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

BY EMAIL

January 25, 2024

Nancy Marconi
Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4
Registrar@oeb.ca

Dear Ms. Marconi:

Re: Ontario Energy Board (OEB) Staff Submission
E.L.K. Energy Inc.
Application for 2024 Rates
OEB File Number: EB-2023-0013

Please find attached the OEB staff's submission in the above-referenced proceeding, pursuant to Procedural Order No. 1.

Yours truly,

Original Signed By

Abla Nur
Digitally signed by Abla Nur
Date: 2024.01.25 16:27:12 -05'00'

Abla Nur
Case Manager, Generation & Transmission

Encl.
cc: All parties in EB-2023-0013

ONTARIO ENERGY BOARD

OEB Staff Submission

E.L.K. Energy Inc.

2024 Rates Application

EB-2023-0013

January 25, 2024

Introduction

E.L.K. Energy Inc. (E.L.K.) filed an incentive rate-setting mechanism (IRM) application with the Ontario Energy Board (OEB) on October 11, 2023, under section 78 of the *Ontario Energy Board Act*, *1998* seeking approval for changes to its electricity distribution rates to be effective May 1, 2024.

Consistent with the Chapter 3 Filing Requirements,[1] E.L.K. applied the Price Cap IR adjustment factor to adjust the monthly service charge and distribution volumetric rate during the incentive rate-setting years. An inflation factor of 4.80% applies to all IRM applications for the 2024 rate year.[2] OEB staff have identified no concerns with the price cap adjustment proposed by E.L.K.

E.L.K. has also sought OEB approval to adjust the Retail Transmission Service Rates (RTSRs) to recover its cost of transmission services. OEB staff has no concerns with E.L.K.'s requested adjustments to its RTSRs, however E.L.K. should include an updated 2024 Rate Generator Model to reflect the approved 2024 Uniform Transmission Rates (UTRs) and Hydro One's final host RTSR[3] as part of its reply submission. E.L.K. should also consider any findings from the staff submission in its reply submission, specifically updates to the ICM and z-factor rate riders on the rate generator model.

OEB staff makes detailed submissions on the following:

- Group 1 Deferral and Variance Accounts (DVA)
- Z-factor claim
- Incremental Capital Module (ICM)

[1] Filing Requirements for Electricity Distribution Rate Applications - 2022 Edition for 2023 Rate Applications - Chapter 3 Incentive Rate-Setting Applications, May 24, 2022
[2] OEB Letter, 2024 Inflation Parameters, issued June 29, 2023
[3] EB-2023-0222, Decision and Rate Order, January 18, 2024

1. Group 1 Deferral and Variance Accounts

E.L.K. requested to defer disposition of all Group 1 DVA balances in this proceeding to complete an external audit of accounts, which is being conducted by the third-party auditing firm, KPMG. The balances in accounts 1588/1589 were last disposed in 2015, while the remaining accounts were last disposed in 2020. E.L.K. plans to file for disposition of all Group 1 DVA accounts in its 2025 IRM application.

In the OEB's Decision and Order on E.L.K.'s 2022 Cost of Service application[4], E.L.K. agreed to engage an external auditor to review balances in accounts 1588 and 1589 for the 2016-2021 period and would make best efforts to dispose of balances in both accounts by the 2023 or 2024 IRM application.

In its 2023 IRM proceeding, E.L.K. noted it was not able to dispose of the balances in accounts 1588 and 1589 as a result of staffing constraints. Over the course of the 2023 IRM proceeding, OEB staff posed questions related to the balance of accounts other than 1588 and 1589. E.L.K. in response requested additional time to investigate the discrepancies highlighted by OEB staff. In its decision, the OEB accepted E.L.K.'s request to defer disposition of accounts 1588 and 1589 to the 2024 IRM application and also deferred the disposition of all other Group 1 DVA accounts.

In an interrogatory response filed in this proceeding, E.L.K. noted that the audit of all Group 1 DVA accounts were still ongoing and would make every effort to dispose of all accounts in the next rate application.[5]

To address the staffing and resource constraints, E.L.K. has noted in the application evidence that it entered into a management services agreement with Entegrus Inc. (Entegrus) on March 13, 2023. As part of the agreement, Entegrus is providing management services to E.L.K. across multiple areas of the business operations. In addition, Entegrus is acting as an interlocuter between E.L.K. and the OEB's compliance group to resolve open items with its Group 1 DVA balances.[6]

OEB Staff Submission

OEB staff accepts that E.L.K. is not in a position to dispose of all Group 1 DVA accounts at this time given the ongoing audit. This consideration aligns with past proceedings, as noted in the 2023 IRM, where E.L.K. sought to dispose of Group 1 accounts, excluding 1588 and 1589. Those specific accounts were later found to have discrepancies. OEB staff recognizes the prudence of reconciling accounts and ensuring accuracy before

[4] EB-2021-0016, Settlement Proposal, Decision and Rate Order
[5] OEB Staff IR, Q.1
[6] EB-2023-0013, Application Evidence, Manager's Summary pg 10

including them for disposition.

OEB staff acknowledge that E.L.K. has taken steps to address the issue of staffing constraints by entering into a management services agreement with Entegrus. The expectation is that E.L.K. should consistently implement strategies to ensure adequate staffing as an operational requirement. OEB staff underscores the importance of learning from previous proceedings to prevent a recurrence of this issue in future rate applications. As such it is OEB staff recommendation that E.L.K. takes preemptive measures to ensure that audits are completed in a timely manner, avoiding further delays in the disposition of accounts. OEB staff expects E.L.K. to bring the result of the audit and request disposition of all Group 1 DVA account balances in the next rate application.

