



London Hydro Inc.
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July 17, 2014

Ms. Kirstin Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Re: Application for Accounting Order EB-2014-0196

Dear Ms. Walli:

London Hydro Inc. ("London Hydro) hereby files its reply to the submissions by Board staff and LPMA.

This document is being filed pursuant to the Board's e-Filing Services.

Yours Truly,

Martin Benum
Director of Regulatory Affairs
London Hydro
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1 London Hydro Reply Submission

2

3 **Background**

4 On May 20, 2014, London Hydro Inc. (“LH”) filed an application with the Ontario Energy Board
5 (“OEB”) for an Accounting Order, requesting the Board to approve the establishment of three
6 deferral and variance accounts (“DVA”) relating to retiree life insurance benefits. The Board
7 assigned our application case number EB-2014-0196 and issued a Notice of Application and
8 Procedural Order #1 (“PO # 1”) on June 18, 2014. In accordance with PO#1 LH notified all
9 intervenors of record from its 2013 Cost of Service (“2013 COS”) application EB-2012-0146. LH
10 received interrogatories from Board staff and London Property Management Association
11 (“LPMA”) on June 24, 2014. LH responded to the interrogatories on July 2, 2014 and included a
12 request for the confidential filing of the “Mercer Report” in response to Board Staff IR #7a and
13 LPMA IR #5a on July 7, 2014. On July 11, 2014 LH received the submissions of Board Staff and
14 LPMA, including submission with respect to the confidential filing of the Mercer Report
15 (“Report”). The following is LH’s reply to those submissions.

16

17 **Prelude to Reply Submission**

18 LH has identified a financial opportunity as described in our application, that if successfully
19 handled may ultimately result in LH customers realizing future costs savings. LH has
20 determined that certain steps must be taken in order to pursue this opportunity. LH has
21 approached the Board requesting the establishment of three deferral and variance accounts as
22 one of those steps. The successful completion of this step will allow LH’s Management to
23 approach its Board of Directors (“BoD”) with the next step in the plan. LH management believes
24 that the opportunity afforded by knowledge of the availability to use these accounts will provide
25 our BoD some comfort in making the decision to pursue this opportunity. If unsuccessful, LH
26 management may need to review and propose alternative course.

27



1 During this application process, LH has come to learn that there are evolving accounting
2 complexities with respect to OPEB's being investigated by the Board that were not originally
3 envisioned by LH, and that there is no one simple answer to some of the questions posed by
4 Board staff or LPMA.

5
6 However LH is very optimistic that the Boards approval of our request will result in satisfactory
7 results for all affected parties in the future. We look forward to all opportunities that lie ahead.

8

9 **Board Staff – Request for Deferral and Variance Accounts**

10 As noted on page 4 Board staff submitted that they do not oppose the establishment of the
11 requested accounts for three distinct reasons. First, Board staff noted the complexity in
12 accounting methodology that Other Post-Employment Benefits ("OPEB") have with respect to
13 rate making purposes. Second, Board staff recognizes that LH's identified potential costs in
14 aggregate exceed London Hydro's materiality threshold as established in LH's 2013 COS.
15 Lastly, Board staff submits that LH appears to be acting prudently in assessing and considering
16 options available.

17
18 Board staff recommended that if the Board grants the establishment of the accounts, that LH
19 provide a draft Accounting Order, identifying the entries in each of the accounts, in detail. Board
20 staff also recommends a brief submission process by all parties should follow before the Board
21 issues the final Accounting Order. LH concurs with Board staff's recommendation.

22

23 **Board Staff – The Future Benefit obligation account**

24 Board staffs IR # 2a requested LH to describe what would be the nature of the accounting entry
25 for each of the three requested DVA accounts. Board staff has raised some questions with
26 respect to LH's response for the third variance account. LH's IR response was as follows:

27

28 The final account represents the change in the Employee Future Benefit account
29 associated with the retirees. Any amounts changing the liability will be offset within the



1 deferral account up to the initial liability as recorded during the first cost of service
2 application. Based on the last full valuation prior to the London Hydro's first cost of
3 service, the Accrued benefit obligation for the life insurance benefits was \$3,374,000
4 (Valuation date September 1, 1999).

5
6 In Boards staff's submission they submit that:

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

12
13 LH can appreciate Board Staffs confusion with respect to our request because of the complexity
14 of the accounting that belies this transaction and to segregate the 1998 Life Insurance benefit
15 component from the other components of the OPEB account. When LH will ultimately present
16 our disposition request to the Board, LH anticipates that it will have been able to properly
17 reconcile its position. That said, LH would confirm that our third request is for a deferral account
18 based on changes to the OPEB actuarial valuation accrual differences,

19 **Board Staff - Incrementality – Past Recoveries of Non-Pension Post-Retirement**
20 **Benefits**

21 LH respectfully notes that in Board staff IR#5b the request was to provide the comparison of
22 total non-pension post-retirement benefits expenses currently included in rates to the cash
23 contributions paid since 2010.

