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

BY EMAIL

July 24, 2024

Ms. 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
Elexicon Energy Inc.
Application for 2023 Distribution Rates and Incremental Capital Funding
OEB File Number: EB-2022-0024

Please find attached OEB staff's submission on the Draft Rate Order in the above referenced proceeding, pursuant to the Decision and Order – Phase 2.

Yours truly,

Donald Lau Digitally signed by Donald Lau
Date: 2023.07.24 16:58:31 -04'00'

Donald Lau
Major Rate Applications

Encl.

cc: All parties in EB-2022-0024

ONTARIO ENERGY BOARD

OEB Staff Submission

Elexicon Energy Inc.

2023 Rates Application – Phase 2 Incremental Capital Projects

EB-2022-0024

July 24, 2024

OEB Staff Submission

Elexicon Energy Inc. (Elexicon Energy) filed its Draft Rate Order on July 17, 2023, following the OEB's Decision and Order – Phase 2 (Decision).[1] In Elexicon Energy's Draft Rate Order (DRO), Elexicon Energy requested that the OEB approve the use of the 2023 inflation factor in the Whitby Rate Zone for the incremental capital module (ICM) materiality threshold calculation.

In the Decision, dated July 6, 2023, the OEB stated that:

> The parameters used for the calculation of the ICM rates riders should reflect the currently known parameters, such as the approved 2023 rates, 2022 billing determinants and the most up-to-date inflation factor.[2]

On June 29, 2023, the OEB released the 2024 inflation parameters.[3]

In filing the DRO, Elexicon Energy stated that the impact of using the 2024 inflation parameters for the Whitby Rate Zone is that Elexicon Energy would receive no incremental capital funding, despite being approved for $2.4 million in ICM eligible expenditures.[4] Elexicon Energy submitted that it is materially harmed by "the most up-to-date inflation factor" aspect of the Decision and that had the 2024 inflation parameters been available and the impacts they have on the ICM models known, these new facts would have resulted in a change to the Decision.

OEB staff makes the following submissions on the issues:

Whitby Rate Zone

Elexicon Energy proposes to continue using the 2023 inflation factor for the Whitby Rate Zone. Elexicon Energy believes that there is an error in the design and logic of the materiality threshold formula and if not corrected would fail to appropriately factor in the cumulative, multiplicative impact of the price cap index over the years since the Whitby Rate Zone last rebased. Elexicon Energy also believes that the outcome of the materiality threshold when using the 2024 inflation factor is inconsistent with the spirit and intention of the Decision.

OEB staff notes that the intent of the materiality threshold is to calculate how historical Price Cap IR adjustments (i.e., historical Input Price Index (IPI)) and growth have affected the level of depreciation expense being recovered in current rates, from the level of depreciation expense recovered as part of the revenue requirement

[1] EB-2022-0024 Decision and Order – Phase 2, July 6, 2023
[2] *Ibid*, p. 28
[3] OEB Letter – 2024 Inflation Parameters, June 29, 2023
[4] EB-2022-0024 Decision and Order – Phase 2, July 6, 2023, pp. 14-16

underpinning approved rates at the utility's last rebasing.[5] The higher the price cap adjustment (due to higher IPI) and/or growth, the higher the depreciation expense that is recovered in rates. This results in a higher level of capital expenditures that can be funded through current distribution rates. In turn, this reduces the amount of capital expenditure that would require incremental capital funding, all else being equal.

With respect to the inflation factor that should be used in the calculation of the ICM materiality threshold calculation, OEB staff notes that the Decision did not state that either the 2023 or 2024 inflation factor should be used. Rather, it said to use the "the most up-to-date inflation factor". Based on the record of this proceeding, OEB staff had understood that the 2023 inflation factor was intended to be used because:

- The Decision found that Elexicon Energy met the criteria of Materiality in approving an exception to the ICM funding policy and practice **in 2023** [Emphasis Added].
- Throughout the entirety of the application, only the 2023 inflation factor is on the record.
- While the 2024 inflation factor was issued prior to the Decision, the 2024 inflation factor does not come into effect for setting rates until 2024.
- The OEB approved the $8.8 million in ICM funding which was based on the use of the 2023 inflation factor. If the 2024 inflation factor of 4.8% were to be used in this application, there would be a material decrease ($2.4 million) in the amount of ICM funding available to Elexicon Energy.[6]

As a result, OEB staff does not oppose Elexicon Energy's request to use the 2023 inflation factor for the Whitby Rate Zone as it is consistent with OEB staff's understanding of the Decision.

However, if that understanding is misplaced, OEB staff submits that the Decision would still result in just and reasonable rates using the 2024 inflation factor. With a 4.8% inflation factor, Elexicon Energy can fund a higher level of capital expenditures through current distribution rates, which reduces the amount of incremental capital funding required.

