Application for Accounting Order

London Hydro Inc.

EB-2014-0196

BOARD STAFF SUBMISSION

July 11, 2014

Background

On May 20, 2014, London Hydro Inc. ("LH") filed an application for an Accounting Order, requesting the Board to approve the establishment of three deferral and variance accounts ("DVA") relating to retiree life insurance benefits. In its application, LH indicated that it has a grandfathered retiree life insurance benefit program providing coverage to 121 existing retirees and two qualified future retirees. The term of its retiree life insurance benefit program with its current insurance provider ends December 31, 2014. The annual premium expense for its current term is $285,000. LH included $210,000 in rates in its last cost of service rate application (EB-2012-0146) for the 2013 rate year.

LH expects that it will be unlikely to renegotiate a similar contract for its continuing retiree life insurance benefits obligations without significant increases in costs. LH expects that premiums from 2014 to 2024 would exceed $5.1 million in total.[1] LH has considered options including voluntary buy-out, paid-up life insurance, self-insurance, and a combination of these options. LH management indicated that it is recommending the voluntary buy-out as its first choice, which is estimated to cost $3.8 million as at January 1, 2014. [2]

In its response to interrogatories, LH clarified why it requires three accounts depending on the option it pursues. The first account, a deferral account would be used to record all actual settlements paid. The type of settlement would vary depending on the course of action taken. For example, if a buy-out option occurred, the costs incurred to buy-out the insurance policies of the retirees would be recorded in this account. The second account, a variance account would track any amounts paid as life insurance premiums in excess of amounts provided for in rates in the last approved cost of service rate order and increased based on the IRM escalator. The third account, also a variance account would track the change in the Employee Future Benefit obligation account associated with the retirees. Employee Future Benefits, which are actuarially determined amounts for non-pension post-retirement benefits (including the retiree insurance benefits obligations) have been included as compensation expense in LH's revenue requirement in its last cost of service rate application. LH states that any amounts changing the liability will be offset within the account up to the initial liability as recorded during the first cost of service application.

[1] LH IRR Staff-4b
[2] LH IRR Staff-2d

Depending on the option LH pursues, the use of one account may be more likely than the others, although a combination of all three accounts may also be used.

Also in response to interrogatories, LH, by way of letter dated July 7, 2014, requested confidential treatment for its response to Board staff interrogatory 7a and London Property Management Association interrogatory 5a, where both interrogatories asked for a copy of the Mercer report regarding retiree life insurance options available to LH. LH sought confidential treatment of the entire report on the grounds that it contains information that could be considered personal information, confidential information or commercially sensitive information. There is no provision for submissions on confidentiality requests in the Notice of Application and Hearing and Procedural Order No. 1 issued on June 18, 2014. However, to assist the Board in this regard, Board staff will address this confidentiality request later in this submission.

Submission

Request for Deferral and Variance Accounts

In accordance with the Filing Requirements for Electricity Distribution Rate Applications, dated July 17, 2013, Chapter 3, paragraph 3.2.2.1 states that in the event an applicant seeks an accounting order to establish a new deferral/variance account, the following eligibility criteria must be met:

- Causation – The forecasted expense must be clearly outside of the base upon which rates were derived;
- Materiality – The forecasted amounts must exceed the Board-defined materiality threshold and have a significant influence on the operation of the distributor, otherwise they must be expensed in the normal course and addressed through organizational productivity improvements; and
- Prudence – The nature of the costs and forecasted quantum must be reasonably incurred although the final determination of prudence will be made at the time of disposition. In terms of the quantum, this means that the applicant must provide evidence demonstrating as to why the option selected represents a cost-effective option (not necessarily least initial cost) for ratepayers.

