EPCOR Natural Gas Limited Partnership

Cost of Service Application
EB-2024-0130
July 18, 2024

Exhibit 10 – Incentive Rate Setting Proposal

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Contents

10.0 Incentive Rate-setting Proposal

Consistent with its most recently approved Cost of Service Application (EB-2018-0336, Exhibit 10), ENGLP is proposing a Price Cap Incentive Rate-setting Plan ("**Price Cap IR Plan**") for its Aylmer business unit, which is based on the OEB's guidance on IRM's for electricity distributors.

In accordance with the OEB's Renewed Regulatory Framework ("**RRF**"), ENGLP is proposing a Price Cap IR Plan that is materially aligned with the OEB's Filing Requirements for Electricity Distribution Rate Applications – 2023 Edition for 2024 Rate Applications, Chapter 3 Incentive Rate-setting Applications dated June 15, 2023 ("**Chapter 3: Incentive Rate Setting Applications**") for the purpose of setting rates throughout the five-year period covered by this Application.

ENGLP proposes that, with the 2025 Test Year as the re-rebasing year, rates for its Aylmer business unit for year one (2025 Test Year) of the five-year period covered by this Application will be as applied for, or as otherwise approved by the OEB. Rates for each of the subsequent four years through to December 31, 2029 (the "**Price Cap IR Plan Term**") will be adjusted annually by applying the elements of this proposed Price Cap IR Plan.

The elements proposed for the Price Cap IR Plan for ENGLP Aylmer business unit are:

a) an annual adjustment mechanism or Price Cap Adjustment;
b) specified Y-factors;
c) use of Z-factor adjustments;
d) tax changes;
e) use of an incremental capital module; an earnings-sharing mechanism; and
f) an earnings dead band off-ramp.

These elements are described in more detail in the sections that follow.

10.1 Annual Adjustment Mechanism

ENGLP is proposing an annual rate adjustment for its Aylmer business unit using a Price Cap Adjustment ("**PCA**") mechanism which is determined by an inflation factor less a productivity factor and stretch factor. The proposed Price Cap Adjustment formula is as follows:

Price Cap Adjustment = Inflation ("I") – [(Productivity + Stretch)("X")]

The inflation factor, productivity factor and stretch factors proposed for the calculation of the PCA annually are outlined below in Sections 10.1.1 through 10.1.3.

With the exception of Rate Class 1, ENGLP is proposing that its distribution system rates, including both fixed and variable charges are adjusted annually using the proposed PCA. For clarity, the PCA will not apply to any rate riders in effect during the Price Cap IR Term.

For of the two proposed Rate 1 classes, (R1-Residential and R1-General Service), ENGLP is proposing to increase the fixed monthly charge annually by 15% (after inflation) and to correspondingly adjust the volumetric charges to achieve a total projected revenue for the Price Cap IR year equivalent to the prior year OEB approved revenue for each Rate Class 1 increased by the PCA. Increasing the proportion of the fixed monthly charge over the Price Cap IR term in this manner follows the rate design principle the Board has implemented for electricity distributions in Ontario. The shift to a fixed distribution revenue rate for residential customers is also aligned to address the risk of stranded assets during a time of energy transition. Customers who continue to rely on having access to Natural Gas will contribute to on-going maintenance and operation of the Natural Gas distribution network.

As noted in Exhibit 8, ENGLP is proposing a $3.50 increase to the fixed distribution charge in 2025 for R1-Reseidential Customers and a $3.00 increase for R1-General Service. A 15% increase in the fixed charge (under an assumption of 2% inflation/annum), would increase as per the table below:

Table 10.1-1 Rate 1 Fixed Charge

R1-Residential	Rate	Change
2024	$20.50	
2025	$24.00	$3.50
2026	$28.15	$4.15
2027	$33.02	$4.87
2028	$38.74	$5.71
2029	$45.44	$6.70

R1-General Service	Rate	Change
2024	$20.50	
2025	$23.50	$3.00
2026	$27.57	$4.07
2027	$32.33	$4.77
2028	$37.93	$5.59
2029	$44.49	$6.56

(Calculations can be found on tab H1.1_IRM of ENGLP's rate model excel workbook).