It is important to note that using the 2023 inflation factor in this application should not be considered as setting a precedent for the application of the ICM (or capital funding option) policy in future proceedings. As for other aspects of the application already well documented on the record in the proceeding, such as the advanced application for ICM review beyond the year that the ICM-funded assets will enter service, the application

[5] EB-2007-0673, *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, September 17, 2008, pp. 27-28.
[6] This is because the Whitby Rate Zone has not rebased since 2011 and historically has not experienced an inflation factor of 4.8%. Using the 2024 inflation factor would therefore inflate the materiality threshold value, relative to the impact that actual historical price cap rate adjustments and growth have had on rates and revenues.

has been unique and extends the capital funding option policy in ways that were never considered and for which the policy and the associated ICM methodology was not designed. The application, and points raised by Elexicon Energy in the DRO, demonstrates some of the unintended consequences – and which themselves have associated costs, which ultimately will be borne by someone. OEB staff submits that the OEB should make it clear that its determinations in this case, including necessary variations in the application of the ICM policy and model, with changes, should be seen as being unique to this case, and not setting a precedent on the application of the capital funding policy.[7]

OEB staff has reviewed both of the ICM models for the Whitby Rate Zone and has no issues with the calculations. However, OEB staff wishes to make submissions on various matters addressed in Elexicon Energy's DRO.

Other Input Price Index Calculations

Elexicon Energy's point in making its proposal in the DRO, or alternatively to be dealt with if the OEB wishes to treat the filing as a Motion to Review, is that the ICM materiality threshold assumes the current inflation factor (Input Price Index or IPI) applies for all years since the last rebasing. Elexicon Energy then quotes from the Report of the Board on New Policy Options for the Funding of Capital Investments: Supplemental Report (Supplemental Report),[8] and characterizes the materiality threshold formula as being in "error".[9]

OEB staff submits that the formula is not in error. Both with the original ICM policy developed in 2008, and as updated as capital funding options with the Advanced Capital Module (ACM) and the capital funding options, originally and the Supplemental Report, the decision to use the current IPI in calculating the ICM materiality at the time of any ICM application was a conscious decision of the OEB in setting and then updating the policy. The conscious decision to use the current IPI allowed for a simpler and more practical formula, and where no material issue of inflation volatility was identified for the simple reason that inflation was relatively stable around the Bank of Canada's target of 2%. The stability of inflation from about 2007 up until the onset of the COVID-19 pandemic has been documented in other proceedings.[10]

[7] OEB staff acknowledges that the capital funding option policy is a policy and can be deviated from based on the circumstances of any application, if the OEB panel hearing cases finds that variances from the policy are warranted and supported. See EB-2009-0084*, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, December 11, 2009, p. 13
[8] *Report of the Board on New Policy Options for the Funding of Capital Investments: Supplemental Report*, January 22, 2016
[9] DRO, page 7, para. 21
[10] EB-2019-0018, Exhibit K3,1/Tab 2 and associated Excel spreadsheet, and EB-2021-0212, Procedural Order No. 1, Schedule B, *Preliminary Calculations of 2022 Inflation Factors for 2022 Non-Cost of Service Rate Adjustment Applications Fact Sheet of Statistics Canada and Bank of Canada Data and Description*

For infrequent ICM and ACM applications, and with only three years between rebasing applications (during 3rd Generation IRM until 2013, and for four years between rebasing applications (from 2014 onwards), the practical advantage of using the current IPI generally outweighed potential negative outcomes in light of stable inflation when the capital funding option was established and subsequently updated.

The situation we are facing here reflects a number of factors that are different from the conditions that existed when the policy was developed and subsequently updated, and for which the policy and methodology were not designed to have the necessary flexibility. Simplicity and practicality were chosen over a more flexible but more complex approach.

As noted earlier, OEB staff agrees with Elexicon Energy's ICM model calculations for the Whitby Rate Zone assuming either the 2023 electricity IPI of 3.7% or the recently announced electricity distribution IPI of 4.8%. However, OEB staff wishes to point out some issues with respect to the comparator analyses of historical rate adjustments that Elexicon Energy has documented.[11] These are the following:

- Actual PCI (Price Cap Index)
- Geometric mean (Geomean) of the PCI since Whitby Hydro's last rebasing from 2011. Elexicon Energy calculates the geomean from 2012 to 2025 to be 1.95%.
- Arithmetic mean of the PCI since Whitby Hydro's last rebasing from 2011. Elexicon Energy calculates the arithmetic mean from 2012 to 2025 to also be 1.95%.

Table 2 in the DRO shows Elexicon Energy's calculations on the differences in the ICM materiality threshold using the 2023 and 2024 IPIs versus these historical comparators.

OEB staff submits that Elexicon Energy has incorrectly calculated the historical geomean and arithmetic mean, due to a misunderstanding of the ICM methodology and the materiality threshold. Elexicon Energy documents the PCI for Whitby Hydro and the Whitby Hydro Rate Zone since consolidation in Table 1.[12] The PCI is the IPI - (X + stretch factor) in Table 2.

