February 8, 2016

John Pickernell
Board Secretary
Ontario Energy Board
PO Box 2319
2300 Yonge Street, Suite 2700
Toronto ON M4P 1E4

Dear Mr. Pickernell:

Re: E.L.K. Energy Inc.
Distribution License ED- ED-2003-0015
2016 Incentive Regulation Mechanism ("IRM") Distribution Rate Application EB-2015-0064
Final Response to OEB Staff Submission

In accordance Procedural Order #1, provided below is E.L.K.'s written reply submission due prior to February 11, 2016.

Regards

Mark Danelon, CPA, CA
Director, Finance & Regulatory Affairs
Telephone (519) 776-5291 ext 204
Fax (519) 776-5640
Email mdanelon@elkenergy.com

Introduction

E.L.K. Energy Inc. (E.L.K.) filed an application with the Ontario Energy Board (OEB) on September 28, 2015 under section 78 of the *Ontario Energy Board Act*, 1998 seeking approval for changes to the rates that E.L.K. Energy charges for electricity distribution, effective May 1, 2016. The application is based on the 2016 Price Cap IR option.

Return on Equity

In its January 28, 2016 OEB response letter, the OEB wrote that on October 16, 2015 the OEB issued a letter to E.L.K. regarding regulatory return on equity. The letter stated, "OEB Audit and Performance Assessment staff concluded that E.L.K. Energy Inc.'s regulatory ROE measured 19.22% in 2014 – 1010 basis points above the target ROE that was the basis upon which its rates were established." The letter also indicated the OEB will assess the appropriateness of granting E.L.K.'s request for an incremental adjustment to its base rates for the 2016 rate year giving the earning performance measured in 2014.

In its December 29, 2015 letter, the OEB posed several interrogatories, two minor questions related to E.L.K.'s overearnings and five questions not relating to the over earnings, leaving myself with the impression that the inflationary increase would not become a significant issue in this proceeding especially due to the fact it is was an IRM.

The following two questions were posed:

1. Given E.L.K.'s Energy's over-earning in 2014 has E.L.K. considered filing to not increase its base rates for the 2016 rate year?
2. Please explain if any of the drivers are expected to continue into 2015 and 2016.

E.L.K. fully replied to both of these questions in its response dated January 14, 2016. OEB staff notes that E.L.K. did not indicate which over earnings drivers were one-time occurrences and would not persist in 2015 and 2016. E.L.K.'s position is that this question was never asked of E.L.K. in any manner.

To both VECC and the OEB, E.L.K. responded that this was a one-time occurrence and it does not expect the over-earning to persist in 2015 or 2016. There were no structural changes within E.L.K.'s business processes.

Additional Costing Facts

E.L.K. anticipation was that this IRM proceeding would not have preceded to this length after all of the time and work committed with the OEB Audit and Performance Assessment team. From a costing perspective, E.L.K. has estimated the total cost to date on this IRM, between legal affidavit's, 3rd party assistance and internal resources is in excess of $5,000 for a request of the inflationary increase of 1.6%. In prior years, an IRM application may have costed approximately $1000.

2017 Cost of Service

A tertiary point of fact, to be addressed is that of E.L.K.'s COS application scheduled for 2016 was approved for deferral into 2017 by the OEB. The OEB considered the rationale for deferral set out in E.L.K.'s letter as well as E.L.K.'s financial position, as shown in its audited financial statements and financial reporting to the OEB and E.L.K.'s 3-year performance with respect to system reliability indicators and electricity service quality requirements. Based on the aforementioned considerations, the OEB concluded that it will not require E.L.K.'s 2016 rates to be set on a COS basis. The OEB would place E.L.K. on the list of distributors whose rates would be scheduled for rebasing for the 2017 rate year. E.L.K.'s point of confusion is that if the 1.6% was of such great significance E.L.K. would not have been granted this deferral.

Looking through a lens of simplicity, the purpose of the deferral accounts is to track overpayments or underpayments and true them up at a future point in time. The last time ELK was granted permission for disposal was its 2012 COS. Therefore, at a rudimentary level, any over or under collected amount until our next COS would be a part of these deferral accounts including the minimal inflationary increase, and disposed of in next year`s application.