While the fixed charge will coincidently increase at the same dollar value, the overall fixed to variable ratios for the R1 - Residential and R1 - General Service customers will deviate as ENGLP is proposing a separate rate design. The following table shows the anticipated fixed and variable distribution revenue for all years of the proposed term. With the proposed increase in fixed revenue, residential customers will continue the transition towards a fully fixed distribution structure, (94% fixed in 2029). The expectation is that a 100% fixed structure be brought forward in ENGLP's next Cost of Service Application.

In contrast, while the fixed charge will continue to increase for the R1-General Service rate class, there will still remain a large variable portion (25% variable in 2029) which is driven by the higher annual customer consumption in this rate class.

Table 10.1-2 Rate 1 Fixed Charge

R1 - Residential	Current	2025	2026	2027	2028	2029
Distribution Fixed	$246	$288	$338	$396	$465	$545
Distribution Variable	$251	$247	$208	$160	$103	$34
Total	$497	$535	$546	$557	$568	$579
% Fixed Distribution	50%	54%	62%	71%	82%	94%
% Variable Distribution	50%	46%	38%	29%	18%	6%
Increase in Fixed Revenue Percentage		17%	15%	15%	15%	15%
Increase in Distribution Revenue		8%	2%	2%	2%	2%
Increase above inflation (2%)		6%	0%	0%	0%	0%

R1 - General Service	Current	2025	2026	2027	2028	2029
Distribution Fixed	$246	$282	$331	$388	$455	$534
Distribution Variable	$1,383	$1,473	$1,519	$1,418	$1,581	$1,613
Total	$1,629	$1,755	$1,790	$1,826	$1,862	$1,899
% Fixed Distribution	15%	16%	18%	21%	22%	25%
% Variable Distribution	85%	84%	82%	79%	78%	75%
Increase in Fixed Revenue Percentage		15%	15%	15%	15%	15%
Increase in Distribution Revenue		8%	2%	2%	2%	2%
Increase above inflation (2%)		6%	0%	0%	0%	0%

10.1.1 Inflation Factor

ENGLP proposes to use the two-factor input price index methodology adopted by the OEB for electricity distributions per EB-2010-0379[1] for the calculation of the annual PCA. The methodology uses the year-over-year change in Gross Domestic Product Implicit Price Index Final Domestic Demand ("**GDP IPI FDD**") and Average Weekly Earnings ("**AWE**") in Ontario. ENGLP is proposing to base the factor on the year-over-year change in these indices. Specifically, the percentage change shall be calculated as the weighted sum of 70% of the annual percentage change in the GDP-IPI FDD for the prior year relative to the index value for the year that is two years prior and 30% of the annual percentage change in the AWE for the prior year relative to the data for the year that is two years prior. This method ensures consistency with the methodology proposed for ENGLP's Southern Bruce system, as well as with that used by Ontario electric utilities.

10.1.2 Productivity Factor

The first component of the X-factor for the PCA is the productivity factor and ENGLP proposes a productivity factor of zero for the calculation of the annual PCA for its Aylmer business unit over the Price Cap IR Term. This would also be consistent with the productivity factor assigned by the Board for electricity distributors for the last number of years. Implementing a productivity factor

[1] Report of the Board, Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors, November 21, 2013, page 7.

of zero for the Price Cap IR Term for ENGLP's Aylmer business unit ensures consistency among Ontario utilities.

10.1.3 Stretch Factor

The second component the X-factor for the PCA is the stretch factor and ENGLP proposes to maintain a stretch factor of 0.4% for the calculation of the annual PCA for its Aylmer business unit over the Price Cap IR Term.