2. Z-Factor Claim

E.L.K. applied for recovery of costs related to damage caused by two storms in 2023. On February 22, 2023 and July 26, 2023, E.L.K. experienced severe storms resulting in considerable infrastructure damage to their distribution system and significant storm restoration expenses. E.L.K. indicated that both events resulted in widespread outages with approximately 24% of customers affected in the February ice storm, and 41% of customers experienced interruptions during the July thunderstorm event.[7]

In this application, E.L.K. seeks recovery of a total of $417,611 to cover costs from the two storms. E.L.K. proposes that the claimed amount be allocated across all rate classes, and to recover this amount via fixed rate riders effective May 1, 2024, until April 30, 2026. The $417,611 total cost consists of $404,401 OM&A costs and $13,210 revenue requirement on capital spending. The combined requested relief from the two storms is shown in Table 1 below:

Table 1: Combined Storm Recovery

Category	February Storm Event	July Storm Event	Total ($)
Operating Costs	$226,863	$177,538	$404,401
Capital Revenue Requirement	$8,400	$4,809	$13,210
Total	$235,263	$182,348	$417,611

This recovery is sought under the OEB's policy for z-factor treatment for events or causes that are outside of the utility's ability to predict or control. The claimed amount consists of incremental operating, maintenance, and administration (OM&A) costs, the revenue requirement associated with capital expenditures, and carrying charges on the costs incurred for two storms.

As part of the pre-filed evidence, E.L.K. provided a breakdown of the capital and OM&A costs from each storm as shown in Table 2 and 3 below:

Table 2: February 2023 Storm Event Cost Breakdown

[7] EB-2023-0013, Application Evidence, Appendix A.

Category	OM &A ($)	Capital ($)	Total ($)
E.L.K. Staff	$66,582		$66,582
Work Order for Reconnect	$10,461		$10,461
Electrical Contractor	$112,503		$112,503
Distributor A	$34,664		$34,664
Distributor B	$2,653		$2,653
Electrical Contractor		$49,063	$49,063
Material		$11,326	$11,326
Total	**$226,863**	**$60,389**	**$287,252**

Table 3: July 2023 Storm Event Cost Breakdown

Category	Operating $	Capital $	Total $
E.L.K. Staff	$38,487		$38,487
Work Order for Reconnect	$8,007		$8,007
Electrical Contractor	$67,520		$67,520
Distributor A OM&A	$4,772		$4,772
Distributor B OM&A	$23,486		$23,486
Vegetation Management Contractor	$12,968		$12,968
Excavation Contractor	$5,100		$5,100
Distributor C OM&A	$17,199		$17,199
Hydro Vac Capital		$4,182	$4,182
Distributor B Capital		$10,907	$10,907
Distributor C Capital		$6,231	$6,231
Material		$13,253	$13,253
Total	**$177,538**	**$34,574**	**$212,112**

Z-factors provide for funding to cover costs of unforeseen events outside of a distributor's management control.[8] The OEB has previously indicated that for Z-factor treatment to apply, generally, the cost to the distributor must be material and its causation clear.[9]

[8] EB-2007-0673, *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, July 14, 2008, p. 34
[9] *Ibid,* p. 34

In order for amounts to be recoverable by way of a Z-factor, the amounts must satisfy the following three eligibility criteria:

- Causation – Amounts should be directly related to the Z-factor event. The amount must be clearly outside of the base upon which rates were derived.

- Materiality – The amounts must exceed the Board-defined materiality threshold and have a significant influence on the operation of the distributor; otherwise they should be expensed in the normal course and addressed through organizational productivity improvements.

- Prudence – The amounts must have been prudently incurred. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.[10]

Causation

In the pre-filed evidence, E.L.K. states that all costs included in the Z-factor claim were directly related to both storm events. E.L.K. further states that the event was outside of E.L.K.'s control and submits that the amounts sought for recovery are outside of E.L.K.'s base rates.

Capital Costs

In response to staff interrogatories, E.L.K. specifies that $60,389 and $34,574 capitalized from the February and July storm events, respectively, are allocated specifically for pole replacement.[11] Additionally, in response to staff interrogatories, E.L.K. indicated its intention to write off damaged assets from its books as part of its year-end financial closing process. As such, the associated depreciation expenses will no longer be recognized throughout the assets' useful life.[12] In response to an OEB staff interrogatory, E.L.K. outlines its policy for the capitalization of labor charges, stating that it includes contracted services, materials, transportation costs, direct labor, overhead costs, borrowing costs, and any other costs directly related to bringing the asset to a working condition.

In its response to an OEB staff interrogatory[13], E.L.K. mentions that it does not budget for storm related capital costs and allocates storm response costs to its budget line items as they are incurred during the fiscal year. The costs that have been incurred are incremental with the exception of staff's regular labour which has not been included in this Z-factor claim.

[10] *Ibid*, p. 25
[11] OEB Staff IR – 2
[12] OEB Staff IR - 3
[13] OEB Staff IR - 6

As part of the February storm response, E.L.K. replaced 3 poles that were scheduled for replacement as part of the pole inspection capital plan.[14] These poles were damaged by the storm and replaced. Table 4 below shows a breakdown of the total capitalized cost of $60,389 for the February storm event.

Table 4: February 2023 Storm Event Capitalized Costs

Asset / Equipment	Quantity	Repaired/ Replaced	Estimated Net Asset Value (CA$)[15]
Poles	10	Replace	Avg. $1180[16]
Fuses	20	Replace	Avg. $266
Insulator	30	Replace	Avg. $120

As part of the July storm response, E.L.K. replaced 1 pole that was scheduled for replacement as part of the pole inspection capital plan.[17] Table 5 below shows a breakdown of the total capitalized cost of $34,574 for the July storm event.

