**EB-2023-0039**

**Newmarket-Tay Power Distribution Ltd.**

**Application for changes to electricity distribution rates in the Newmarket-Tay Power and Midland Rate Zones effective May 1, 2024**

**VECC Submissions March 8, 2024**

Newmarket-Tay Power Distribution Ltd. (NT Power) filed an application with the Ontario Energy Board (OEB) on November 22, 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.

NT Power's application includes a request for incremental capital funding (ICM) required for the mandatory relocation of electrical distribution assets due to a road widening project, in the NT Rate Zone (RZ) . NT Power has also requested that the OEB approve a retroactive adjustment to correct an error in previously approved balances in its cost of power flow-through variance accounts.

VECC's submissions relate to the above two issues.

**Incremental Capital Module**

NT Power is requesting approval for an ICM for 2024 with respect to an externally-driven and non-discretionary road widening project in the NT RZ for a total estimated incremental capital expenditure of $9,277,757. The road widening requires the relocation of electrical distribution assets on Yonge Street (Davis Drive to approximately 200 metres north of Green Lane), as requested by the road authority under the Public Service Work on Highway Act ("PSWHA"). The total incremental annual revenue requirement associated with the ICM request is $785,699.

ICM Criteria

In order to qualify for ICM funding, a distributor must satisfy the OEB's eligibility criteria of materiality, need and prudence as follows:[1]

[1] OEB Report of the Board New Policy Options for the Funding of Capital Investments: The Advanced Capital Module, September 18, 2014 p.17

| | |
|---|---|
| **Materiality** | A capital budget will be deemed to be material, and as such reflect eligible projects, if it exceeds the OEB-defined materiality threshold.<br><br>Any incremental capital amounts approved for recovery must fit within the total eligible incremental capital amount (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. Minor expenditures in comparison to the overall capital budget should be considered ineligible for ACM or ICM treatment.<br><br>A certain degree of project expenditure over and above the OEB-defined threshold calculation is expected to be absorbed within the total capital budget. |
| **Need** | The distributor must pass the Means Test (as defined in the ACM Report). Amounts 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. |
| **Prudence** | 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. |

Materiality

The inflation measure (the Input Price Index or IPI) used to calculate the Price Cap Index (PCI) in the OEB-defined materiality threshold formula[2] is the OEB-approved inflation factor for the respective ICM year (i.e., 4.8% in 2024 for electricity distributors), and this inflation factor is applied to each historical year.

In its application, NT Power deviated from the above ICM policy by not using the OEB-approved IPI in determining the Price Capital Index (PCI) used to calculate the materiality threshold as it believes the recent inflation factor (4.8%) has a material impact on the resultant threshold

[2] Manager's Summary p.33

value. Rather, NT Power proposed the use of a geometric mean of IPIs calculated from 2011 to 2024 (2.12%) in the ICM Module for the purposes of calculating the threshold capital expenditure level.[3] [4]

The table below shows the variation in the materiality threshold, maximum incremental capital and revenue requirement between NT Power's geometric mean proposal (2.11%) and OEB ICM Policy (4.8%).

| **IPI** | **Geometric Mean 2.11%** | **2024 IPI 4.80%** |
|---|---|---|
| 2024 Capital Expenditure Forecast | $18,631,284 | $18,631,284 |
| Materiality Threshold | $6,812,164 | $10,556,028 |
| Maximum Incremental Capital | $11,819,120 | $8,075,256 |
| Revenue Requirement | $785,699 | $683,864 |

In its recent ICM application, Alectra Utilities Corporation (Alectra Utilities) deviated from the ICM policy by not using the OEB-approved IPI found in its most recent Price Cap IR application in determining the Price Capital Index (PCI) used to calculate the materiality threshold, but similar to NT Power proposed the use of a geometric mean of IPIs from the first incentive rate mechanism (IRM) year for each RZ.[5]

In this Decision and Order, the OEB denied Alectra Utilities proposed deviation from the 2024 inflation factor input into the ICM formula used to calculate the Materiality Threshold.[6]

Specifically, the OEB stated:

> "The OEB does not agree with Alectra Utilities' proposed replacement of the current applicable 2024 IPI with a geometric mean inflation factor in the ICM formula to calculate the maximum eligible incremental capital for the following reasons:
>
> - The OEB in the 2023 ICM decision stated that altering the inflation factor in the ICM formula could best be considered as part of a review of the OEB's ICM policy.19 The OEB is still of that view.
>
> - The inflation factor is but one parameter in a complex formula. The OEB is not prepared to alter a single parameter in isolation. The existing ACM/ICM formula was developed