10.2 Y-Factors

Y-factors are costs associated with specific items that are subject to deferral account treatment and passed through to customers without any PCA. ENGLP is proposing the following items be treated as Y-factors for its Aylmer operations over the five-year period covered by this Application:

- Gas Supply costs continue to be treated as a pass-through cost through the use of the PGCVA and GPRA and will be updated during the Price Cap IR Term in accordance with the Board's established QRAM process;
- Upstream transportation costs continue to be treated as pass-through for all customer rate classes (Rates 1 through 6) and for customers in Rate Classes 1-5 the PGTVA 1-5 and associated process as outlined in Section 9.1.1 of Exhibit 9, continue**;**
- Costs approved in other proceedings (i.e. DSM program costs etc.), as applicable, will continue to be implemented as part of the annual rate applications[2] through the Price Cap IR Term;
- Costs related to greenhouse gas emissions programs applicable to the utility will continue to be recorded in the GGEIDA, FCCVA and CCCVA, or other deferral or variance accounts as established through specific proceedings regarding greenhouse gas emissions programs;

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[2] Ontario Energy Board Filing Requirements for Natural Gas Rate Applications, Chapter 2 Cost of Service Applications, February 16, 2017, Section 2.10, pg. 41.

- Costs related to unaccounted for gas costs continue to be treated as pass-through for customers in rates 1-5 through the UFGVA (as outlined in Section 9.1.2 of Exhibit 9);.and

  Costs associated with participating in generic and other Board hearings that impact the utility, including Enbridge Gas (and formerly Union Gas) proceedings.

10.3 Incremental Capital Module

ENGLP proposes the inclusion of an Incremental Capital Module ("**ICM**") in its Price Cap IR Plan to address the treatment of capital investment needs that arise during the Price Cap IR Term. ENGLP will apply for rate adjustments through a proposed ICM for qualifying incremental capital investment beyond what is normally funded through approved rates consistent with the OEB-established policies on ICM for electricity distributors.[3] As noted in Exhibit 9, Tab 1, Schedule 1, the establishment of any deferral accounts required to record incremental capital assets in accordance with OEB's policies will be requested at the time of the ICM application.

Qualifying capital investments may be discretionary or non-discretionary and would be discrete projects that satisfy the eligibility criteria of materiality, need and prudence as defined by the OEB in its filing requirements. In conjunction with the criteria, ENGLP understands that it must pass the Means Test[4] established by the OEB to be eligible for incremental funding and the ICM will not be available if ENGLP's regulated return exceeds 300 basis points above the deemed ROE embedded in its rates.

The materiality criterion represents a level of capital expenditures that can be funded through ENGLP's current approved rates. ENGLP would therefore be eligible to identify projects for ICM if its proposed capital budget for the year exceeds the defined materiality threshold value. The amount eligible for incremental funding will be calculated by subtracting the threshold value in dollars from the proposed capital budget for the year.

[3] Board's Filing Requirements for Electricity Distribution Rate Applications – 2023 Edition for 2024 Rate Applications, Chapter 3 Incentive Rate-setting Applications dated June 15, 2023, Section 3.3.
[4] EB-2014-0219, Report of the Board, New Options for the Funding of Capital Investments: The Advanced Capital Module dated September 18, 2014, pg. 15.

The threshold value in dollars is calculated by applying the threshold value as a percent to the approved depreciation expense. The calculation of the threshold value as a percent is:

Threshold Value (%) = $(1+ [(RB/d) \times (g + PCI \times (1 + g))]) \times ((1 + g) \times (1 + PCI))^{n-1} + 10\%$

Where:

- Rate Base (RB) will be the approved rate base from this cost of service Application;
- Depreciation (d) will be the approved depreciation expense from this Application;
- Growth (g) is the annualized growth rate calculated as the percentage difference in distribution revenues between the forecasted distribution revenues for the 2025 Test Year and the actual distribution revenues from the most recent complete year. The growth factor is annualized by dividing by the number of years between the most recent actuals and the 2025 Test Year;
- Price Cap Index ("**PCI**") is the Price Cap Adjustment from ENGLP's most recent Price Cap IR application; and,
- Years since rebasing (n) is the number of years since the 2025 Test Year.