E.L.K. Performance

E.L.K. is currently one of the leanest and lowest cost LDC's by rates in the province. E.L.K. continues to strive to provide electricity to our customers in a safe and efficient manner at a fair and reasonable cost. This can be evidenced and proven using the OEB's website tool "Calculate your Bill". E.L.K. calculated each utility in the tool using the monthly average of 800 kWh and Time-of-use Pricing plan and the results exhibited that there were only 4 other utilities in both the Residential and Small Business Sector whose bills were lower cost than E.L.K.`s.

E.L.K. prides itself on being efficient while at the same time improving operationally and as an organization. E.L.K. has consistently met the targets of all service quality indicators and strives in being a consistent strength in this industry. Without providing the minimal inflationary increase E.L.K. would be left to fight a battle of ever increasing costs with a stagnant revenue base that could potentially affect E.L.K. in continued success of providing reliable and safe electricity to our customers at a reasonable rate.

Cash Flow

A key factor to any business is cash flow. E.L.K.'s cash flow will definitely decrease if the 1.6% inflationary increase is not granted. Costs continue to rise and rise sharply. Canada Economics is forecasting the Canadian inflationary rate to rise to 2.1% by 2020 and also specifically mentioning that transport prices which includes gasoline went up for the first time since Oct 2014. This will significantly affect E.L.K. in terms of increased cash outflow. A point of interest is that E.L.K.'s 2014 audited financial statements reported E.L.K.'s unrestricted cash decreasing approximately 44% from 2013.

The increasing cost fact as a standalone element is significant, but coupled with the region in which E.L.K. is situated possess a secondary problem which when looked at together could potentially create a significant cash flow issue. Per the government of Canada website (Service Canada), E.L.K.'s service territories fall within 2 economic regions, those being the Economic Region of Huron whose unemployment rate is currently 7.8% and the Economic Region of Windsor, whose economic employment rate is 9.9%. This represents the second highest unemployment rate in all of Ontario. This presents a challenge to E.L.K. in collections and increasing our position of stability. These rates are significantly higher than the Canadian Average of 7.1 and the Ontario Average of 6.7%. E.L.K. requires this increase to assist with managing our positive cash flow.

With no offsetting increase, E.L.K. must consider its asset management plan for 2016 and the future.

Currency Exchange

In addition, with the increase in the value of the US dollar and E.L.K. having to pay our smart metering contract in U.S. dollars this is posing an additional obstacle for E.L.K. which is likely not alone in this challenging avenue. E.L.K.'s premium of 35% due to exchange is simply a cash drain, and a challenge to manage.

E.L.K. Audited Financial Statements

What is ROE ? ROE is a measure of profitability that calculates how many dollars of profit a company generates with each dollar of shareholder`s equity. The formula for ROE is

ROE= Net Income /Shareholder`s Equity

Provided below is E.L.K.'s audited financial statements for 2014 which possess the 2013 comparatives for your review and analysis.

E.L.K. ENERGY INC.
Non-consolidated Statement of Earnings

Year ended December 31, 2014, with comparative information for 2013

	2014	2013
Service revenue	$ 26,298,875	$ 24,123,558
Service revenue adjustment	(37,670)	684,968
	26,261,205	24,808,526
Cost of electricity	22,963,742	21,152,044
Gross margin on service revenue	3,297,463	3,656,482
Other operating revenue:		
Interest and other	464,113	585,450
Late payment charges	107,336	111,041
Unrealized gain on investments	6,494	16,457
	577,943	712,948
	3,875,406	4,369,430
Expenses:		
Administration	866,088	1,012,393
Billing and collecting	592,754	593,037
Amortization	352,695	376,750
MIFRS regulatory adjustment (note 4(g))	-	625,581
Interest	310,612	369,198
Operations and maintenance	806,466	725,313
	2,928,615	3,702,272
Earnings before payments in lieu of income taxes	946,791	667,158
Payments in lieu of income taxes	115,000	229,247
Net earnings	$ 831,791	$ 437,911

See accompanying notes to non-consolidated financial statements.

