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ÉNERGIR, LLC
REQUEST FOR APPROVAL OF THE SUPPLY PLAN AND AMENDMENTS TO ÉNERGIR'S TERMS OF SERVICE AND RATES R-4287-2024, PHASE 3

Dustin Madsen, CPA, CA, CPA (IL, USA), CDP, CRRA

BACKGROUND OF DUSTIN MADSEN

- More than 20 years of regulatory and accounting experience.
- CPA, CA, CPA (IL, USA), CDP, CRRA
- Testimony or major submissions filed in Canada (Alberta, British Columbia, Manitoba, New Brunswick, the Northwest Territories, Nova Scotia, and Ontario).
- Testimony or major submissions filed in United States (Arizona, Maryland, Mississippi, New York, North Carolina, Ohio, and South Carolina).

SCOPE OF PRESENTATION

- Defining the issue before the Régie de l'énergie (Régie or Board)
- Overview of formula ratemaking
- Énergir's cost variation formula (FVC)
- Indices to use in the FVC
- Productivity factor and the "gap" in revenues
- Growth factor
- Reconciliation
- Income taxes
- Summary of recommended FVC impacts

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THE ISSUE BEFORE THE BOARD

- Approval of a one-year formula to vary the costs of Énergir for 2026/27.
- Future formulas covering two-year periods after the 2027/28 rate application.
- Requirement to approve reasonable components within the formula with future consideration of additional changes.

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OVERVIEW OF FORMULA RATEMAKING

- Formula results should seek to mimic results under full cost-of-service ratemaking
- Benefits: reduced regulatory costs, improved rate predictability, longer rate effective periods, and reduced regulatory lag, among other benefits.
- Costs: reduced scrutiny, potential transfer of forecast risk, and improper or insufficient incentives to control costs.

ÉNERGIR'S FVC

$$OPEX\ CT\ t = OPEX\ CT\ t\text{-}1\ X\ (1 + I)$$

where: OPEX CT t-1 : represents the operating expense envelope authorized during the Previous CT, without the net cost of services rendered by the ASF;

I: corresponds to a weighted inflation index, composed of 75% of the growth of the EERH index (average remuneration), capped at 4.0%, and at 25% of the CPI.

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MY RECOMMENDED FVC

$$\text{Revenue}_{\text{Base t}} = \text{Revenue}_{\text{Base t-1}} * (1 + I + G_{\text{Base t}} * 75\% - X)$$

Where: I = Quebec CPI 100% weighted

G = -0.20%

X = 0.265%

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INDICES TO USE IN THE FVC

- Purpose of the index is to adjust the costs to reflect the expected future costs.
- Should reflect the cost pressures expected in the formula rate term.
- Indices can either rely on historical information, forecasts, or a hybrid.
- Can also rely on a naïve forecast based on the most recent actual data.
- **Recommendation: Use a single index of Quebec CPI calculated over the preceding 12 months.**
- **Rationale: This result is largely consistent with forecasts. Over the long-term salaries tend to trend towards the rate of inflation. Single year FVC creates risk that variances will not normalize.**
- **Alternatives: Use known salary escalation information for fiscal 2025/26. Update indices to reflect actual indices when known.**

PRODUCTIVITY FACTOR

- Intended to adjust for the effects of regulation.
- Cost efficiencies are an ordinary part of utility operations.
- Economies of scale.
- Timing of certain costs can influence escalation and influence the productivity savings.
- **Recommendation: Use a productivity factor 0.265%.**
- **Rationale: Annual savings have been achieved historically. Need to reflect efficiency gains. Exclusion of a productivity factor implies that the Board does not consider Énergir should become more efficient in 2026/27 than 2025/26.**
- **Alternatives: Rely on detailed productivity factor analysis, though this is costly and may not provide a reliable estimate that is specific to Énergir.**

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THE "GAP" AND EFFICIENCY GAINS

- In response to the Board's Request for Information No. 11 certain new information came to light:
- Per 11-2: There were lower actual operating expenses in fiscal year 2025 than were approved ($12.5 million).
- May suggest the need to normalize the approved forecast for 2025/26 for this trend.
- Also supports a productivity factor and contradicts the position that operating costs are largely fixed.
- Incorporating a more recent annualized trend of year-to-date actual costs into the FVC for operating expenses may resolve some of this issue and would be symmetrical.