Board staff submits that the establishment of the DVA(s) may allow LH to track and recover a portion of its non-pension post-retirement benefits in a manner that can smooth out potential volatility in future rates. Board staff also notes that the Board has approved DVAs similar to the third account requested by LH. DVAs to record changes in the cumulative actuarial gains or losses for Other Post-Employment Benefits ("OPEB") have been approved for utilities such as PowerStream Inc., Oshawa PUC Networks Inc., Hydro Ottawa Limited, Ontario Power Generation and Enersource Hydro Mississauga Inc.[3]

Subject to Board staff's comments below regarding the purpose and mechanics of the Employee Future Benefit obligation account, and the incrementality of the costs going forward (which is reflected in the causation test), Board staff does not oppose the establishment of these accounts for three reasons.

First, while requesting recovery of a cost increase for one component of a revenue requirement in between rebasing applications would not normally be consistent with good regulatory practice, Board staff acknowledges the complexity of the pension and other post-employment benefit issues, including the question of what the appropriate accounting methodology should be for ratemaking purposes.

Second, LH has quantified the potential increases in its costs in this area and in aggregate, they would exceed LH's materiality threshold of $313,377.[4]

Third, with the use of the Mercer report, it appears that LH has been prudent in considering its options going forward as the report assesses options available to LH. The final test of prudence should be conducted at the time of disposition as only then will the Board know the option selected and the final quantum.

Board staff recommends that if the Board grants the establishment of the accounts, that LH provide a draft Accounting Order, identifying the entries in each of the accounts, in detail. Board staff also recommends a brief submission process by all parties should follow before the Board issues the final Accounting Order.

[3] PowerStream Inc. EB-2012-0161, Oshawa PUC Networks Inc. EB-2011-0073, Hydro Ottawa Limited EB-2011-0054, OPG EB-2011-0090, Enersource Hydro Mississauga Inc. EB-2012-0033
[4] EB-2012-0146 Settlement Agreement Service Base Revenue Requirement is $62,675,465. Materiality threshold applicable is $62,675,465*0.5% = $313,377

The Employee Future Benefit obligation account

LH requested three separate DVAs pertaining to retiree life insurance benefits. For the third account, in its interrogatory responses, LH stated:

> The final account represents the change in the Employee Future Benefit account associated with the retirees. Any amounts changing the liability will be offset within the deferral account up to the initial liability as recorded during the first cost of service application.…Based on the last full valuation prior to the London Hydro's first cost of service, the Accrued benefit obligation for the life insurance benefits was $3,374,000 (Valuation date September 1, 1999).

Board staff is unclear as to whether LH is requesting a variance account as indicated in its initial application or a deferral account as referenced in the above interrogatory response. Board staff is also unclear as to whether LH is proposing that the account track differences in the liability against the liability as at September 1, 1999 or the liability included in its first cost of service application after 1999.

It appears to Board staff that LH has included a liability and has been recovering actuarially determined non-pension post-retirement benefits, which includes the retiree life insurance benefits, since its 2006 cost of service application.[5]

Board staff invites LH to clarify these issues in its reply submission and also explain why it has proposed to record variances against the liability as at a date earlier than the liability included in its last cost of service rate application.

Subject to LH's reply, Board staff is of the view that the third account should be a variance account that tracks variances in the Employee Future Benefit obligation pertaining to retiree insurance benefits between the actual amount and the amount included in its rates from its last cost of service rate application for 2013 rates.

[5] RP-2005-0020/ EB-2005-0389. The 2004 audited financial statements filed by LH were the basis of its 2006 EDR application. OPEBs were included in 2004 expenses on an accounting accrual basis which was underpinned by an actuarial valuation.

Incrementality - Past Recoveries of Non-Pension Post-Retirement Benefits

The following portion of the submission is intended to assist the Board in understanding the quantum of the potential variance in the requested accounts in light of the fact that LH has effectively requested to track an incremental cost for one component of post-employment benefits (excluding pensions, i.e. OPEBs).

The Board has in the past used both the cash and accrual accounting bases for determining the OPEB amounts that underpin distribution rates. The purpose of recovering the accrual accounting amount is to recognize that employees earn their retirement benefits while working. This is a requirement of GAAP. It is not necessarily a regulatory requirement. In LH's case, the Board approved the accounting basis in LH's last two cost of service applications.