		2014		2013
Liabilities and Shareholder's Equity				
Current liabilities:				
Accounts payable and accrued liabilities (note 12)	$	3,727,382	$	4,020,158
Current portion of customer deposits		193,019		193,019
Bank debt (note 7)		5,900,000		4,800,000
Shareholder promissory note (note 6)		-		1,900,000
		9,820,401		10,913,177
Long-term liabilities:				
Customer deposits		903,367		876,961
Regulatory liabilities (note 4)		132,298		3,225,359
Employee future benefits (note 8)		688,452		693,056
		1,724,117		4,795,376
Shareholder's equity:				
Share capital (note 9)		2,000,100		2,000,100
Retained earnings		905,576		73,785
Contributed surplus		4,402,375		4,402,375
		7,308,051		6,476,260
Contingencies (note 17)				
	$	18,852,569	$	22,184,813

See accompanying notes to non-consolidated financial statements.

On behalf of the Board:

Director

Director

The results of both 2013 and 2014 ROE are not in excess of the deadband by the definition of ROE for either year. E.L.K. does not have 2015 data available as E.L.K.'s audit has not yet occurred.

2013 ROE= $437,911/$6,476,260 = 6.8%
2014 ROE= $831,791/$7,308,051=11.4%

Return on Equity work with OEB Audit and Performance Assessment

Further, as previously mentioned E.L.K. worked tremendously hard and closely with the OEB Audit and Performance Assessment Team and agreed collectively on the analysis below which includes the normalization of the one-time factors. The chart shown below actually results in a under earnings of 5.33%.

E.L.K provided the OEB with a follow-up email stating that E.L.K. would want the facts below to be known so this important point is not missed at any point in the future. No response was received back from this e-mail. My belief is that the below diagram has not made it into the proceeding and is vital to our application in obtaining the inflationary increase of 1.6%.

Agreed together by OEB and E.L.K.

Normalization and One-Time Factor for ROEs of 2013 and 2014

	Reported ROE for the Year (A)	**One-Time Expense and Impact on ROE for the Year (Note 1) (B)**	**Normalization Factor: Decrease in Amortization (Note 2) as compared to 2012 CoS and impact on ROE (C)**	**Normalized and Adjusted ROE after removing the decrease in amortization expense and one-time factor (D = A +B+C)**
2013	9.2%	$625,581 (14.19% decreased of ROE)	-$588,301 (13.99% increased ROE)	9.40% (within)
2014	19.22%	None	-$612,356 (13.89% increased ROE)	5.33% (under)

Note 1: There is no one-time driver identified for the 2014 over-earning. However, there is a one- time expense identified for 2013 ROE for regulatory credit for the accounting changes under CGAAP (Account 1576) for $625,581 recorded in 2013 AFS.
Note 2: the decrease of the amortization expense was due to ELK's Change in capitalization policies in 2013, which impacts the 2013 and 2014 ROE.

Trend Analysis of ROE

E.L.K. has not been overearning year-after-year. The average ROE over the past 4 years per the OEB Scorecard is 11.10% within the +-300 deadband. On that basis and because E.L.K. is scheduled to file a COS application for 2017, E.L.K. believes the swings are not significant in nature. Reviewing E.L.K.'s ROE from 2011 to its 2014 ROE, the fluctuations do not indicate any particular trend of overearnings.

Conclusion

In conclusion, the amount of effort put into this response is indicative of the importance E.L.K. feels that the inflationary increase of 1.6% is reasonable in nature especially due to the aforementioned reasons as well as ELK going into a COS next year which will analyze everything in greater detail and make any adjustments as required. VECC confirms that an amendment to E.L.K.'s 2016 rate plan is not warranted and is not opposed to the Price Cap IR adjustment of 1.6%, and that E.L.K.'s approach appropriately responds to the interests of consumers.

Normalized for one-time factors for 2014 and agreed upon by the OEB and ELK, clearly shows an under earnings of 5.33%.

E.L.K. thanks you in advance for reviewing all of our information and evidence provided. E.L.K. is confident to continue to grow and improve and provide better service to our customers. This minimal increase will assist us in achieving our goals.