



EB-2011-0099

IN THE MATTER OF a proceeding initiated by the Ontario Energy Board to set distribution rates for E.L.K. Energy Inc.

BEFORE: Paula Conboy
Presiding Member

Ken Quesnelle
Member

DECISION AND PROCEDURAL ORDER No. 2

On July 18, 2011 the Ontario Energy Board (the “Board”) on its own motion issued a Notice of Proceeding and Order Respecting Interim Rates (the “Notice”) to make an order fixing just and reasonable rates for E.L.K. Energy Inc. (“E.L.K.”) pursuant to sections 19 and 78 of *Ontario Energy Board Act, 1998*. The Board assigned this proceeding File No. EB-2011-0099.

The Notice set out the underpinning circumstances and a number of Board expectations for the proceeding, namely that:

- (i) E.L.K. would file its 2012 cost of service application in a timely manner, with the reminder that the deadline for filing cost of service applications for 2012 rates was August 26, 2011;
- (ii) E.L.K.’s levels of return for 2009 and 2010, as calculated by E.L.K., were 700 basis points above the rates that underpinned E.L.K.’s approved rates for 2009 and 2010; and,
- (iii) the issue of any over earnings for the remainder of the 2011 rate year, and the appropriate remedy (if any) to such overearnings would be an issue that may be explored in E.L.K.’s application for 2012 rates.

In this regard, the Board also declared E.L.K.'s existing rates interim effective July 18, 2011 pending the hearing of the application to be filed by E.L.K. The Board denied E.L.K.'s March 30, 2011 request to defer its scheduled 2012 cost of service rate setting proceeding on the basis of the company's demonstrated over earning and that the Board had not received an application to demonstrate otherwise. In that E.L.K. was originally scheduled to have its rates reset effective May 1, 2012 through a cost of service proceeding, the Board was concerned with the potential for customers being required to initially pay more than need be and the related issue of intergenerational cross subsidies that arises when current customers leave the system.

On April 25, 2012 the Board issued Procedural Order No.1 ("Procedural Order") as of which date the Board had not yet received a cost of service application from E.L.K. The Procedural Order indicated that, based on its reasons for denying E.L.K.'s request for deferral, the Board was considering, subject to any submissions from E.L.K. on the matter, the merit of adjusting E.L.K.'s existing interim rates (base monthly service charge and base distribution volumetric rate for all customer classes) downward by 14.2% effective June 1, 2012.

On May 8, 2012, E.L.K. filed a response with the Board. E.L.K. submitted that the proposed 14.2% rate decrease was inappropriate and that the Board should maintain E.L.K.'s distribution rates at their current levels on an interim basis pending the Board's disposition of E.L.K.'s 2012 cost of service distribution rate application which it expected to file by September 2012.

E.L.K. indicated that in the course of preparing its 2011 financial statements E.L.K. and its auditors determined that the 2010 financial statements contained an error regarding the booking of certain cost of power and wholesale market services costs which resulted in an overstatement of earnings and revenues in 2010. E.L.K. submitted that on a restated, and corrected, basis E.L.K.'s 2010 return on equity was less than Board approved. On a corrected basis, distribution net earnings drop by \$641,968, from \$1,178,049 to \$536,081. E.L.K. calculated that on a corrected basis the return on equity decreases from 16% to 7.97%. E.L.K. also noted that its return on equity for 2011 was approximately 4.66%. E.L.K. concluded that a downward rate adjustment based on incorrect data would result in significant bill volatility due to the subsequent recovery of the associated foregone revenue and any incremental revenue requirement arising from the application for 2012 rates.

Finding

The Board's intent to order a downward adjustment in E.L.K.'s rates was informed by audited financial statements for the year ended December 31, 2010. E.L.K.'s submission of May 8th brought to light the fact that those financial statements were incorrect; having realized this, with its auditors, during the preparation of its recently finalized audited financial statements for the year ended December 31, 2011.

