E.L.K. Energy Inc.

March 07, 2024

Nancy Marconi
Board Secretary
Ontario Energy Board
PO Box 2319
2300 Yonge Street, Suite 2700
Toronto ON M4P 1E4

Dear Ms. Marconi:

Re: E.L.K. Energy Inc. 2024 Incentive Regulation Mechanism ("IRM") Distribution Rate Application EB-2023-0013

In accordance with the instructions released by the Ontario Energy Board ("the Board") in Procedural Order No 2 dated February 29, 2024 E.L.K. Energy Inc. ("E.L.K. Energy") hereby submits its responses to the OEB's additional questions.

An electronic copy of this Application has been filed with the Board RESS Filing System.

Regards

Kayla Lucier

Kayla Lucier
Supervisor, Finance & Regulatory
E.L.K. Energy Inc.
172 Forest Ave
Essex, ON N8M 3E4
Telephone (519) 776-5291 ext 204
Email klucier@elkenergy.com

E.L.K. Energy

Answer to Questions from

OEB Panel

Panel Information Request-1

Reference:

(1) EB-2023-0013, Appendix A, paragraph 47, p. 16 of 20.
(2) EB-2023-0013, Appendix B, paragraph 95, p. 25-26.
(3) EB-2023-0013, Reply Submission, p.12-14.

Preamble:

As stated in Reference (1), ELK Energy rebased in 2022, with its most recently filed ROE for 2022 at (1.97%). ELK Energy further states that this trend is expected to persist in the immediate future as it makes necessary investments to revitalize. Per Reference (2), ELK Energy estimates that, should the OEB reject its request for ICM funding, it would realize a 310 basis point reduction to its regulated ROE based on ICM additions to rate base, incremental depreciation, and interest expense being added to 2022 Cost of Service approved rate base and revenue requirement. The OEB seeks further clarity as to the impact to ELK Energy's ROE should the OEB deny its proposed PILS treatment or approve its proposed PILS smoothing methodology as indicated in Reference (3).

Questions:

a. Please explain in detail what caused ELK Energy to underperform by 10.63% relative to its deemed 8.66% ROE in the year in which it rebased its rates.

b. Please describe and detail the revitalization initiatives that cause ELK Energy to project that it will continue to underearn relative to its deemed ROE in the immediate future. Also explain the duration of the immediate future in years. Does ELK Energy's revitalization initiatives involve capital expenditures over and above expenditures identified in its Distribution System Plan at the time it rebased for 2022 rates?

c. When does ELK Energy project that it will be in a positive taxable income position? Does ELK Energy project that will be in a positive taxable income position before it rebases in 2027?

d. Using the calculation methodology in Reference (2), what would be the impact on ELK Energy's 2024 ROE under the following scenarios, should the OEB:

   i. reject ELK Energy's proposed PILS treatment? Please explain.
   ii. approve ELK Energy's PILs smoothing proposal made in its reply submission? Please explain.

Responses:

a. E.L.K. Energy's ROE underperformance in its 2022 rebasing year was driven by OM&A variances of $1.08 million, primarily resulting from 4 contributing factors: accrual of the cost for auditing services relating to Deferral and Variance Accounts (DVA), increased vegetation management, the onset of 40-year high inflation, and accrual of organizational restructuring costs. Given the relatively small size of E.L.K. Energy, the combined impact had a significant effect on 2022 ROE, driving a negative value. The following elaborates on each of these contributors:

   - **DVA Audit Accruals:** As described on page 10 of E.L.K. Energy's IRM application, the approved settlement proposal in EB-2021-0016 included a commitment to engage an external auditor to review balances in Accounts 1588 and 1589 over the 2016 to 2021 period. Over the course of E.L.K. Energy's 2023 IRM (EB-2022-0023), OEB Staff posed questions pertaining to the balances requested for disposition in E.L.K.'s other Group 1 variance accounts (Accounts 1550, 1551, 1580, 1584 and 1586) up to and including December 31, 2020. E.L.K. Energy noted to the OEB in a letter dated March 3, 2023, that it required further time to investigate the discrepancies highlighted by OEB Staff, and subsequently requested deferral of Group 1 DVA disposition in this application for the same reason. E.L.K. Energy's 2022 financial statements include an accrual for the estimated cost of auditing services relating to the above noted DVAs.
   - **Increased Vegetation Management:** As outlined in response to interrogatory Staff-6, E.L.K. Energy's proposed vegetation management budget for 2022 was $61k. However, as part of the settlement proposal in EB-2021-0016, E.L.K. Energy committed to spend at least $80k on vegetation management. In 2022 E.L.K. Energy conducted a thorough system inspection and clearing program along its primary and secondary lines, covering approximately 1/3 of its system, ultimately incurring vegetation management expenses well in excess of the committed amount.
   - **40-Year High Inflation:** At the time of preparing E.L.K. Energy's last rebasing application and evidence in late 2021 and early 2022[1], the severity and duration of inflation impacts in 2022 and beyond was not known. In the release most proximate to E.L.K. Energy's evidence preparation, the Bank of Canada stated in its December 8, 2021 overnight rate communication that it expected "[Consumer Price Index]