Table 5: July 2023 Storm Event Capitalized Costs

Asset / Equipment	Quantity	Repaired/ Replaced	Estimated Net Asset Value (CA$)
Poles	6	Replace	Avg. $1180
Cross Arm	1	Replace	$598
Fuses	15	Replace	$266
Insulators	18	Replace	$120

OEB Staff Submission on Z-factor Capital Costs

OEB staff submits that E.L.K. should not be allowed to recover the costs of those poles which were already scheduled for replacement. This would result in (i) a 30% reduction in the costs associated with the 10 poles replaced as part of the February storm; and (ii) a 16.7% reduction in the cost associated with the 6 poles replaced as part of the July storm. In OEB staff's view, E.L.K. should not be placed in a position better than it would

[14] OEB Staff – VECC-4
[15] Net Value Asset is the remaining undepreciated value of these assets.
[16] Based on 40 year useful life.
[17] OEB Staff – VECC-4

have been had these storms not occurred.

This approach is consistent with recent decisions of the OEB in Elexicon Energy's 2023 Z-factor application[18] and CNPI's Z-factor claim where the OEB did not allow cost recovery for poles that were in poor/very poor condition and therefore expected to be replaced.

Operating Costs

In its application, E.L.K. claims total OM&A costs of $226,863 related to the first storm event, and $177,538 in operating costs related to the second storm event. In response to an OEB staff interrogatory[19] E.L.K. provided a breakdown that shows the cost components underpinning the total OM&A costs of the Z-factor claim, which includes labour (overtime), LDC mutual aid costs, contracted service (line services and excavation) and other OM&A costs.

Additionally, E.L.K. submits that there were electrical contractor costs that did not directly lead to the placement of assets in-service and were therefore expensed.[20] The work that these electrical contractor costs related to included re-stringing overhead wire, replacing fuses, clearing trees and branches, attaching secondary services, guying poles, and temporary pole guying.

OEB Staff Submission on Z-factor Operating Costs

Based on E.L.K.'s evidence for the OM&A related Z-factor claim, OEB staff submits that the costs incurred as a result of both storm events qualify for the Z-factor treatment in accordance with the OEB's policy and practice. OEB staff acknowledges that the labour and other aspects of the OM&A costs paid were supported by invoices and receipts as part of E.L.K.'s responses to staff interrogatories.

Materiality

The OEB has previously indicated that the materiality threshold for a Z-factor applicable to a distributor with a distribution revenue requirement less than or equal to $10 million is $50,000.[21] The materiality threshold applicable to E.L.K. is $50,000.

OEB Staff Submission on Materiality

The combined amount requested as a result of the two storm events is $417,611. Individually, the costs of each storm event also satisfy the $50,000 materiality threshold. This will remain the case even if the OEB accepts OEB staff's position that the capital

[18] Decision and Order, EB-2022-0317, Elexicon Energy Inc., Z-factor Application for Rates and Other Charges to be Effective July 1, 2023, p. 9;
[19] OEB Staff IR - 3
[20] OEB Staff IR - 2
[21] *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, September 17, 2008, Appendix B: Amended Filing Guidelines, p. VIII

cost should be reduced to remove poles that were already scheduled for replacement. OEB staff submits that E.L.K. meets the required materiality threshold.

Prudence

In its application, E.L.K. states that it acted in the interests of its customers to restore service as quickly as possible following the two storm events by choosing the most cost-effective option for ratepayers. The damage caused extensive harm to E.L.K.'s distribution system and E.L.K. states that capital additions primarily utilized existing inventory, though certain items were procured due to significant grid damage. [22]

E.L.K. mentions that both events resulted in widespread outages, approximately 24% of customers affected in the ice storm, and 41% of customers experienced interruptions during the thunderstorm event.

In the application evidence, E.L.K. also notes that it deployed internal labor and external contractors, adhering to pre-approved agreements. Despite not being part of a mutual assistance agreement during the first storm event, E.L.K. sought aid from neighboring utilities, and subsequently joined the Ontario Mutual Assistance Program (OnMAG) to assist in deploying available crews to repair damage and restore power. Key members of the E.L.K. Restoration team promptly responded to the impending weather event and power outages, with regular on-call staff and additional crews on standby.

OEB Staff Submission on Prudence

OEB staff notes that E.L.K. called upon available internal and external resources to address the storm outages and took efforts to join mutual assistance programs following the events of the first storm. OEB staff also recognizes that E.L.K. acted promptly and restored power within a reasonable period. Based on the evidence E.L.K. provided in its application and interrogatory responses, OEB staff submits that E.L.K. has met the criteria of prudence.

Summary of Z-factor Cost Claim Recommendations

OEB staff acknowledges that E.L.K. incurred significant costs for its storm restoration efforts, and which were largely beyond E.L.K.’s costs funded through distribution rates paid by ratepayers. OEB staff does not dispute the severity of the storm, or E.L.K.’s efforts to fix its infrastructure and restore service to customers in a swift manner. However, OEB staff submits some of the capitalized costs associated with the pole replacements and other equipment should be part of E.L.K.’s ongoing program budgets based on the asset conditions and planned replacement. Except for this adjustment,

[22] Manager’s Summary, Appendix A, p. 13

and based on the record in this application, OEB staff submits that the criteria for causation, materiality and prudence for the Z-factor claim are met.

PILs Treatment in the Z-Factor Costs Recovery

In its 2024 IRM Application, E.L.K. questions the appropriateness of the negative PILs adjustment to the incremental revenue requirement resulting from the Z-factor capital expenditures.[23] E.L.K. states that the premise of negative PILs adjustments is that these amounts will be netted out from actual PILs paid, leaving the utility in a net-neutral position. However, the utility has no actual PILs amount to offset the impact, "thus would simply lose recovery of a significant proportion of the incremental revenue requirement otherwise resulting from Z-Factor capital expenditures". E.L.K. has proposed a 0% tax rate for calculating the Z-Factor revenue requirement.