The ICM materiality threshold includes the PCI in the formula, but this is not the actual PCI used for price cap adjustments in the IRM model. As is documented in the Supplemental Report, the middle stretch factor of 0.3% is used. As is explained in the Supplemental Report, this assumption was to ensure equitable treatment for all utilities for incremental capital eligibility, ignoring whether they were better, poorer, or middle

of Possible Alternative Inflation Indices for 2022 Rates Compiled by Ontario Energy Board Staff, Appendices B, C, D, August 27, 2021

[11] DRO, page 10, Table 2: Comparison of different approaches to PCI

[12] DRO, page 8, Table 1: Actual Whitby Rate Zone PCI Values

performers. This also avoided impacts if a utility's cohort changed.[13]

OEB staff notes that Whitby Hydro and the Whitby Hydro Rate Zone were under the OEB's Annual Index, during which the 0.6% stretch factor applied. This applied for 2018 to 2022 inclusive. The stretch factors appear to be correct for other years. Once corrected for, OEB staff calculates a geomean from 2012 to 2025 of 2.05% and an arithmetic mean of 2.06%. This results in a materiality threshold of $9.05 million ($5.16 million eligible incremental capital) using the geomean and $9.06 ($5.15 million eligible incremental capital) million using the arithmetic mean. These numbers do not change the point that Elexicon Energy is raising, but the issue is not as egregious as Elexicon Energy's calculations submit. OEB staff is also unclear what Elexicon Energy's "actual PCI" analysis is based on, as, conceptually, it should equate to the properly calculated geomean.

OEB staff also has a concern with the IPI analyses all extending their values to 2025. The ICM materiality threshold assumes the most recent IPI for the ICM year that the assets enter service. In this application, Elexicon Energy is seeking approval for these projects that, as amended during the proceeding, enter service in 2025 – two years from now. We are having to assume the most recent IPI (being either 3.7% for 2023 or 4.8% for 2024) will in fact extend to 2025.

OEB staff submits that in the current post-pandemic environment, it is nearly impossible to accurately predict the rate of inflation or the volatility of the rate of change to inflation. OEB staff makes no suggestion on how to address this but points out the concern in trying to extend the ICM horizon beyond the next year.

On another matter, Elexicon Energy suggests that substantive changes are required to the ICM model to accommodate changes to address the increased volatility of inflation to get a more correct calculation of the materiality threshold (i.e., the amount of capital funded or fundable through price cap-adjusted rates) and hence of the eligible incremental capital funding. OEB staff acknowledges that it is appropriate to revisit the formula and the capital funding option policy. Not only is this impactful now, during the post-pandemic recovery, but it will persist for a number of years after, particularly in light of consolidating utilities with deferred rebasing periods.

To provide some elaboration on this point, even if inflation returns to around the 2% target within a few years, the "bump" in inflation rates for 2022 to 2024 or 2025 will multiplicatively and cumulatively grow the revenue requirement and the capital funded or fundable through rates. Using a current inflation rate around 2% in the future will then understate the impact of three or four years of much higher inflation, and thus will then have the opposite effect by understating what is fundable through rates and hence overstating eligible incremental capital.

[13] Supplemental Report, pages 17-18, The 0.3% stretch factor is fixed on Tab 1 of the model. Elexicon Energy did its comparator analyses outside of the ICM model

OEB staff notes that the ICM or capital funding options policy has been around for nearly fifteen years. The policy was reviewed and updated in the 2014-2016 period. There have been a fair number of applications for ICM, ACM and analogous applications (e.g., EB-2019-0018). OEB staff submits that the issues that Elexicon Energy are not new, and that changes in the policy and the models, while not insubstantial, are not as complex as Elexicon Energy suggests. A review and change in the generic policy that applies as frequently and as importantly as the capital funding option policy should not be done in the application of an individual utility. OEB staff also notes that the ICM update is on the OEB's prioritization list for updating adjudicative policies.

Veridian Rate Zone

Elexicon Energy updated the materiality threshold calculation with the 2024 inflation rate. Elexicon Energy also submitted that the capital expenditures for the Veridian Rate Zone should be $43.7 million and not $40.6 million and was corrected as part of the Oral Hearing Undertakings.[14] Elexicon Energy has updated the ICM model and notes that this update has no bearing on any subsequent calculations and is for the completeness of the record.

OEB staff has reviewed the Oral Hearing Undertakings and agrees that there was an update to the capital budget for the Veridian Rate Zone. However, OEB staff notes that Elexicon Energy used $40.6 million as the capital budget for the Veridian Rate Zone in its argument-in-chief, which likely resulted in confusion as to the appropriate number.[15] Given that Elexicon Energy has now confirmed that the appropriate number is $43.7 million, OEB staff agrees that such number should be used.

OEB staff submits that the Veridian Rate Zone ICM model should also use the 2023 inflation factor for the reasons outlined above. By using the 2023 inflation factor, the maximum eligible incremental capital is increased to $17.6 million and does not affect the ICM amount in the Veridian Rate Zone.

OEB staff has reviewed the other aspects of the ICM model for the Veridian Rate Zone and has no issues.

~All of which is respectfully submitted~

[14] EB-2022-0024 Oral Hearing Undertakings J1.1
[15] Elexicon Energy Argument in Chief, Table 7