Q. Please provide information on how other jurisdictions in Canada, whether under cost of service or performance-based regulation, adjust customer rates between test years, specifically addressing if rates are reset to meet the mid-point of the targeted return on rate base or to recover the explicit cost increase being incurred by the utility.

A. **Introduction**

Newfoundland Power completed a jurisdictional scan of investor-owned electric utilities in Canada to determine how customer rates are adjusted between test years, including the basis for the utility's respective return. In each case, the utility's range of return is based on its return on equity ("ROE"). As such, the discussion addresses the ROE in each jurisdiction as opposed to their return on rate base.

Table 1 provides an overview of the five jurisdictions reviewed.

Table 1:
Jurisdictional Scan[1]

Jurisdiction (Utility)	Rate Setting Approach	Basis for Setting ROE	ROE	Range of ROE[2]
Ontario (Various)	PBR	AAF	9.21%	±300 basis points
Alberta (Various)	PBR	GCOC / AAF	9.28%	±200 basis points
British Columbia (FortisBC)	Hybrid	GCOC / MRP	9.65%	±150 basis points
Nova Scotia (Nova Scotia Power)	COS	GRA	9.00%	±25 basis points
PEI (Maritime Electric)	COS	GRA	9.35%	+35 basis points

Jurisdictional Scan

Ontario

Under PBR, a formula is used to set electricity rates for a specified term, typically five years, based on rates originally set after full review of the utility's cost of service (the "going-in rates"). Fundamentally, the formula allows for changes in electricity rates for inflationary increases less an efficiency improvement factor on an annual basis, without a fulsome review of utility costs and revenues.

In Ontario, the Ontario Energy Board ("OEB") has three rate setting options.[3] Two of the three rate options follow a traditional formulaic PBR approach of changing the "going-in

[1] Definitions for acronyms used in Table 1: Performance Based Regulations ("PBR"); Automatic Adjustment Formula ("AAF"); Generic Cost of Capital ("GCOC"); Multi-Year Ratemaking Plan ("MRP"); Cost of Service ("COS"); General Rate Application ("GRA"); and Prince Edward Island ("PEI").

[2] See the discussion for each jurisdiction for details on their respective range of ROE.

[3] In 2009, the OEB concluded that a formulaic approach was necessary to be able to continue regulatory oversight of over 80 utilities in Ontario. See OEB Staff Report, EB-2009-0084, *Review of the Cost of Capital for Ontario's Regulated Utilities*, January 14, 2016.

rates" annually for inflation less productivity-related factors while the third option allows a utility to follow a custom incentive rate approach.[4]

In the cost of service year, customer rates are determined using the utility's test year rate base and ROE (i.e. the mid-point), which is calculated using the AAF for that year.[5] The ROE underpinning customer rates is constant throughout the PBR term, and each subsequent year's actual achieved ROE will be compared against that "deemed" ROE until the next cost of service rebasing.[6]

The range of ROE is ±300 basis points. Earnings of more than 300 basis points from the deemed ROE may trigger a more detailed review of the utility's financial and service level performance by the OEB.[7]

Alberta

In Alberta, utilities are regulated on five-year PBR terms.[8] In addition to the inflationary increases less efficiency improvement factor ("I-X"), the PBR formula also includes a *Type 1 capital tracker* and *K-bar* capital funding provision to provide funding for capital projects in addition to the revenue provided under I-X.[9]

Similar to the approach in Ontario, in the cost of service year customer rates are determined using the utility's test year rate base and ROE. Between test years, the approved ROE derived from the AAF is factored in the PBR formula by way of the *K-bar* calculation which utilizes the utility's weighted average cost of capital.[10]

In Alberta, the range of ROE is ±200 basis points. If a utility's actual ROE is between 200 and 400 basis points higher than the ROE used to set customer rates, the utility retains 60% and customers receive 40% of the incremental earnings in that range. For

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[4] Using this option, a distribution utility can apply to set electricity rates based on a forecast of costs which is similar to the COS approach; however, the utility must demonstrate how efficiency is incorporated throughout the rate term, which is set at five years. For further information on the rate setting options in Ontario, see the Ontario Energy Board's *Handbook for Utility Rate Applications*, October 13, 2016, at pages 23 to 24.

[5] The cost of capital parameters are calculated based on the formulaic methodologies documented in the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, issued December 11, 2009. The OEB updates the cost of capital parameters for setting rates once per year. The 2024 cost of capital parameters were established on October 31, 2023.

[6] In a cost of service year, Ontario utilities may also apply for approval of additional incremental capital expenditures above the levels approved in going-in rates through the Advanced Capital Module. See the OEB's decision EB-2014-0219 - *New Policy Options for the Funding of Capital Investments: The Advanced Capital Module*, issued September 18, 2014.

[7] In its Rate-setting Policies for Consolidations, the OEB also provides that for electricity distributors deferring rebasing beyond five years, an Earnings Sharing Mechanism ("ESM") is required above 300 basis points. Under the ESM, excess earnings are shared with consumers on a 50:50 basis for all earnings that are more than 300 basis points above the consolidated entity's annual ROE. See page v of the *OEB's Handbook to Utility Rate Applications*, dated October 13, 2016.