Based on the corrected 2010 financial statements, and the new 2011 financial statements, it now appears that E.L.K. did not earn in excess of its allowed rate of return in 2010 and the financial results for 2011 indicate the same. This is supported by the analysis provided by E.L.K. in its submission and by a further analysis prepared by the Board, attached as Appendix A, reflecting a deemed capital structure. Accordingly, based on this new information the Board finds that the interim downward adjustment to E.L.K.'s existing rates is no longer warranted. The Board retains the authority to adjust rates retrospectively back to the date of the interim rate order at the conclusion of the cost of service hearing should circumstances warrant.

The Board notes that E.L.K. indicated that it expected to file its Cost of Service application for 2012 rates by September 2012. The Board plans to proceed on this basis.

THE BOARD ORDERS THAT:

1. E.L.K.'s existing rates declared interim effective July 18, 2011 remain in place pending the hearing of the Cost of Service application for 2012 rates.
2. E.L.K. shall file its Cost of Service application for 2012 rates with the Board by September 14, 2012.

DATED at Toronto, May 29, 2012

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary

APPENDIX A

TO DECISION AND PROCEDURAL ORDER No. 2

EB-2011- 0099

E.L.K. Energy Inc.

DATED: May 29, 2012

E.L.K . Energy Inc.
Computation of Regulated Rate of Return
Revised Fiscal 2010

\$000s

Regulated net income, as per OEB Trial Balance		\$ 536,081	A	Revised 2010 earnings
Deferred income taxes				
Adjustment to interest expense - for deemed debt		(148,921)	B	
Adjusted regulated net income		\$ 387,160	C	
Rate Base:				
Cost of Power		\$ 19,951,904		Revised 2010 cost of power
Operating Expenses		\$ 2,081,909		
Total		\$ 22,033,813		
Working Capital Allowance %		15%		
Total Working Capital Allowance		\$ 3,305,072		
Fixed Assets				
Opening Balance	\$ 8,527,423			
Closing Balance	\$ 8,116,689			
Average	\$ 8,322,056	\$ 8,322,056		
Total Rate Base - 2010		\$ 11,627,128	D	
Regulated Deemed Equity (40%)		\$ 4,650,851	E	
Regulated Deemed Debt (60%)		\$ 6,976,277	F	
Regulated Rate of Return on Deemed Equity		8.32%	G = C/E	
ROE% from most recent Cost of Service application	2006 EDR	9.00%		
Difference - maximum deadband 3%		-0.68%		
<u>Interest adjustment on deemed debt:</u>				
Regulated Deemed Debt - as above	\$ 6,976,277			
Weighted Average Interest Rate	7.25%			
	\$ 505,780			
Actual interest expense as per the OEB trial balance	<u>289,953</u>			
	\$ 215,827			
Tax effect on interest expense (@ 31%)	(66,906)			
	<u>\$ 148,921</u>		B	

E.L.K. Energy Inc.
Computation of Regulated Rate of Return
Fiscal 2011

\$000s

Regulated net income, as per OEB Trial Balance	\$	316,841	A
Remove deferred income tax expense			
Adjustment to interest expense - for deemed debt		(132,524)	B
Adjusted regulated net income	\$	184,317	C

Rate Base:

Cost of Power	\$	20,088,089
Operating Expenses	\$	2,406,037
Total	\$	22,494,126
Working Capital Allowance %		15%
Total Working Capital Allowance	\$	3,374,119

Fixed Assets

Opening Balance	\$	8,116,689	
Closing Balance		7,756,722	
Average	\$	7,936,706	
Total Rate Base - 2010	\$	11,310,824	D

Regulated Deemed Equity (40%)	\$	4,524,330	E
Regulated Deemed Debt (60%)	\$	6,786,495	F

Regulated Rate of Return on Deemed Equity **4.07%** G = C/E

ROE% from most recent Cost of Service application **2006 EDR** **9.00%**

Difference - maximum deadband 3% **-4.93%**

Interest adjustment on deemed debt:

Regulated Deemed Debt - as above	\$	6,786,495	
Weighted Average Interest Rate		7.25%	
Actual interest expense as per the OEB trial balance	\$	492,021	
		307,318	
Tax effect on interest expense (@ 28.25%)	\$	184,703	
		(52,179)	
	\$	132,524	B