OEB staff does not support E.L.K.'s proposal of excluding the negative PILs in the Z-Factor revenue requirement because this proposal does not adhere to the OEB's filing requirements. OEB staff notes that the amounts of the negative PILs adjustments are not material, and the impacts on the ratepayers are minimal compared to the overall Z factor request. OEB staff submits that E.L.K. should utilize its current effective tax rate of 26.5% to calculate the Z-Factor capital revenue requirement. OEB staff further submits that E.L.K should recalculate the revenue requirements on the capital expenditures in its reply submission, according to the OEB's filing requirements.

[23] E.L.K. 2024 IRM Application, Page 116

3. Incremental Capital Funding (ICM)

E.L.K. requested approval of ICM funding of $138,591 for the purchase of two single bucket trucks, and six reclosing switches. The total estimated capital expenditures for the fleet vehicles are $884,907 and $485,024 for the switches. E.L.K. has proposed fixed and variable rate riders for this request covering a three-year period (until next rebasing in 2027).

In calculating the ICM revenue requirement, E.L.K. used a 0% effective tax rate to generate an incremental revenue requirement value that recovers return on rate base and amortization expense without any negative adjustment for PILs. E.L.K.'s calculated total incremental annual revenue requirement associated with the ICM projects at a 0% tax rate is $138,591.

Fleet Vehicle Replacement
E.L.K. requests approval to purchase the following two fleet vehicles that have reached end of useful life:

1. #40615: Underground Truck - 2015 Vintage
2. #10216: Pickup Truck - 2016 Vintage

This request was initially put forth in E.L.K.'s 2022 rebasing application but was withdrawn over the course of the proceeding due to COVID-19 related supply chain issues. E.L.K. submits that the annual maintenance costs of the vehicles are increasing to where replacement is the most cost-effective option. In the prefiled evidence, E.L.K. notes that the fleet replacement considers the following factors:

- Age of the vehicle
- Odomoter reading
- Maintenance costs
- Annual vehicle test results, including stress/electrical testing
- Practicality of existing vehicle including new technology available
- Changing emissions, weight, and road safety regulations obsoleting some existing units; and
- Crew or other department needs.

The cost to replace the two fleet vehicles are as follows:

Table 6: Cost of Fleet Vehicle Replacement

2024 ICM Fleet Vehicles	Total ($)
200-42 Bucket Truck	$406,191
400-46 Bucket Truck	$478,716
Total Incremental Capital	$884,907

E.L.K. has confirmed through staff interrogatories that it has paid to date $129,639 for the Model 400-46 truck, and $257,085 for the Model 200-42 truck.[24]

Recloser Switches

E.L.K. requests ICM funding to purchase six recloser switches. The purchase of the switches is a part of E.L.K.'s Smart Grid Plan to meet customer needs related to reliability. E.L.K. submits that the recloser switches will facilitate a reduction in customer outages due to loss of supply, which is the most significant cause of reliability issues, according to E.L.K.

As part of this application, E.L.K. has proposed the installation of six switches exclusively in the communities of Harrow and Essex, two of the four communities served by E.L.K. E.L.K. asserts that this decision is rooted in two primary considerations. First, installing three or more switches is deemed a system, providing greater advantages in mitigating supply losses. Second, the deployment of switches requires an area with dual supply points, both of which Harrow and Essex possess. E.L.K. plans to assess the viability of enhancing the system requirements for the remaining four communities to leverage the benefits of switch installation.

The total estimate cost for the installation of the six recloser switches is $485,024. The installation of six recloser switches were not specifically noted in E.L.K. Energy's 2022 DSP or the Customer Survey. However, E.L.K. set SAIDI and SAIFI targets as part of the Reliability Commitment Account and suggests the six recloser switches will help in achieving those targets.[25]

Materiality

The ACM/ICM Report [26] states that distributors must meet an OEB defined materiality threshold and project specific materiality threshold. The following is the current definition of materiality as it applies to ICMs:

[24] OEB Staff IR- VECC-8
[25] OEB Staff IR – VECC-10
[26] EB-2014-0219, ACM Report, September 18, 2014

> Any incremental capital amounts must fit within the total eligible incremental capital amounts (as defined in this ACM Report) and must clearly have a significant influence on the operation of the distributor; otherwise they should be dealt with at rebasing.[27]

The OEB-defined materiality threshold is defined in Chapter 3 of the Filing Requirements for Distribution Rate Applications. It represents a distributor's financial capacities underpinned by existing rates, including growth and a 10% dead band. The equation used to calculate the materiality threshold is as follows:

$$Threshold\ Value\ (\%) = \left(1 + \left[\left(\frac{RB}{d}\right) \times \left(g + PCI \times (1+g)\right)\right]\right) \times \left((1+g) \times (1+PCI)\right)^{n-1} + X\%$$

Where: RB = rate base included in base rates ($)
d = depreciation expense included in base rates ($)
g = distribution revenue change from load growth (%)
PCI = price cap index
n = number of years since the cost of service rebasing
X = dead band which is currently set at 10%

E.L.K. used a price cap index of 4.50% based on the 2024 inflation factor of 4.80% less a stretch factor of 0.30%. Using the formula above, E.L.K. has calculated its materiality threshold to be $1,136,438. OEB staff has no issues with this calculation and as such E.L.K. meets the materiality threshold for ICM eligibility.