[8] The formulaic approach applies to 12 electric and gas utilities regulated by the Alberta Utilities Commission (the "AUC"). See page 1 of AUC Decision 27084-D02-2023, October 9, 2023. Alberta's most recent PBR plan is commonly referred to as PBR3.

[9] AUC Decision 27388-D01-2023, October 4, 2023, page 106, paragraph 440.

[10] See, for example, 2.4.1.2 K-bar Accounting Test: Step 2 in FortisAlberta's *Compliance with Decision 27388-D01-2023 and 2024 Annual Rates Application* with regards to AUC proceeding 28576.

earnings more than 400 basis points above the rate-setting ROE for that year, the utility retains 20% and customers receive 80% of incremental earnings.[11]

British Columbia

FortisBC's electricity rates are set using a hybrid approach known as MRP, which combines aspects of COS and PBR.[12] Using this approach, rates are changed annually based primarily on cost of service, rather than using a formula as in PBR jurisdictions. As compared to PBR, the MRP approach allows for electricity rates to better reflect capital expenditures expected by the utility over the five-year rate plan period.[13]

For the purposes of determining annual revenue requirements and setting customer rates between test years, FortisBC utilizes its forecast rate base and debt costs along with its currently approved capital structure and ROE.[14]

Any actual earnings below or above the mid-point ROE in that year are shared 50/50 with customers through the symmetrical *Earnings Sharing Mechanism.*[15] Further, the MRP allows for a plan off-ramp to be triggered if earnings in any one year vary from the ROE by more than ±150 basis points.[16]

Nova Scotia and PEI

Nova Scotia Power and Maritime Electric are regulated under a COS model. COS rate setting requires the regulator to determine a utility's revenue requirement that reflects the amount that must be collected in customer rates, in order for the utility to recover its prudently incurred costs and have an opportunity to earn a reasonable return.

When customer rates are determined, the utility's approved ROE is used to determine customer rates.

It is Newfoundland Power's understanding that Nova Scotia Power and Maritime Electric both have limited ability to set customer rates, beyond annual supply cost mechanisms, outside of general rate application processes or otherwise directed by their respective regulators.

For example, the Island Regulatory and Appeals Commission (the "IRAC") currently approved customer rates for a three-year period, 2023 to 2025, following a full review of Maritime Electric's costs and revenues.[17] Maritime Electric's previous general rate

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[11] See page 89 of Decision 27388-D01-2023, October 4, 2023.
[12] See, for example, the British Columbia Utilities Commission ("BCUC") Decision and Order G-340-23, *FortisBC Inc. 2024 Annual Review of Rates*, December 12, 2023.
[13] See, for example, pages 54 to 73 of FortisBC's *Annual Review for 2024 Rates*, August 4, 2023.
[14] See, for example, pages 8 and 9 of FortisBC's *Annual Review for 2024 Rates*, August 4, 2023.
[15] See page 169 of BCUC Decision and Orders G-165-20 and G-166-20, June 22, 2020.
[16] Ibid.
[17] See page 2 of IRAC Order UE23-04, April 24, 2023.

application was in 2018, which proposed customer rates over a three-year period from March 1, 2019 to February 28, 2022.[18]

With respect to Nova Scotia Power, the utility applied to the Nova Scotia Utility and Review Board (the "UARB") for customer rate changes over the 2022 to 2024 timeframe.[19] It was Nova Scotia Power's first general rate application for an increase to its non-fuel rates since the UARB's decision setting 2013-2014 rates.[20]

For Maritime Electric, any earnings that exceed 9.7% (+35 basis points from the approved 9.35% ROE) during the rate setting period are recorded in a separate rate of return adjustment account for refund to customers as determined by the IRAC.[21]

Nova Scotia Power's approved regulated ROE range is 8.75% to 9.25%, based on an actual five-quarter average regulated common equity component of up to 40%. Any earnings in excess of 9.25% are refunded to ratepayers through the utility's annual Fuel Adjustment Mechanism.[22]

Conclusion

Rate-setting approaches vary by jurisdiction in Canada. However, there are fundamental similarities with respect to the ROE that is used to determine customer rates. There are also fundamental similarities as to what ROE result is considered reasonable between reviews of each utility's cost of service by their respective regulators.

In each jurisdiction, customer rates are set using the mid-point ROE, in particular when the ROE forms part of the revenue requirement calculation.[23]

Between COS reviews, an actual earned ROE is permissible within the respective ranges and mechanisms applicable in each jurisdiction.

In the Company's view, these fundamental concepts are consistent with the Board's approach to rate-setting for Newfoundland Power.

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[18] See page 2 of IRAC Order UE20-06, December 21, 2020.
[19] See UARB Decision M10431, February 2, 2023.
[20] Ibid.
[21] See page 13 of IRAC Order UE23-04, April 24, 2023.
[22] See page 41 of UARB Decision M10431, February 2, 2023.
[23] See the discussion for both Alberta and British Columbia.