[7]

2018 Over-Earnings

On September 29, 2019, the OEB published E.L.K.'s latest Electricity Scorecard on its website which showed the following Return on Equity results for the years 2014 to 2018. For 2018, the achieved ROE is 16.17% compared to a deemed ROE of 8.78%, which represents 739 basis points above the target ROE that was the basis upon which rates were established.

Return on Equity	2014	2015	2016	2017	2018
ROE Deemed (Included in Rates)	9.12%	9.12%	9.12%	8.78%	8.78%
ROE Achieved	19.22%	10.72%	8.39%	11.15%	16.17%

Under OEB policy, a regulatory review may be triggered if a distributor's earnings are outside of a dead band of +/- 300 basis points from the OEB-approved return on equity. Any such review will be prospective, and could result in modifications, termination or the continuation of the respective Price Cap IR or Annual IR Index plan for that distributor. VECC notes a distributor whose earnings are in excess of the deadband can refrain from seeking an adjustment to its base rates as part of its application. E.L.K. did not do this. In fact, E.L.K. did not raise the issue of over-earning in 2018 in its 2020 rate application at all. The OEB subsequently determined that it will review the request for a rate increase in 2020 in the context of E.L.K.'s 2018 earnings.[8]

[5] EB-2015-0064 OEB Letter to E.L.K. dated May 15, 2015
[6] EB-2015-0064 OEB Letter to E.L.K. dated October 16, 2016
[7] EB-2015-0064 Decision and Rate Order dated March 17, 2016 P5
[8] EB-2019-0029 Notice of Application

Reasons for E.L.K's Over-Earning in 2018

In E.L.K.'s RRR Filing (Form 2.1.5.6), E.L.K. submitted that it had achieved an ROE of $743,531 for the 2018 year, which is $321,967 greater than E.L.K.'s deemed ROE as approved in its last CoS application.[9]

E.L.K. provided all of the drivers associated with the over-earnings in 2018 as shown in Table 1. E.L.K. indicates that approximately $188,000 of the achieved ROE is in relation to less spending in legal and regulatory costs (vs 2017), and $160,000 related to an operational review and an asset management assessment that did not materialize in 2018.[10]

Table 1: Drivers Associated with Over Earnings in 2018

Driver	**Ongoing/One-Time Costs**	**2017 OEB Approved**	**2017 Actual**	**2018 Actual**
Legal Costs	Ongoing	$100,000.00	$111,948.78	$7,188.89
Regulatory Costs	Ongoing	$154,000.00	$175,654.79	$92,110.76
Operational Review	One Time	$60,000.00	$0.00	$0.00
Asset Management Assessment	One Time	$100,000.00	$0.00	$0.00
TOTAL		$414,000.00	$287,603.57	$99,299.65
Variance (to 2017 OEB Approved)			*$126,396.43*	*$314,700.35*

First, VECC wishes to point out that the 2017 OEB Approved amounts provided by E.L.K. in Table 1 have not been specifically approved by the OEB. E.L.K. filed a scheduled CoS application in 2017 on November 4, 2016.[11] As part of the OEB approved settlement proposal, E.L.K. agreed to withdraw their CoS application[12] and instead use an Annual IR Index methodology to set 2017 base rates, thus it was no longer relevant for the OEB to make a determination on the proposed levels of planned Capital and OM&A expenditures.

As part of the settlement agreement E.L.K. Energy agreed to a third-party operational review, and a third-party asset condition assessment prior to its next CoS application.[13] E.L.K has not yet undertaken the two third party reviews it agreed to in settlement and this is now driving over 50% of the over-earnings in 2018.[14]

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[9] Staff-1

[10]

[11] EB-2016-0066

[12] with the exception of the request for disposition of Account 1595

[13] EB-2016-0066 Decision and Rate Order dated November 2, 2017 P1

[14] $160,000/$314,700.35

The operational review will include a review on business planning, management oversight, data security, human and financial resources, and a comparison with industry best practices. The asset condition assessment will provide input into an asset registry and E.L.K.'s Distribution System Plan.[15]

VECC submits the requirement for E.L.K. to undertake an operational review is based in part on E.L.K.'s historic underspending compared to budget and concerns raised by the parties that there may be some long-term issues that need to be addressed before E.L.K. should be provided significant additional funding.[16] The requirement for an asset condition assessment stems from insufficient asset condition information data. E.L.K. does not indicate when it plans to undertake the two third party reviews.[17] This is of concern to VECC given the significant concerns that were raised during E.L.K.'s 2017 CoS application and the need for better operational planning and accurate data. In the context of over-earnings in 2018, and in the absence of the results of third party reviews to address the long-term issues identified in the settlement proposal, VECC submits the OEB should not provide E.L.K. with additional funding in 2020.

The settlement proposal requires E.L.K. to file its next CoS rebasing application for 2022 rates. E.L.K. believes the over-earnings are a one-time scenario and will not persist into the future.[18] VECC disagrees. As long as E.L.K. pushes out spending on the studies, E.L.K. has the potential to continue to underspend and the possibility of over-earning continues to exist. E.L.K.'s estimates its Return on Equity for 2019 and 2020 at approximately 9%, yet E.L.K. has not provided any underlying calculations to support these projections.[19] [20] VECC submits the OEB cannot reasonably rely on this information given E.L.K. did not file sufficient evidence to assess whether or not the 2018 over-earnings would persist.

Annual IR is a streamlined regulatory process designed to provide distributors with sufficient revenue to cover cost increases due to inflation while providing an incentive structure to drive productivity improvements. Under Annual IR, rates are subject to the same annual adjustment formula as those under Price Cap IR, and Utilities are required to apply the highest stretch factor of 0.6%. E.L.K. has been on Annual IR with the highest stretch factor of 0.6% since 2017 and it is still over-earning. Clearly, E.L.K. does not need a revenue adjustment in 2020.

Over-earning represents a significant cost to customers. Staff estimated that the level of over-earnings in 2014 represented a cost to residential customers of roughly $1.64 per month.[21]

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[15] Staff-1 (a)
[16] EB-2016-0066 Settlement Proposal Revised October 5, 2017 Appendix B
[17] Staff-1
[18] Staff-1 (e)
[19] VECC-2
[20] Based on E.L.K.'s 2018 Audited Financial Statements
[21] EB-2015-0064 OEB Letter to E.L.K. dated October 16, 2016

In considering the above, VECC submits E.L.K. has not substantiated the need for an annual increase in 2020 in the context of 2018 earnings. There is no external one-time event or timing difference to explain the significant over earnings, as was the case in 2014. VECC submits the current level of investment is adequate. The OEB should deny E.L.K.'s request for an Annual IR increase of 1.4% for 2020. E.L.K. is expected to file a cost of service application for 2022 where base rates will be reset with input from the third party reviews and the context of 2017 to 2021 earnings. E.L.K. has not demonstrated it will have difficultly managing with existing rates in 2020.