The maximum eligible incremental capital amount available to E.L.K. for 2024 is $1,872,084. OEB staff notes that E.L.K.'s ICM request of $1,369,931 is within the maximum eligible incremental capital amount. In the ICM model, E.L.K. forecasted total capital spending of $3,008,522 for 2024, more than double the 2024 forecasted capital spending of $1,356,000 outlined in its Distribution System Plan (DSP) as part of E.L.K.'s 2022 cost of service application. E.L.K. attributes this variance to the inclusion of fleet vehicles and switches in the ICM request, as well as increased system access spending driven by customer growth. [28]

Project-specific materiality

With regard to the project-specific materiality threshold, projects that are minor expenditures in comparison to the overall capital budget of the distributor are not eligible for ICM treatment. OEB staff submits that the incremental capital E.L.K. requested for (i) the switches represent 16% of its total 2024 budget; and (ii) fleet vehicles represents an

[27] *Ibid.*, Page 17
[28] OEB Staff IR – VECC-17

additional 29% of its total 2024 budget.[29] OEB staff submits each of these two projects represents a significant capital expenditure for E.L.K. and therefore satisfies the project-specific materiality threshold.

Need

The ACM/ICM Report describes the need criterion as follows:

- The distributor must pass the Means Test (as defined in the ACM/ICM Report)
- Accounts must be based on discrete projects and should be directly related to the claimed driver
- The amounts must be clearly outside of the base upon which the rates were derived. [30]

Under the Means Test, if a distributor's regulated return on equity (ROE) exceeds 300 basis points above the deemed ROE embedded in the distributor's rates, then the funding for any incremental capital project will not be allowed. E.L.K.'s 2022 achieved ROE was -1.97% which 10.63% (1063 basis points) lower than deemed ROE of 8.66%.[31] OEB staff submits that E.L.K. meets the Means Test for ICM eligibility. OEB staff raise concerns regarding E.L.K.'s low ROE and encourage E.L.K. to take proactive steps to address this.

The need criterion for ICM funding also stipulates that the amounts requested for ICM must be outside of base rates. E.L.K first sought approval to purchase fleet vehicles in the 2022 rebasing application; however, this request was withdrawn due to supply chain issues as previously noted. In the application evidence[32], E.L.K. also submits that the recloser switches were not part of any existing capital program but were introduced as part of E.L.K.'s Smart Grid Plan in 2023, aiming to enhance system reliability. OEB staff are satisfied that the amounts are clearly outside of the base upon which rates were derived.

Prudence

The ACM/ICM Report describes prudence as follows:

> The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.[33]

[29] ACM/ICM Model, tab 9b
[30] ACM Report, p. 17
[31] EB-2023-0013, Manager's Summary, Appendix B, pg 29.
[32] EB-2023-0013,
[33] ACM Report, p. 17

E.L.K. submits that both projects represent prudent investments that deliver the most cost-effective option for customers based on a few considerations. For the fleet vehicles, the cost proposed for ICM recovery aligns with the historical costs of similar fleet vehicles, as indicated in E.L.K.'s 2022 Cost of Service.[34] In the 2022 Cost of Service application, E.L.K. had indicated that the age of the 2007 vintage vehicle (bucket truck ID 20207) would reach 15 years in 2022.[35] In addition, the same vehicle incurred over $30k in reactive repair costs to keep the truck in service.[36]

E.L.K. also considered and rejected the option to lease due to high leasing costs, which would eventually exceed the price of a new vehicle.[37]

E.L.K. submits the costs for the proposed recloser switches are prudent in that they address persistent reliability concerns. The switches are part of E.L.K.'s efforts to address reliability and modernize the distribution system as part of the Smart Grid Plan. E.L.K. did not reference the switches in its 2022 DSP, however E.L.K. set SAIDI and SAIFI targets as part of the reliability commitment and suggests that the installation of the six recloser switches will help in achieving those targets.[38] There are six recloser switches proposed for installation in each of the two proposed communities, with an approximate cost of $80,837 per recloser installation. In response to staff interrogatories, E.L.K. highlighted the work required to complete the installation of the switches as part of the Grid Modernization Report, which includes site assessments, and evaluation of any feeder restrictions or transfer trip requirements.[39]

OEB staff submits that E.L.K.'s request to replace end-of-life fleet vehicles are prudent and reasonable based on historical costs and the condition of the end-of-life vehicles. Based on an assessment of alternatives, replacing the older vehicle is the more prudent option compared to maintaining the vehicle beyond useful life. OEB staff note that the age of the vehicles are 16 years and fully depreciated, while the average useful life of a bucket truck is 15 years, based on Kinectrics' Asset Depreciation Study.[40]

OEB staff also support ICM funding for the reclosers based on the proposed projects ability to address long-standing reliability issues. In the 2022 Settlement Agreement, E.L.K. committed to reliability initiatives to address persistent issues with system

[34] EB-2022-0016 – Application Evidence, Exhibit 2.
[35] EB-2021-0016, Exhibit 2, Tab 4, Attachment 1, pg 522
[36] EB-2021-0016, Exhibit 2, Tab 4, Attachment 1, pg. 522
[37] EB-2023-0013, Manager's Summary, Appendix B, pg 8
[38] OEB Staff IR – VECC-10
[39] OEB Staff IR – VECC-10 – Grid Modernization Report pg 94
[40] EB-2021-0016 – Exhibit 2, Tab 4, Attachment 1, pg. 520

reliability. OEB staff believe these investments are responsive to the OEB recommendations to address these issues. OEB staff also supports E.L.K.'s efforts to modernize the distribution system to better serve ratepayers with the installation of recloser switches. While the planned installation is limited to only two of the communities served by E.L.K., OEB staff recognizes the importance of addressing supply interruption issues which remain the biggest challenge for E.L.K.'s reliability. OEB staff supports the prudence of both projects, aligning with E.L.K.'s commitment to cost-effectiveness and improved service reliability.