[1] Submitted February 4, 2022

inflation to remain elevated in the first half of 2022 and ease back towards 2 percent in the second half of the year."[2] In actual fact, Consumer Price Index inflation peaked at 8.1% in June of 2022, and remains well above the Bank of Canada's 2% target to this day. Significantly elevated inflation had a negative impact on E.L.K. Energy's 2022 ROE.

- **Organizational Restructuring Accrual:** As further described in b) below, E.L.K. Energy has undergone a refresh in leadership; beginning in late 2022 and continuing into 2023. To facilitate this, organizational restructuring costs were accrued impacting 2022 ROE.

b. As described on pages 9-10 of E.L.K. Energy's IRM application, in January of 2023 an entirely new Board of Directors was established for the utility, initially made up of six directors, later expanding to nine directors. E.L.K. Energy's new Board is skills-based, and its establishment included a competitive process to recruit its independent members. The new Board is focused on supporting employees with the resources necessary to run an efficient and effective distribution utility and bringing improved value to customers by supporting much-needed investment in the distribution system. Specifically, the Board has prioritized investment in system renewal, and modernization of the distribution grid through investment in technologies which, while new to E.L.K. Energy, are standard in the industry (e.g. the reclosers which are the subject of the ICM portion of this application). Over time, these investments will drive improvements in system reliability and customer service.

In addition to leadership changes at the Board level, E.L.K. Energy initiated management leadership changes. In March of 2023, E.L.K. Energy engaged Chatham-based Entegrus Inc. ("Entegrus") in a Management Services Agreement ("MSA") to leverage the significant experience and credibility of the Entegrus team in improving performance and outcomes at E.L.K. Energy.

Under the guidance of the new, skills-based Board of Directors, and the experienced Entegrus leadership team via the MSA, E.L.K. Energy is making the investments necessary to improve outcomes for customers now and in the future.

With respect to OM&A expenditures, E.L.K. Energy expects to invest an average of approximately $1 million in incremental OM&A (relative to what is funded in rates) in each of 2024, 2025 and 2026. E.L.K. Energy is not seeking cost recovery of these amounts during this incentive regulation term. Rather, the shareholder will bear these incremental OM&A costs. Incremental OM&A investments anticipated by E.L.K. Energy include, but are not limited to:

[2] Bank of Canada, "Bank of Canada maintains policy rate and forward guidance", December 8, 2021, https://www.bankofcanada.ca/2021/12/fad-press-release-2021-12-08/

- Additional staff recruitment, including Lines staff and Customer Service Representatives to bolster the utility's ability to manage the system and be responsive to outages and customer communications;
- Significant staff training costs to optimize the knowledge, skills and effectiveness of E.L.K. Energy's existing and incremental workforce;
- Additional cyber security costs, to meet evolving expectations and risks associated with cyber security threats;
- Additional costs associated with social media engagement, to modernize the utility's interactions with customers and meet their expectations regarding communication mediums;
- SCADA licencing costs, to improve system visibility, and subsequently enhance response and outage times; and,
- Ongoing inflationary pressures.

In addition to OM&A, E.L.K. Energy requires the expenditure of capital amounts in excess of those outlined in its 2022 Distribution System Plan (DSP) to ensure the provision of safe and reliable service to customers. As shown in tables 10, 11 and 12 of Appendix B – ICM Application (reproduced below) [3], E.L.K. Energy has produced revised capital expenditure forecasts covering the years from 2023 through 2026. Both the higher levels of OM&A described above, and the higher levels of capital expenditure described below, are expected to be incurred beyond 2026 and included in the next rebasing application, scheduled for rate year 2027.