Regardless of the accounting method used, a distributor is responsible for paying the retiree benefits as they become due since ratepayers have already paid for those benefits. The distributor would not be allowed to recover the benefit amounts again when the employees retire. The principle of benefits follow costs means that a distributor will be responsible to fund future retiree costs out of the money already recovered from ratepayers for that exact purpose. If a distributor has not put aside these funds already paid by ratepayers for the specific purpose of paying retirement benefits, the distributor will have to fund the future retirement payments out of operating cash flow or bank borrowings.

In LH's case, the next scheduled rebasing application is due for 2017 rates (assuming that LH remains on the Price Cap IR option). LH has effectively requested these accounts to track the incremental impact of one component of OPEBs between January 1, 2014 and the effective date of its next cost of service rate order (likely May 1, 2017). At the time of the next rebasing, updated costs can be included in revenue requirement.

Accordingly, Board staff explored the quantum of actual recoveries by LH for all OPEBs as compared to the actual contributions paid into OPEBs in recent years assess the net cash flow impact from OEPBs to the utility.

LH has provided a table in response to Board staff interrogatory #5b. The interrogatory requested that LH compare the total non-pension post-retirement benefit expense currently included in rates to the cash contributions paid since 2010. Board staff added the "Total" column.

	2014 Forecast	2013 Actual	2012 Actual	2011 Actual	2010 Actual	Total
Cash contributions						
Life insurance	232,600	235,377	220,137	220,163	228,140	1,136,417
Health benefits	220,100	191,447	235,848	185,836	180,890	1,014,121
Paid up life	80,000	92,008	68,439	15,417	20,856	276,720
	532,700	518,832	524,424	421,416	429,886	2,427,258
Non cash						
Year-end actuarial adjustment	425,000	431,758	661,142	776,100	450,000	2,744,000
	957,700	950,590	1,185,566	1,197,516	879,886	5,171,258

GAAP accrual accounting at year-end is based on the work of actuaries. The sum of the cash contributions for the period 2010 through 2014 in the above table is $2,427,258. Board staff assumes that the sum of the cash and non-cash amounts of $5,171,258 represents the actuarially determined expense amounts. Board staff is unclear as to whether the sum represents the actual expense amounts incurred or the expense amounts included in rates.

LH rebased for the 2009 and 2013 test years. As an example, Board staff notes that the total Employee Future Benefit included for the 2013 test year was $1,071,600, different than the amount included in the above table.[6] This leads staff to believe that the above table reflects total actual expense amounts and not what was asked for in the interrogatory.

As mentioned above, LH has been recovering the actuarially determined amounts in rates since 2006. Board staff cannot confirm the amount approved for 2006 but does note that since 2009, the amount included in rates is approximately $1 million annually[7].

Assuming that the actuarially determined expense amounts in the table approximate the amount included in rates, the difference between the amount included in rates and the cash contributions made is $2,744,000. This means that LH has approximately recovered $2.7 million from ratepayers more than it has paid for retiree benefits since

[6] LH Application EB-2012-0146, Exhibit 4, Page 52
[7] LH 2009 rate application EB-2008-0235, Exhibit 4, Page 20

2010. Board staff requests LH to clarify the information presented in LH's table and to confirm Board staff's assumption and understanding derived from LH's table.

Board staff provides the following two conclusions:

First, Board staff submits that LH's exposure for the life insurance costs identified in this application for the stub period January 1, 2014 to April 30, 2017 may be entirely covered by total OPEB amounts already received from ratepayers.

However, given that LH has not yet chosen an option to address this issue, it is unclear how much the incremental cost for retiree life insurance will be for the stub period and what the exact nature of those costs would be. Therefore, Board staff has no concerns with establishing the accounts.

Second, Board staff submits that although it has no concerns in the establishment of the accounts, when LH applies for disposition of any amount recorded in the proposed DVAs, the Board may wish to consider what the incremental exposure to ratepayers should be pertaining to retiree life insurance as LH has already received recovery for OPEBs in the past This assessment may depend on whether or not the Board establishes a policy on cash versus accrual accounting method for ratemaking purposes going forward.