[3] Manager's Summary p. 34
[4] NT Power revised the geometric mean calculation to 2.11% in response to OEB staff interrogatory 2-1 Staff-2
[5] In response to IR 1-Staff-1b, pp.2-3, part 1 of 7, Alectra Utilities also provided another method by applying the historical years' actual IPI issued by the OEB since the last rebasing year of each RZ
[6] EB-2023-0004 OEB Decision Alectra Utilities Corporation p.2

> after extensive consultation with industry stakeholders. Any change to the formula would be best addressed as part of a review of the OEB's ICM policy.
>
> Similarly, the OEB does not agree with the OEB staff's proposed replacement of the current IPI with the use of the historic annual IPI for the same reasons set out above."[7]

For the same reasons as the OEB found in Alectra Utilities ICM application, VECC submits the OEB should deny NT Power's proposed deviation from the 2024 inflation factor input into the ICM formula and the OEB-approved inflation factor of 4.8% for 2024 should be used. NT Power's ICM request exceeds the maximum eligible incremental capital amount.

As a result, NT Power is eligible to recover $8,075,256 of the 2024 forecast ICM project costs of $9,277,757, $1,202,501 less than NT Power's request.

Project-Specific Materiality and Significant Influence on Operations

NT Power submits that the Yonge Street Road Widening project is clearly material on a project-specific basis, with a significant influence on company operations.

NT Power indicates the Yonge Street Road Widening project budget of $9,277,757 makes up 44.3% of NT Power's total capital expenditure forecast of $21.48 million in 2024 for all rate zones, and 49.8% of the capital expenditures forecast of $18.63 million[8] in 2024 for NTRZ.[9]

VECC agrees the amounts in question meet the project-specific materiality criterion.

**Need**

Means Test

If a distributor's most recently available regulated return on equity (ROE) exceeds 300 basis points above the deemed ROE embedded in the distributor's rates, then funding for any incremental capital project would not be allowed.

NT Power's 2022 regulatory ROE was calculated to be 7.29%, 222 basis points below a deemed ROE for NT Power of 9.51%.

VECC submits NT Power has met the means test.

NT Power describes the Yonge Street Widening project as a discrete project, non-

[7] EB-2023-0004 OEB Decision Alectra Utilities Corporation p.10
[8] Appendix B
[9] Manager's Summary p. 36

discretionary and above the basis on which rates were set. NT Power is obligated to remove, relocate, or reconstruct distribution system assets to accommodate projects conducted by road authorities as defined under the PSWHA. VECC concurs the requested ICM amount is directly related to this driver. NT Power further indicates the project is also material, and not part of a typical, annual capital program and is not funded through existing rates.

VECC agrees NT Power's capital investment needs for this project are not funded through existing distribution rates. In 2024, NT Power budgeted $80,000 for one other road relocation project for the Town of Newmarket. The amount budgeted in base rates for road relocation work is less than this amount.[10]

**Prudence**

The total budget for the Yonge Street Road Widening project is $16.055 million, with a 2024 forecast budget of $15.69 million. The balance of $0.365 million[11] was spent in prior years (2018 to 2023).

This ICM road widening project covers approximately 2.1 km from Davis Drive to approximately 200m north of Green Lane.[12] Subcontractors began construction in November 2023, and the latest in-service forecast is October 2024.[13]

At Appendix A, NT Power provided the ICM Business Case, which references an initial road widening relocation project on Yonge Street from Davis Drive to Sawmill Valley Drive/Savage Road that was completed in October 2017. The project involved installation of 55 concrete poles and approximately 3.2 km of overhead primary cables.[14]

In an effort to compare costs between the two projects on Yonge Street in the Business Case, VECC prepared the following table.

| Yonge Street Road Widening | Km | # Poles | Completion Date | % Underground | Gross Capex ($ M) | Capital Contribution ($M) | Net Capex ($M) |
|---|---|---|---|---|---|---|---|
| Davis Drive to Sawmill Valley | 3.2 | 55 | 2017 | 18% (550 m)[15] | $9.775[16] | $7.427 (76%) | $2.348 |

[10] VECC 1-f & g
[11] Manager's Summary p.36 Table 8.5
[12] Appendix A p. A-2
[13] VECC 1-e
[14] Appendix A p. A-2
[15] VECC-2 b
[16] VECC- 2 a

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Drive/Savage Road | | | | | | | |
| Davis to Green Lane | 2.1 | 68[17] | 2024 | 19%[18] | $16.055[19] | $6.534 (41%) | $9.521 |
| *Variance* | | | | | $6.28 | | |

The project characteristics for the two road widening projects on Yonge Street appear to be comparable, however, the costs are not. It seems the cost to undertake similar work over a shorter distance (2.1 km) in 2024, compared to 3.2 km in 2017, is 64% more costly (gross costs) than the 2017 project. And the percentage in capital contributions for the 2024 project (41%) are significantly less than the 2017 project (76%).