Table 10: E.L.K. Capital Forecast 2023 to 2026 Including ICM Projects

2023 Capital Budget & Forecast to 2026				
Capital Expenditure Category	**2023**	**2024**	**2025**	**2026**
System Access (Net)	$ 833,350	$ 825,051	$ 874,554	$ 927,027
System Renewal	$ 440,000	$ 502,000	$ 472,020	$ 515,701
General Plant	$ 494,000	$ 269,540	$ 146,292	$ 135,339
System Service	$ 42,000	$ 42,000	$ 42,000	$ 56,000
Budget & Forecast Sub-Total	**$1,809,350**	**$1,638,591**	**$1,534,866**	**$1,634,068**
ICM: Fleet Vehicles		$ 884,907		
ICM: Switches		$ 485,024		
ICM Forecast Sub-Total	**$ -**	**$1,369,931**	**$ -**	**$ -**
E.L.K. Total Capital Budget and Forecast	**$1,809,350**	**$3,008,522**	**$1,534,866**	**$1,634,068**

[3] Appendix B – ICM Application, pp.34-35

Table 11: E.L.K. 2022 DSP Capital Forecast 2023 to 2026

2022 DSP Capital Forecast				
Capital Expenditure Category	**2023**	**2024**	**2025**	**2026**
System Access (Net)	$ 247,000	$ 398,000	$ 420,000	$ 445,000
System Renewal	$ 370,000	$ 452,000	$ 494,000	$ 539,000
General Plant	$ 719,000	$ 244,000	$ 117,000	$ 56,000
System Service	$ 42,000	$ 42,000	$ 42,000	$ 56,000
Budget & Forecast Sub-Total	**$ 1,378,000**	**$ 1,136,000**	**$ 1,073,000**	**$ 1,096,000**

Table 12: Capital Forecast Variance Between 2023 Forecast and 2022 DSP

Variance 2023 Forecast vs 2022 DSP Forecast				
Capital Expenditure Category	**2023**	**2024**	**2025**	**2026**
System Access (Net)	$ 586,350	$ 427,051	$ 454,554	$ 482,027
System Renewal	$ 70,000	$ 50,000	$ (21,980)	$ (23,299)
General Plant	$ (225,000)	$ 25,540	$ 29,292	$ 79,339
System Service	$ -	$ -	$ -	$ -
Budget & Forecast Sub-Total	**$ 431,350**	**$ 502,591**	**$ 461,866**	**$ 538,068**
ICM: Fleet Vehicles	$ -	$ 884,907	$ -	$ -
ICM: Switches	$ -	$ 485,024	$ -	$ -
ICM Forecast Sub-Total	**$ -**	**$1,369,931**	**$ -**	**$ -**
E.L.K. Total Capital Budget and Forecast	**$ 431,350**	**$1,872,522**	**$ 461,866**	**$ 538,068**

On review of requirements by the new Board of Directors and MSA team, it became apparent that the modernization and improvement needs of the business significantly outweigh those included within the 2022 DSP. Accordingly, the E.L.K. Energy Grid Modernization Report was developed, and implementation was commenced[4]. Further, as noted above, Net System Access expenditures, which are non-discretionary, are expected to be more than double those included in the DSP in each year from 2023 to 2026.

At the time of the preparation of this application, System Renewal capital requirements were forecast to be modestly overspent in 2023 and 2024, and modestly underspent in 2025 and 2026. Related to System Renewal, E.L.K. Energy filed an Assurance of Voluntary Compliance in 2022, which noted that in the course of OEB inspection:

[4] Please see Appendix B – ICM Application, Section 5.2 E.L.K. Grid Modernization Roadmap summary. See also the full Grid Modernization Report provided in interrogatory response to VECC-10, as well as an implementation status update in interrogatory response to Staff-10.

> "E.L.K. could not provide evidence that it regularly inspects its assets in accordance with Appendix C of the DSC. E.L.K. stated that it does not have formal asset inspection procedures in place and instead relies on verbal reporting of issues identified during inspections. E.L.K. confirmed that no documentation exists to show that inspections were scheduled or that corrective actions were taken on identified issues."[5]

As inspection practices were put in place in 2022 and continued under new E.L.K. Energy leadership over the course of 2023, the extent of System Renewal required has demonstrated itself to exceed amounts provided in Table 10, which were prepared in early 2023 for E.L.K. Energy's Board of Directors. Accordingly, the 2024 budget finalization process will include consideration of additional investment in System Renewal.