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GROWTH FACTOR

- Intended to adjust revenues for changes in billing determinants.
- "Growth" does not mean an increase in the context of this factor.
- Individual costs included in the revenue requirement vary differently based on changes in growth.
- The previous formula included a growth factor.
- **Recommendation: Growth factor of -0.2% be applied to all costs, based on the change in customers in 2024, subject to a 75% weighting.**
- **Rationale: Limited current evidence of a sustained decline. No strong evidence of the impact of decline on costs. Costs should vary to some extent by reductions.**
- **Alternatives: Application of the growth factor only to capital costs. Require further study of the impacts of changes in growth on the fixed and variable components of rates.**

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RECONCILIATION OF COSTS

- Reconciliation mechanisms are designed to true up costs included in the formula or otherwise forecast and recovered in the test year.
- Reconciliations should only be used where there is a risk the formula will not reflect the actual cost experience, or when there is significant uncertainty.
- Énergir opposes reconciliations, but risk of forecast error is symmetrical.
- Risk of over or under recovery under the formula if forecasts are erroneous.
- The escalation is based on approved costs from 2025/26 not actuals.
- **Recommendation: True up all costs forecast (not included in the FVC).**
- **Rationale: Significant amount of judgment and risk with no potential for normalization in future formula years.**
- **Alternatives: Leave costs as forecast and address prudence in a future application.**

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INCOME TAXES

- Income taxes vary due to changes in income, the amount of deductible costs, tax policy and tax rates.
- Income taxes can be highly volatile from year-to-year.
- Énergir acknowledges the volatility but proposes to escalate income taxes using the FVC.
- Énergir also explained it will be undertaking a new approach in the future.
- **Recommendation: Full reconciliation of income taxes as part of the FVC. Address more precise forecasts in the next FVC application.**
- **Rationale: Income taxes are a statutory cost, and timing differences should not flow through to shareholders or customers.**
- **Alternatives: Implement a deferred tax approach to recovery of income taxes to remove volatility.**

SUMMARY OF CHANGES

($000s)	2025/26 Rate Case	2025/26 Base subject to FVC	2025/26 cost forecast	Indices	2026/27 Rate Base and Revenues
Rate base	$ 2,647,834	$ 2,493,248	$ 154,586	2.05%	$ 2,544,235
Distribution costs of the CDG	$ 8,059	$ 8,059		2.05%	$ 8,224
Other operating income	$ (4,195)	$ (4,195)		2.05%	$ (4,281)
Operating expenses excluding cost of services rendered - ASF	$ 241,536	$ 241,536		2.05%	$ 246,475
Costs of services rendered - ASF	$ 20,392		$ 20,392		$ -
Other components of the cost of ASF	$ (11,038)		$ (11,038)		$ -
Comprehensive Energy Efficiency Plan (CEEP)	$ 6,855		$ 6,855		$ -
Depreciation fixed assets	$ 157,310	$ 157,310		2.05%	$ 160,527
Depreciation deferred expenses and intangible assets	$ 80,187	$ 48,718	$ 31,469	2.05%	$ 49,714
Property taxes and other	$ 50,977	$ 50,977		2.05%	$ 52,019
Income tax	$ 24,601	$ 24,601		2.05%	$ 25,104
Return	$ 160,459	$ 151,091		2.05%	$ 154,181
Income required before GHG contribution	**$ 735,143**	**$ 678,097**	**$ 47,678**		**$ 691,964**
Contribution GES	$ (6,036)	$ -	$ (6,036)		$ -
Income required from regulated clients	**$ 729,107**	**$ 678,097**	**$ 41,642**		**$ 691,964**
				Previous simulation	**$ 695,282**
				Difference	**$ (3,318)**

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