London Hydro
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October 24, 2018

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

Re: Regulated Price Plan Pilot (Board File No. EB-2016-0201) and In-Kind Contributions

Dear Ms. Walli:

We are writing to seek clarification from the Board with respect to the appropriate accounting treatment of a particular type of capital expenditure incurred by London Hydro, both in respect of a current OEB approved Regulated Price Plan Pilot - Board File No. EB-2016-0201 (RPP Pilot Project) that London Hydro is delivering to its customers and in respect of potential future projects that London Hydro may participate in. While we are hopeful that the Board can simply confirm that London Hydro's understanding of the appropriate accounting treatment is correct, if that is not possible we would humbly suggest that the Board consider initiating a generic proceeding in order to establish an appropriate resolution for the issue going forward.

During the course of London Hydro's participation in the RPP Pilot Project London Hydro was asked by the Board, when applying for project funding, whether it (or any participating 3rd party) proposed to provide any contributions to the Project. It was clear in the request that while contributions were encouraged they were not required as a pre-condition to project funding approval.

The types of contribution that were identified by the OEB were two-fold; "cash" contributions and "in kind" contributions.

London Hydro understands "cash" contributions to be injections of the contributing entities (being the OEB) cash towards the costs of the project that, once approved for funding by the OEB, would not be recoverable by the applying entity (being London Hydro) from rates. Such funding contributions would be, in essence, contributions or offsets to the project. London Hydro does not raise any issues with respect to such contributions.

With respect to “in kind” contributions, London Hydro understood there to be two ways in which such contributions could be made.

In the first instance, London Hydro understood that a distributor could make an operating “in kind” contribution by allocating existing internal resources to the project on a temporary basis, with those resources being re-allocated to normal distribution functions once no longer required for the project. For example, an operating “in kind” contribution of $15,000 could relate to the use of $15,000 worth of internal labour towards a project. The distributor is not providing $15,000 in cash to pay for 3rd party labour to work on a project; instead the distributor is providing $15,000 worth of its own internal labour force, temporarily diverted from normal distribution related activities, to work on the project. London Hydro believes it has properly understood how this type of “in kind” contribution operates and raises no issue with respect to how it is accounted for.

In the second instance, London Hydro understood that a distributor could make an “in kind” contribution by making a capital investment in assets needed for the project. In London Hydro’s view this is an example of an “in kind” contribution where the contribution is the use of the capital asset for the purposes of the project. It is with respect to this type of “in kind” contribution that London Hydro seeks clarification from the Board.

It was and continues to be London Hydro’s view that when it invests in a capital asset that is used or useful with respect to the provision of distribution services to its customers that capital investment remains eligible for inclusion in the rate base that underpins London Hydro’s distribution rates, whether or not the use of that asset is part of an OEB funded project or not.

However, during the course of the RPP Pilot Project, it was suggested to London Hydro that contributing the value of a capital investment as an “in kind” contribution may in fact disqualify the value of that investment from inclusion in rate base. This suggestion is a serious concern for London Hydro, as it, if true, fundamentally impacts on London Hydro’s ability to participate in such projects.

In the RPP Pilot Project, for example, the capital investment component of the project was a $1,679,000 in hardware and development capital costs. London Hydro proposed an “in kind” contribution by funding $345,000 of that capital investment, with the remaining $1,334,000 being provided by OEB approved funding. In making this contribution London Hydro believed that its

$345,000 investment would be treated as any other capital investment it makes and included in its regulated rate base (subject to normal regulatory requirements such as prudence), with the $1,334,000 being treated as a capital contribution that reduces the amount that is included in rate base (to the benefit of ratepayers).

The suggestion that was made to London Hydro, if true, would mean that London Hydro would have invested $345,000 in assets as part of the pilot project, but be unable to recover any of that investment cost through inclusion in rate base even though the investment may have been prudent and the assets were and remain used or useful in London Hydro's distribution activities.

In London Hydro's view it would be unreasonable to essentially prevent, as a matter of regulatory policy, distributors from taking advantage of available 3rd party funding (such as the OEB approved funding for the RPP Pilot Project) by precluding distributors from making "in kind" contributions to the project in the form of capital investments which remain recoverable in rate base. It should not be the case capital investments by a distributor that happen to attract 3rd party funding should somehow be automatically disqualified from recovery through rate base treatment. To the contrary, distributors should be encouraged to obtain 3rd party funding to offset, to the extent possible, the cost of capital investments that they make for the benefit of their customers.

In the example of the RPP Pilot Project, London Hydro could have proceeded with the full $1,679,000 capital investment as a prudent investment on behalf of its distribution customers without participating in the Pilot Project program, in which case the full $1,679,000 (subject to a prudence review in the normal course) would have been included in rate base. Instead, based on London Hydro's understanding of the appropriate accounting treatment for such investments, London Hydro sought to participate in the RPP Pilot Project with the result that it obtained a $1,679,000 capital asset for only $345,000 on behalf of its customers, a savings to its customers equal to the Project Funding of $1,334,000 towards the capital costs of the project (not to mention the benefits to customers flowing from participation in the Pilot Project).

To be clear, London Hydro is not claiming any special recovery with respect to such capital investments. In the example of the $345,000 of "in kind" contribution capital investment in the RPP Pilot Project, London Hydro is not suggesting that that capital cost should attract special recovery outside of London Hydro's existing rates, either through the use of a deferral account to track the revenue requirement of that spending or as a form of incremental capital module spending. London Hydro is only asserting that that investment would be included in its rate base in the same way all it capital spending is included in rate base; in this instance, since London Hydro rebased for the 2017 rate year and the $345,000 in spending did not go into service until 2018, this particular capital investment would not directly affect rates until London Hydro has its distribution rates rebased, currently scheduled for the year May 1, 2022.

London Hydro is hopeful that the Board can confirm that, in the specific case of London Hydro's $345,000 capital investment during the course of the RPP Pilot Project, and more generally with respect to any instance where a distributor is offered the opportunity to combine 3rd party funding to offset the costs of capital investments made for the benefit of the distributor's customers, that the residual investment made by the distributor will continue to qualify for rate base treatment as is the case in the normal course. Failing such confirmation London Hydro would request that the Board initiate a process to explore the issue and come to a generic policy in order to make clear the appropriate accounting treatment of such contributions and the rationale for that treatment, so that distributors such as London Hydro have a clear understanding as to the implications that flow from their participation in projects that involve 3rd party funding.

Yours Truly,

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