Over the Price Cap IR Term, ENGLP will continue to update its asset inventory and associated data, assess the infrastructure and refine its Asset Management Plan. These activities will likely result in further refinement of the USP and associated projects and programs, which may bring rise to the need for incremental capital during the Price Cap IR Term. ENGLP will request approval of a rate adjustment for forecasted qualifying incremental capital projects that are not subject to a Leave to Construct ("**LTC**") Application as part of its annual rate application under this Price Cap IR Plan, following the ICM filing requirements as defined by the OEB in "Chapter 3: Incentive Rate Setting Applications"[5] and as outlined in the OEB's

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[5] Board's Filing Requirements for Electricity Distribution Rate Applications – 2018 Edition for 2019 Rate Applications, Chapter 3 Incentive Rate-setting Applications dated July 12, 2018, Section 3.3.2.1.

ACM Report.[6] In the case of a qualifying project that requires a LTC application, the request for approval of the proposed adjustment to rates will be filed with the LTC.

10.4 Z-Factor Adjustments

ENGLP proposes the inclusion of a Z-factor adjustment in its Price Cap IR Plan for the Aylmer business unit to address material cost increases or decreases associated with unforeseen events that are outside the control of management over the Price Cap IR Term. As noted in Section 9.3 of Exhibit 9, Tab 1, Schedule 1, ENGLP proposes to continue the $50,000 event cost materiality threshold previously approved by the OEB for ENGLP's predecessor, NRG. To qualify for recovery of the relevant costs, the materiality threshold must be met on an individual event basis.

ENGLP proposes to follow the criteria outlined in the OEB's Filing Requirements for Natural Gas Rate Applications when assessing whether a Z-factor event qualifies for recovery:

- **Causation** – The cost increase or decrease, or a significant portion of it, must be demonstrably linked to an unexpected, non-routine event and must be clearly outside of the base upon which rates were derived;
- **Materiality** – The cost increase or decrease must meet a materiality threshold, in that the event cost must be equal to or greater than $50,000;
- **Prudence** – The cost subject to an increase or decrease must have been prudently incurred; and,
- **Management Control** – The cause of the cost increase or decrease must be: (a) not reasonably within the control of utility management; and (b) a cause that utility management could not reasonably control or prevent through the exercise of due diligence.

The process for Z-factor claims under this Price Cap IR Plan will be as outlined in Section 9.3 of Exhibit 9, Tab1, Schedule 1.

10.5 Tax Changes

[6] EB-2014-0219, Report of the Board, New Options for the Funding of Capital Investments: The Advanced Capital Module, dated September 18, 2014 at section 7.

ENGLP proposes to include an adjustment for future tax changes in its Price Cap IR Plan. ENGLP proposes that the impacts of legislated tax changes that occur over the Price Cap IR Term as compared to ENGLP's tax rates known at the time of this Application and embedded in the base rates approved by the OEB under this Application be shared 50/50 between customers and ENGLP. ENGLP proposes that these amounts be recovered from or refunded to customers through the use of a fixed monthly rate rider (calculated annually as applicable) implemented for a 12-month period.

10.6 Earnings Sharing Mechanism

As part of the previous filing, ENGLP was approved for an earnings sharing mechanism, and corresponding deferral account. ENGLP proposes to include an earnings sharing mechanism as part of this application, largely consistent with the previously filing. ENGLP has included a proposed revised accounting order in Exhibit 1.

10.7 Earnings Dead Band Off-Ramp

ENGLP proposes continuation of the earnings dead band off-ramp mechanism and consistent with the off-ramp outlined in the OEB's "Chapter 3: Incentive Rate Setting Applications for Electricity Distributors".

Under this mechanism, 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. The OEB will monitor the results filed by ENGLP as part of the reporting and record-keeping requirements and will determine if a regulatory review is warranted.

ENGLP will refrain from seeking an adjustment to its base rates through its Price Cap IR Plan if cumulative earnings are in excess of the dead band during the Price Cap IR Term unless it has reason to believe that such an adjustment can be substantiated in consideration of the excess earnings.