24
25 Perhaps LH was remiss in not explaining the difficulty in establishing determining the amounts
26 included in rates and hence why this was not included in the response.

27
28 In the 2009 COS application Exhibit 4 Page 20 (EB-2008-0235) LH applied for \$686,447 (Gross
29 \$926,900) in respect to OPEBs. The Boards Decision and Order reduced LH OM&A by
30 \$350,000 using the envelope approach. Potentially some component of the OPEBs would likely
31 be considered in the reduction. In addition a segment of the OPEB's are included in capital



1 which compound the itemization of the amount included in rates. The determination for the
 2 value of that component included in rate recovery requires further study. Ultimate determination
 3 of what is included in rates also requires examination of the impact of OPEBs on the PILs
 4 included in rates.

20

Table 16 - Employee Future Benefit Information

POST RETIREMENT BENEFIT INFORMATION			
	2007	2008	2009
	Actual	Bridge Year	Test Year
TOTAL Post Retirement Benefits	932,550	852,000	926,900
Adjustments			
Less: amount capitalized	218,116	224,665	240,453
Amount expensed in each year	714,434	627,335	686,447

21

5
 6 In the 2013 COS LH's Settlement Agreement item 4.1 effectively reduced OM&A expenses by
 7 \$944,562 (net \$866,562 after solar generation interest adjustment of \$78,000). This was again
 8 an envelope style reduction which LH has applied to Administrative and General Expenses.
 9 How the application of the envelope reduction will impact the amount that is presumed to be
 10 included in rates need to be determined. The settlement agreement essentially gives LH the
 11 allowance to determine where the reduction is to be derived from.

Settlement Table #8: OM&A Expense Budget

Distribution Expenses	Initial Application	IR Questions		Supplementary IR Questions	Settlement Agreement	
Distribution Expenses - Operation	8,812,161	8,812,161		8,812,161	8,812,161	
Distribution Expenses - Maintenance	7,791,680	7,791,680		7,791,680	7,791,680	
Billing and Collecting	4,849,165	4,849,165		4,849,165	4,849,165	
Community Relations	205,337	205,337		205,337	205,337	
Administrative and General Expenses	12,186,220	12,386,220	a) c)	12,386,220	11,319,658	d) j)
Total Eligible Distribution Expenses	33,844,562	34,044,562		34,044,562	32,978,000	

12

13 As noted by Board staff our original application for OPEB was identified as \$1,071,600. LH
 14 application also allocated 73.2% of total benefits or \$784,400 to OM&A expense for OPEB. The
 15 difference is capitalized.



12

Table 4-23 - Benefit Cost Increases (2009 to 2013)

Benefit Cost Changes 2009 - 2013							
	2009 Actual	2010 Actual	2011 Actual	2012 Bridge	2013 Test	Change 2009 Actual - 2013 TEST	
CGAAP							
STATUTORY							
CPP	\$ 592,453	\$ 625,721	\$ 652,348	\$ 744,000	\$ 755,400	\$ 162,947	27.5%
EI - Employer's Portion	247,290	263,655	282,663	359,100	364,600	117,310	47.4%
Employer's Health Tax	413,198	434,000	450,927	455,800	462,800	49,603	12.0%
WSIB Admin/Premium Exp	141,907	292,692	161,291	230,700	238,900	96,993	68.4%
	1,394,847	1,616,068	1,547,230	1,789,600	1,821,700	426,853	30.6%
EMPLOYEE FUTURE BENEFIT	816,594	879,886	1,197,516	1,042,600	1,071,600	255,006	31.2%
ACTIVE							
OMERS	1,374,363	1,475,067	1,692,245	2,178,700	2,445,700	1,071,337	78.0%
EI - Employee Portion	129,094	132,536	139,505	172,400	172,200	43,106	33.4%
LTD Insurance	360,170	372,891	398,405	422,800	435,500	75,330	20.9%
Life Insurance	121,228	94,615	100,662	106,500	109,700	(11,528)	-9.5%
Health and Other Benefits	1,016,913	1,210,114	1,021,299	1,151,200	1,222,000	205,087	20.2%
Employee OHIP Premiums	162,414	171,845	173,939	201,600	206,200	43,786	27.0%
	3,164,182	3,457,068	3,526,056	4,233,200	4,591,300	1,427,118	45.1%
TOTAL BENEFIT COSTS:	\$ 5,375,624	\$ 5,953,022	\$ 6,270,801	\$ 7,065,400	\$ 7,484,600	\$ 2,108,976	39.2%