PILs Treatment in the ICM Model

Background

In its 2024 ICM Application, E.L.K. questions the appropriateness of the negative PILs amount used in the ICM model, noting that it had the PILs embedded in the 2022 rebasing application set as Nil due to the forecast tax loss and it has entered a period of revitalization in which capital expenditures above its historical trends. As a result, E.L.K. states that it has set the current tax rate in the ICM model to 0% to exclude the impact of PILs (i.e., the negative PILs amount) on the ICM funding.[41]

Based on E.L.K.'s proposal, the proposed incremental revenue requirement of $138,591 in the application recovers only the Return on Rate Base and Amortization Expenses but does not include the gross-up negative PILs amount of $67,393. This negative PILs amount represents a tax loss of $67,393 resulting from the deduction of a greater amount of Capital Cost Allowance (CCA) than the amortization of three ICM assets proposed by E.L.K. E.L.K. notes that this proposal is not in accordance with the filing requirement[42] but requested the OEB's approval of its one-off proposal due to its unique circumstance. E.L.K. also states that all of the above represents a unique situation that, to E.L.K. Energy's knowledge, has not been encountered in any ICM application to date.

As part of its response to a staff interrogatory, E.L.K. updated the ICM / ACM model using its current effective tax rate of 26.5%. The recalculated incremental revenue requirement is reduced by $67,397 from $138,591 to $71,193 solely attributed to the gross-up negative PILs amount of $67,397.

OEB staff notes that the tax loss calculated in the ICM model is attributable to the difference between the CCA and the accounting amortization expenses, mainly associated with two bucket trucks proposed by E.L.K. In this application, E.L.K. requested two bucket trucks for $884,907 and switches for $485,024. The annual tax depreciation for trucks is 30% on a declining balance which is significantly higher than

[41] E.L.K. 2024 IRM Application, Appendix B- ICM Application, Page 31
[42] Staff 8b – E.L.K. 2024 ACM ICM Model, January 11, 2024

the annual accounting deprecation rate of 6.67% on a straight-line balance (with a useful life of 15 years). There is no substantial difference between the accounting amortization and CCA for switches.

E.L.K notes its three main reasons for supporting the "one-off" proposal:

1. Inconsistent tax loss treatment between the ICM model and the PILs model in cost of service applications

E.L.K. noted the inconsistent treatment of the tax losses between the PILs calculation in the ICM model and the PILs calculation in the PILs model of the rebasing applications: the ICM model allows negative taxable income (i.e., tax loss) to yield a negative PILs value leading to a reduction in ICM funding in this application. However, the PILs calculation in the PILs model of the rebasing application sets the value as nil when there is a negative taxable income generated. In response to a staff interrogatory, E.L.K. notes that its request is consistent with the OEB's PILs model in Cost of Service Applications."[43] E.L.K. notes a precedent from its 2022 rebasing application, where the PILs approved in the 2022 rates was Nil due to the forecast tax loss generated in the PILs model).

In its response to the staff interrogatory, E.L.K states that this divergence from the PILs model is based on the logic that utilities applying for ICM funding are incurring PILs costs. To the degree the CCA associated with ICM capital expenditures drives negative taxable income on the ICM revenue requirement, this negative income would reduce the utility's existing actual PILs costs, and the reduced cost should be reflected in a reduction to ICM funding.

2. Financial viability

E.L.K. emphasizes its concerns about cash flow and financial viability. It states that incorporating a 26.5% corporate tax rate in the ICM model would reduce the incremental revenue requirement by 51%, causing "an unjust and unreasonable arbitrary reduction in ICM funding that would seriously undermine the financial viability of E.L.K., which as noted is already operating at a loss."[44]

E.L.K. states that the utility has posted a significant tax loss of nearly $1 million for the year ended on December 31, 2022, and anticipates further tax losses in excess of $4 million from 2023 through 2026.

E.L.K. notes its actual achieved Regulated Return on Equity (ROE) was negative 1.97% in 2022. This is a trend that E.L.K. also expects to persist in the immediate future as it

[43] IR response to Staff-8 (a)
[44] IR response to Staff-8 (b)

makes necessary investments to revitalize.

3. No forecasted reversal of the trend when CCA deductions outstrip net income before tax

E.L.K. states that as noted elsewhere in E.L.K.'s combined IRM, ICM and Z-Factor application, E.L.K. is entering a period of revitalization in which capital expenditures above its historical trends are planned for. E.L.K. does not anticipate a reversal of the trend in which CCA deductions outstrip Net Income before Taxes and require the payment of PILs amounts.

Staff Submission

Overview

OEB staff submits that it may not be appropriate for E.L.K. to exclude the negative PILs amount from the incremental revenue requirement, and therefore recommends OEB not approve E.L.K.'s proposal because: 1) E.L.K.'s proposal does not comply with the filing requirements which requires the utilities to use the current tax rate in the ICM mode; 2) there is precedent where the OEB approved the ICM revenue requirement with a negative PILs adjustment in Halton Hill's 2019 ICM application; 3) E.L.K's proposal of not incorporating the tax benefits in the ICM revenue requirement may result in a loss of the actual tax benefits to be realized by the utility subsequently; 4) The ratepayers haven't shared the benefits E.L.K. has gained from a higher-than-deemed ROE in the past years, even though they are asked to fund E.L.K. when the utility experiences a negative ROE The impact of denying E.L.K.'s proposal is reducing the ICM revenue requirement by $67,393 on an annual basis until its next rebasing application.