System Service capital in EB-2021-0016 was forecast at a mere $47,000 per year; an amount which can have minimal practical impact on needed reliability improvements such as those that can be enabled through the recloser switches described in this ICM application. As noted in its application and evidence, E.L.K. Energy is actively investigating plans to tie the communities of Belle River and Kingsville to second (dual) supply points and allow for recloser implementation, to mitigate loss of supply in a similar manner to the proposal for Essex and Harrow in this application. Due to the timing and uncertainty of engineering and coordination with the host distributor for this work, any costs associated with this work are currently not included in Tables 10 and 12 above.[6]

Finally, E.L.K. Energy's current capital needs also include basic General Plant requirements which cannot be accommodated within DSP forecasts, such as the installation of a back-up generator at its administrative and operational centre, or GIS, SCADA and Quadra Implementation. Though E.L.K. Energy is seeking ICM funding for 2 discrete projects in this application, significant portions of the incremental capital expenditures described above will receive no incremental funding, requiring that E.L.K. Energy's shareholders also absorb incremental depreciation and interest expense associated with these needed investments.

Despite the cost pressures outlined above, E.L.K. Energy has made all reasonable efforts to mitigate and right-size incremental expenditures; prioritizing funding where it is needed most to stabilize the utility and ensure the provision of safe and reliable service for customers. Importantly, E.L.K. Energy is confident its increased expenditures are not only prudent and good utility practice, but in line with customer needs and preferences,

[5] EB-2022-0078, Assurance of Voluntary Compliance submitted by E.L.K. Energy Inc., February 28, 2022, p.3
[6] Appendix B – ICM Application, p.34

as demonstrated by the customer engagement materials submitted in this proceeding.[7] While required investments will increase rates over time, E.L.K. Energy notes its current position as having the lowest residential distribution rate in Ontario, as well as the lowest distribution revenue per customer.[8]

In light of the investment needs outlined above, E.L.K. Energy anticipates earning less (potentially substantially less) than its OEB-approved ROE up to its next rebasing application, scheduled for rate year 2027.

c. E.L.K. Energy does not project being in a positive taxable income position for regulatory purposes (i.e. excluding the tax impact of year-to-year regulatory balance changes) until after completion of its next rebasing application, scheduled for rate year 2027.

d. Please see below:

   i. In the event the OEB were to reject any alternative solution to the ICM negative PILs issue described in evidence, the annual incremental revenue associated with the ICM requests would be reduced from $138,591 to $71,193[9], resulting in a total reduction to ICM funding of $202,194 over 3 years.[10] Utilizing the same methodology relied upon in Reference 2,[11] this would result in a further reduction to E.L.K. Energy's ROE of 191 basis points; an effect which would persist over each of 2024, 2025 and 2026.

   ii. In the event the OEB were to approve the Capital Cost Allowance ("CCA") Smoothing Proposal outlined at Reference 3, there would be no reduction to E.L.K. Energy's ROE resulting from the ICM requests. As described in Reference 3, the proposal would require E.L.K. Energy to book CCA tax deductions (which are optional deductions) in the exact amount required to negate any positive or negative PILs value arising from the investments detailed in the ICM model. By making CCA claims for the ICM projects equal to accounting depreciation plus ROE linked to the net book value of the ICM assets, E.L.K. Energy's taxable income attributable to the ICM projects will be $0. In addition to being responsive to the suggestion of OEB Staff on this

[7] EB-2023-0013, E.L.K._Letter of Comment_2024 IRM_20231122, ELK_Letter of Comment_2024 IRM_OEB_Residential_Support_20231122, Harrow_Letter of Comment_20231101
[8] E.L.K. Energy Reply Argument, pp.11-12
[9] Staff-8, p.2
[10] E.L.K. Energy Reply Argument, p.5
[11] Described on page 26 of Appendix B – ICM Application as "Based on ICM additions to rate base and incremental depreciation and interest expense being added to 2022 Cost of Service approved rate base and revenue requirement with no incremental ICM revenue." In the calculation above, $71,193 has been substituted for "no incremental ICM revenue" in the original reference

matter,[12] this approach addresses OEB Staff's concern regarding the preservation of tax benefits to be realized in future years.[13] As summarized in E.L.K. Energy's Reply Submission, "E.L.K. Energy's CCA smoothing proposal ensures E.L.K. Energy receives much needed cost recovery and cashflow, while simultaneously ensuring [Undepreciated Capital Cost] is preserved for the future benefit of the utility and ratepayers."[14]

[12] OEB Staff Submission, p.22
[13] Ibid., p.18
[14] E.L.K. Energy Reply Submission, p.14