13

1

6

Table 4-24 - Allocation of Benefits Costs

Benefit Cost Allocation							
	2009 Actual	2010 Actual	2011 Actual	2012 Bridge	2013 Test	Change 2009 Actual - 2013 TEST	
CGAAP							
TOTAL Benefit Cost	\$ 5,375,624	\$ 5,953,022	\$ 6,270,801	\$ 7,065,400	\$ 7,484,600	\$ 2,108,976	39.2%
Allocation to Capital and Billable	\$ 1,310,393	\$ 1,326,911	\$ 1,397,518	\$ 1,841,459	\$ 2,005,267	\$ 694,874	53.0%
Benefit Cost in OM&A	\$ 4,065,230	\$ 4,626,111	\$ 4,873,283	\$ 5,223,941	\$ 5,479,333	\$ 1,414,103	34.8%
Allocation to Capital and Billable (%)	24.4%	22.3%	22.3%	26.1%	26.8%	2%	
Allocation to OM&A (%)	75.6%	77.7%	77.7%	73.9%	73.2%	-2%	

7

2

3 LH would suggest that the determination of final value recovered in rates for OPEBs needs
 4 further determination and possible negotiation with the Board and intervenors in arriving at
 5 agreed upon values.

6



1 In Boards staff's submission they submit that:

2 Board staff is unclear as to whether the sum represents the actual expense amounts
3 incurred or the expense amounts included in rates.

4

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

7

8 LH would submit that the table provided by LH in response to Board staff IR#5b shows the
9 values recorded and estimated in LH's OMA financials. As identified by Board staff the numbers
10 present a reasonable quantum to help the Board to understand potential variances. LH would
11 submit that the ultimate determined amount may or may not be as significant as presented.

12

13 In Boards staff's submission they submit that:

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

21

22 Board staff notes¹ that should the Board decide to grant LH's request, the establishment
23 of the DVA(s) do not guarantee LH that any amounts will necessarily be recovered.
24 Board staff submits that the costs recorded in the account(s) will be subject to the three
25 tests noted above when LH seeks clearance of the balance in the account(s) in a future
26 proceeding.

27

28 LH concurs with Board staffs statements that caution is required in determining the ultimate
29 disposition of the deferral accounts. LH understands that the establishments of the DVA's do not
30 represent any guarantee of future recovery. LH intent for this application is only to follow good

¹ LPMA also comments with respect to this issue.



1 regulatory practice by notifying the Board upfront of our intent to venture into alternative action
2 and give our shareholder some comfort that our buyout proposal will be reviewed reasonably in
3 a future proceeding.
4

5 **LPMA - Submission**

6 LPMA submits that it supports LH efforts to reduce future costs, but does not support the need
7 for the requested deferral accounts. LPMA submits that LH has not provided any evidence that
8 this additional cost would cause significant harm to LH's return on equity during the IRM term.
9 LPMA submits that the Board should not approve deferral accounts for cost increases unless
10 they qualify as a Z-factor. LPMA also submits that under the IRM regime distributors like LH
11 should be expected to operate within the price cap envelope as determined under the Board
12 approved cost of service and IRM adjustment process.

13
14 LH appreciates LPMA's points and would normally concur except for the simple fact that LH
15 recognizes that it needs to serve multiple masters; the OEB and regulated entity practice, its
16 customers and ultimately its own BoD. In respect to LH's BoD, it is expected that they would not
17 be receptive to approving a potentially large disbursement when presented with alternative
18 options, one of which is to continue with the status quo. LH has the ability to continue operating
19 as is, allowing other operating savings to buoy the rising costs of the retiree life insurance
20 premiums until the next cost of service.

21
22 What LPMA is ultimately posturing to the Board is the limitation or stifling of financial creativity
23 within regulated entities, which could be financially detrimental to customers in the long run. The
24 regulatory system, by itself, can promote mediocrity by stifling financial creativity, but has
25 developed the tools to allow a regulated entity the opportunity to overcome this. LH
26 management believes the establishment of the requested deferral accounts is necessary to
27 provide some measure of assurance to our BoD that LH has the tools at its disposal to
28 safeguard their financial and fiduciary duties.



File Number: EB-2014-0196

Tab: 1

Schedule: 1

Page: 8 of 8

Date Filed: July 17, 2014

1 **Board staff/LPMA - Confidentiality of the Mercer Report**

2 Board staff, with concurrence from LPMA, has submitted that the report identified as the Mercer
3 Report and referenced in our application, should not be received as a confidential document
4 and should be placed on the public record, subject to some suggested redaction. Board staff
5 has referenced the Boards recent combined decisions about the confidential treatment of similar
6 documents.

7

8 LH appreciates the Boards position with respect to the transparency of process and
9 completeness of record. LH believes, however, that there is professional principle and ethics
10 required when one entity enters into or requests confidential consultation from another entity.
11 LH believes that it is compelled to honour the requests made by Mercer when they prepared the
12 report and made their disclaimer for confidentiality. In our confidential submission of the report
13 to the OEB on July 7, 2014 LH explains all our reasons as to why we believe the document
14 should be kept confidential.

15

16

All of which is respectfully submitted.