On the other hand, OEB staff acknowledges E.L.K.'s concern of applying the current tax rate in the ICM model resulting in a negative gross-up PILs amount, thereby significantly reducing the ICM revenue requirements in this application. If OEB accepts E.L.K.'s request to exclude the negative PILs amount from the incremental revenue requirement, instead of excluding the $67,393 which is the gross-up negative PILs amount in 2024, OEB staff recommends that E.L.K. be required to include a smoothing mechanism to spread out the impact of the negative PILs between 2024-2026. OEB staff recommends that E.L.K. include an explanation of how it would smooth out the impact of the negative PILs as part of its reply submission.

Analysis

OEB staff acknowledges E.L.K.'s observation of the divergence in the PILs treatment in the ICM model and cost of service applications. The incremental impact of a negative PILs amount derived from the ICM model is to either offset the overall PILs cost or to increase the accumulated tax loss carry-forward (a tax benefit to the utility and

ratepayers as it reduces PILs cost in subsequent years).

Although E.L.K. states that to its knowledge, the utility's unique situation where a negative PILs amount associated with the ICM assets has no actual PILs to be netted off has not been encountered in any ICM application to date,[45] OEB staff notes that a recent ICM application by Halton Hills Hydro is factually similar to E.L.K.'s situation.

In Halton Hills' 2019 ICM decision and order, the OEB approved a $1,698,085 ICM revenue requirement which included a negative gross-up PILs amount of $152,818[46]. Similar to E.L.K.'s situation, Halton Hills' PILs approved in the 2016 cost of service proceeding was set as nil due to a forecast tax loss of $2.1 million at the time. The negative grossed-up PILs adjustment was not brought up in Halton Hill's 2019 ICM proceeding and therefore there was no discussion of the issue.

Furthermore, OEB staff is of the view that while including the negative PILs amount of $67,397 from the ICM revenue requirement may not totally cover all the funding needed for the ICM assets, completely omitting the taxes would be unfair to the ratepayers.

If E.L.K.'s proposal were to be accepted by the OEB, E.L.K. would collect the ICM revenues over the next three years for a total amount of $415,773 (calculated as the annual ICM revenue requirement of $138,591 multiplied by 3 years) at the end of 2026. During this time period, E.L.K. is also accumulating a tax loss associated with the ICM assets. Table 7 and Table 8 below calculate the accumulated tax loss (grossed-up PILs) at the end of 2026, totaling $121,395. These tax losses would be lost if the ICM would not be trued up in E.L.K.'s next rebasing application because the ICM true-up in the rebasing application is not guaranteed. The OEB's ACM/ICM Report notes that, where there is a material difference in the ICM true-up calculation, the OEB may direct that the over/under collection be refunded to/recovered from ratepayers. Furthermore, OEB staff notes that the loss generated from the cost of capital proceeding is to be carried forward and offset against the taxable income in the test year of the next rebasing application. However, the loss in the ICM model, if not trued up, would be permanently lost and hence would not be fair to the ratepayers.

Table 7: ICM – Grossed Up PILs for the Years 2024 to 2026

[45] IR response to Staff-8 (a)
[46] EB-2018-0328, Decision and Order, Capital Module ACM Model, April 4, 2019

Grossed up Taxes/PILs	2024 (As Filed by E.L.K.)	2025 (Staff Calculation)	2026 (Staff Calculation)	Total
Regulatory Taxable Income (Based on E.L.K's ICM Model)	$ 46,223	$ 46,223	$ 46,223	**$ 138,668**
Add Back Amortization Expense (Prorated to Eligible Incremental Capital)	$ 71,119	$ 71,119	$ 71,119	**$ 213,358**
Deduct CCA (As calculated by the OEB Staff in Table 2)	$ 304,274	$ 221,528	$ 162,923	**$ 688,725**
Incremental Taxable Income	$ (186,932)	$ (104,186)	$ (45,581)	**$ (336,699)**
Current Tax Rate @26.5% Taxes/PILs Before Gross Up	$ (49,537)	$ (27,609)	$ (12,079)	**$ (89,225)**
Grossed-Up Taxes/PILs	$ (67,397)	$ (37,564)	$ (16,434)	**$ (121,395)**

Table 8 below outlines the CCA calculated by OEB staff for the proposed ICM projects for the subsequent IRM years leading up to E.L.K.'s scheduled next rebasing in 2027. The total CCA values in the respective years are used in Table 8 to compute the grossed-up PILs associated with the ICM assets.

Table 8: OEB Staff Calculated Tax Depreciations for ICM Projects (2024 -2026)

Project Descriptions:	Proposed ACM/ICM Cost	CCA			
		2024 (As Filed by E.L.K.)	2025 (Staff Calculation)	2026 (Staff Calculation)	Total CCA from 2024 to 2026
200-42 Bucket Truck (CCA 10 @ 30%)	$ 406,191	$ 121,857	$ 85,300	$ 59,710	**$ 266,867**
400-46 Bucket Truck (CCA 10 @ 30%)	$ 478,716	$ 143,615	$ 100,530	$ 70,371	**$ 314,516**
6x Reclosing Switches (CCA 47 @ 8%)	$ 485,024	$ 38,802	$ 35,698	$ 32,842	**$ 107,342**
Total	$ 1,369,931	$ 304,274	$ 221,528	$ 162,923	**$ 688,725**

Additionally, OEB staff notes that E.L.K. has consistently achieved a higher-than-deemed ROE since 2017 as indicated in the previously filed RRR 2.1.5.6. Table 9 below outlines the differences between the achieved ROE and the deemed ROE from 2017 to 2021. E.L.K. emphasizes that financial viability is one of the main reasons for its "one-off' request. However, OEB staff is of the view that while in 2022 E.L.K. under earned, on average (2017 to 2022) has still over earned.