Board staff notes that should the Board decide to grant LH's request, the establishment of the DVA(s) do not guarantee LH that any amounts will necessarily be recovered. Board staff submits that the costs recorded in the account(s) will be subject to the three tests noted above when LH seeks clearance of the balance in the account(s) in a future proceeding.

LH indicated that multiple accounts would be required regardless of which option is selected by LH.[8] Board staff submits that since LH has not decided on which option to pursue, the separation of the three accounts may be helpful to show the transparency of the costs in a future prudence review of the costs. However, Board staff is of the view that it is more appropriate to establish one main account with three sub-accounts than three separate accounts.

[8] LH IRR Staff-2e

Should the Board grant LH's request to establish the account(s), Board Staff submits that carrying charges should not apply to the account to record the changes in the Employee Future Benefit liability as this is a non-cash item. This practice would be consistent with the Board's decisions of other OPEB-related DVAs for the utilities referenced above. Should the Board allow carrying charges to apply, Board staff is of the view that a separate carrying charge sub-account would be required for each applicable corresponding sub-account.

Confidentiality of the Mercer Report

Board staff recognizes LH's argument that Mercer, the report owner has proprietary interest in the information included in the report and that LH has agreed with Mercer to request confidential treatment of the document. However, Board staff submits the Board has consistently allowed this type of information to form part of the public record in the past.

Board staff has considered the findings of the Board in the combined decision for EB-2013-0115, EB-2013-0159 and EB-2013-0174 wherein the Board had to make a very similar determination about confidential treatment of similar information. In this case, all three applicants were requested to produce a benchmarking survey prepared by a third party, MEARIE. In its decision, the Board stated

> As set out in the Board's *Practice Direction on Confidential Filings*, it is the Board's general policy that all records should be open for inspection by any person unless disclosure of the record is prohibited by law. This reflects the Board's view that its proceedings should be open, transparent and accessible. The Practice Direction seeks to balance these objectives with the need to protect information that has been properly designated as confidential. In short, placing materials on the public record is the rule and confidentiality is the exception. The onus is on the person requesting confidentiality to demonstrate why confidentiality is appropriate.
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> The Board recognizes that the distributors have non-disclosure agreements with MEARIE. However, as noted by this Board in previous decisions, applicants must be cognizant of the fact that it is up to the Board to determine confidentiality and that when regulated entities enter into confidentiality agreements with third parties that extend to the provision of information and documents, the utility

knows or ought to know that they may reasonably be required to produce the documents as part of the regulatory process.

LH is concerned that the public disclosure of this document, even in redacted form, potentially exposes the business processes of Mercer to its competitors. Board staff submits that the onus is on LH to demonstrate this. However, LH has not presented any evidence of what or how the business processes of Mercer are exposed to its competitors. In addition, LH has not highlighted any particular areas in the report that it deems to be confidential information or commercially sensitive information. Board staff has reviewed the report and has noted that the report provides a mainly qualitative discussion of the pros and cons of the options. The methodology in the valuation of the options is not disclosed.

Board staff is of the view that the report does not hold proprietary information. However, Board staff does note that it would not object to LH redacting the certificate numbers, gender and date of birth columns shown in the retiree cost comparisons in Appendix A of the Mercer report for privacy concerns.

Board staff submits that the document's content and relevance to the matters at issue in the proceeding is a significant consideration in determining whether or not a document should become part of a public record. LH has indicated that its sole purpose in referencing this document is to give informational background to the quantum and timing of the future expenditures required. In its application, LH used information from the Mercer report to support the need for its request for DVAs. This information provides a basis of the context for the causation and materiality of the proposed DVAs, and also demonstrates to a significant degree that LH has been sufficiently prudent by considering options, as noted earlier in this submission. As such, Board staff is of the view that this report is relevant to the current proceeding and should be placed on the public record in its entirety.

\- All of which is respectfully submitted -