This ICM project was included in NT Power's 2020-2024 DSP at a cost of $9 million, less capital contributions of $5.5 million (61%), for a net capital expenditure of $3.5 million, for work over the 2021 to 2023 period. NT Power indicates variances between $3.5 million at the time of the DSP and $9.52 million now, an increase of 172% can be attributed to cost increases due to COVID-19, inflation, the war in Ukraine, additional scope to accommodate the relocation of existing customer services, and the final scope of work associated with the project.[20] The increase in costs for the ICM project since the DSP are concerning and in VECC's view beyond the cost drivers provided by NT Power.

VECC submits the project characteristics and reasons for the variance in costs needs to be further clarified before the OEB can determine if the forecast amount for this ICM project is reasonable and prudent. VECC asks that NT Power provide a comparison in the scope of work in its reply submissions between the two road widening projects on Yonge Street (2017 and 2024) to explain the increase in costs for the 2024 ICM project compared to the 2017 project.

NT Power considered three options for the project: Status Quo; installation of underground feeder cables in place of an overhead system; and the (recommended solution) to relocate Overhead and Underground Assets based on current configuration.

NT Power indicates if this project is not approved, this mandatory work will still need to be completed to comply with the Distribution System Code and PSWHA. NT Power would need to reassess other planned projects, and whether, and to what extent, these projects would have to be deferred and the resulting impact on customers.

NT Power proposes that the rate riders associated with ICM funding be effective May 1, 2024, through to the effective date of NT Power's next rebasing application. VECC takes no issue with this proposal.

[17] Appendix A p. A-2
[18] VECC- 3 b
[19] Manager's Summary p. 36
[20] VECC – 1d

In summary, VECC submits NT Power has passed the Materiality and Needs test for the ICM project and $8,075,256 of the 2024 forecast ICM project costs are eligible for recovery, provided the OEB is satisfied the forecast project costs for the ICM have been reasonably established based on a comparison to the 2017 project in the Business Case. VECC could not reach this conclusion based on the evidence. The net capex for the 2024 projects is three times that of the 2017 project ($2.348 M vs $9.521 M). This needs to be further explained.

**Retroactive Adjustments to RSVA 1588 and 1598**

NT Power seeks total Group 1 disposition of $5,435,652 ($4,373,785 for NTRZ and $1,061,868 for MRZ).[21] The disposition requested relates to principal balances as at December 31, 2022, plus any adjustments identified in the application, along with the carrying charges projected to April 30, 2024.

Included in the Group 1 account disposition request is a proposal to recover a retroactive adjustment of $768,874 in NTRZ, associated with an accounting error that impacted the 2020 Group 1 account balances. The 2020 balances were approved for disposition on a final basis as part of NT Power's 2022 IRM application (EB-2021-0044).

In December 2020, NT Power accrued a credit amount of $768,874 in its variance accounts 1588 and 1589, to account for the impact of the Class B Global Adjustment credit (in the form of Charge Type, or CT, 2148). In September of 2021, the IESO confirmed to NT Power that the adjustment in question was actually included in a CT 2148 credit within the December 2020 IESO invoice and not in a pending CT 2148 adjustment as originally anticipated. NT Power realized the implications of this when preparing its 2021 GA Analysis Workform as part of its submission for its 2023 IRM Rate Application.[22]

The OEB will determine on a case-by-case basis whether to make a retroactive adjustment based on the particular circumstances of each case, including factors such as:[23]

- whether the error was within the control of the distributor
- the frequency with which the distributor has made the same error
- failure to follow guidance provided by the OEB
- the degree to which other distributors are making similar errors

NT Power does not suggest that the error was outside of its control. NT

[21] Manager's Summary p. 12

[22] Manager's Summary p. 17-18

[23] OEB's October 31, 2019 letter titled "Adjustments to Correct for Errors in Electricity Distributor "Pass-Through" Variance Accounts After Disposition

Power indicates it should have corrected its 2020 balances during the 2022 IRM proceeding, and regrettably it did not.[24]

In VECC's view, NT Power should bear some of the cost of the error. VECC suggests a 25% reduction in the principle amount would be appropriate. Further, VECC submits the OEB should deny recovery of the interest related to the adjustment so NT Power doesn't earn interest on its own error.

[24] Manager's Summary p. 19