Table 9: Differences between the Achieved ROE and the Deemed ROE

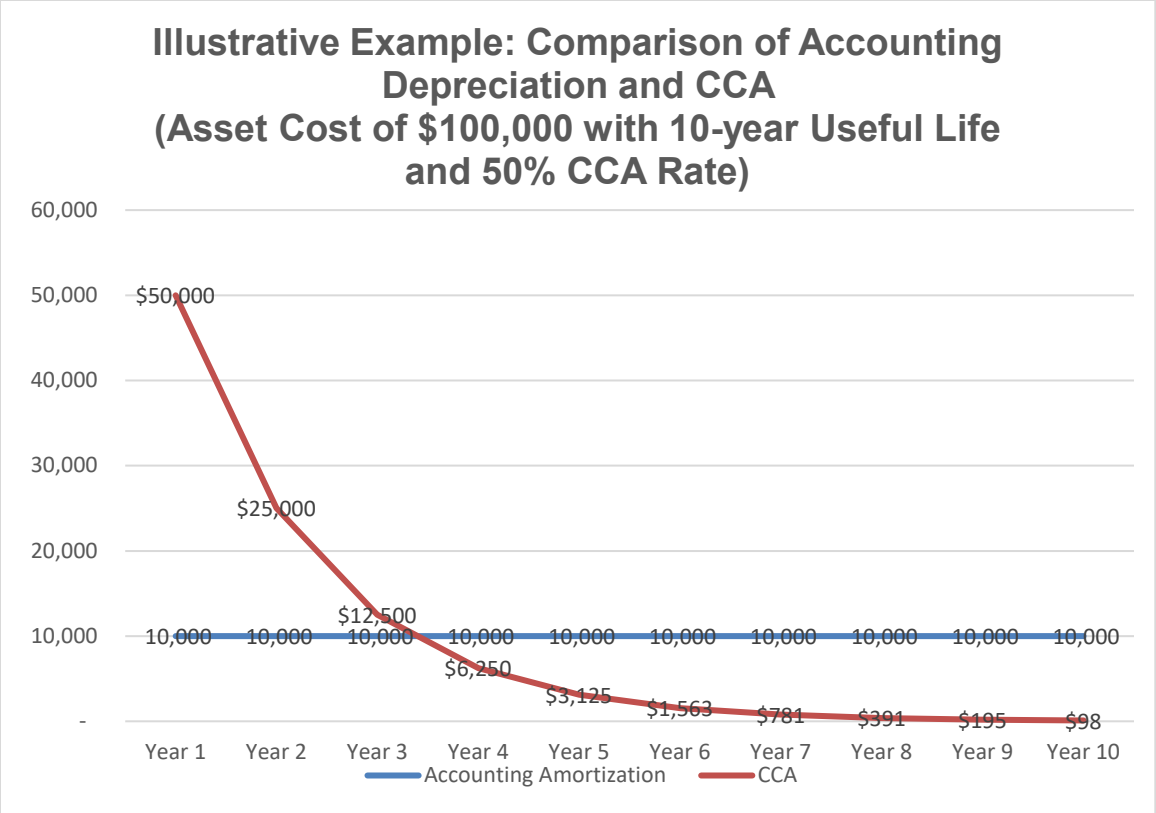
RRR 2.1.5.6 Filing Information	2017	2018	2019	2020	2021
Achieved ROE %	11.15	16.17	9.66	11.76	10.93
Deemed ROE %	8.78	8.78	8.78	8.78	8.78
Deference	**2.37**	**7.39**	**0.88**	**2.98**	**2.15**

Based on the above analysis, OEB staff submits that E.L.K. should adhere to the guidelines[47] set out in the OEB's ACM/ICM Report to apply its current effective tax rate of 26.5% for calculating the revenue requirement associated with incremental funding.

CCA Smoothing Mechanism Recommendation (If E.L.K.'s Proposal is Approved in Principle)

E.L.K.'s proposed approach may result in a complete omitting of the actual tax benefits from the accumulated tax loss to be realized later by E.L.K. The concern arises due to the difference in calculating the CCA on a declining basis and the accounting amortization expense on a straight line basis. The gap between the accounting depreciation and the CCA is most significant in the first year when the CCA is deducted the most in the taxable income calculation. This gap is further magnified when the CCA rate is much higher than the accounting amortization rate. The graph below illustrates the differences between the CCA and the accounting amortization for an asset of $100,000 cost with a 10-year useful life and a CCA rate of 50%:

[47] Report of the Board – New Policy Options for the Funding of Capital Investments: The Advanced Capital Module, EB-2014-0219, September 18, 2014, Page 24



As seen from the graph, the CCA amount declines over the life of the asset. The difference between the CCA and the accounting amortization is a timing difference that would reverse itself at the asset level. As a result, the negative PILs amount from the ICM asset decreases over time due to the declining CCA amount and will turn into a positive PILs amount in year 4, as illustrated in the above example. These negative PILs amounts generate tax losses that are to be carried forward and offset against the anticipated taxes when the accounting amortization exceeds the CCA, setting aside other business income.

OEB staff invites E.L.K. to comment in its reply submission on OEB staff's proposed smoothing mechanism of smoothing the gross-up negative PILs amounts in 2024 to 2026 to share the tax benefit arising from the tax loss generated, mainly from the frontloading CCAs of the ICM assets.

However, overall OEB staff recommends that E.L.K. should adhere to the guidelines set out in the OEB ACM/ICM Report to apply its current effective tax rate of 26.5% for calculating the revenue requirement associated with incremental funding.

~All of which is respectfully submitted~