THE SOCIETY
OF ENERGY PROFESSIONALS
IFPTE LOCAL 160

31st July 2015

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VIA Canda Post, email and RESS Filing

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
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Re: EB-2015-0040 Consultation on the Regulatory Treatment of Pensions and Other Post-Employment Benefit Costs – The Society's Initial Submission

Dear Ms. Walli,

With reference to your letters of May 14 and June 10, 2015 on the subject consultation, attached please find The Society Of Energy Professionals' initial written submission in this proceeding. Please be informed that The Society believes that the establishment of an agreed set of principles at the commencement of this consultation would be a key factor in achieving a successful outcome and gaining stakeholder buy-in.

The Society looks forward to receiving details from the OEB on the next steps in what it assumes will be a fulsome consultation, as well as the overall schedule. The Society intends to participate actively in the ongoing consultation and in particular plans to attend any technical conferences and/ or working sessions which the OEB may initiate on this very important subject matter.

Thank you.

D. Kellar

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copy: Interested Parties

EB-2015-0040 Consultation on the Regulatory Treatment of Pensions and Other Post-Employment Benefit Costs

Initial Submission of The Society of Energy Professionals

I General introduction

The Society of Energy Professionals (The Society) appreciates the Ontario Energy Board's (the Board) invitation to provide comments on specific questions the Board has posed in its letter of May 14, 2015 to electricity and gas transmitters and distributors, Ontario Power Generation Inc. (OPG) and other interested parties. The Society agrees that seeking affected stakeholders' views on these questions is a useful first step in the Board's consultation on the Regulatory Treatment of Pensions and Other Post-Employment Benefit Costs for electric and gas utilities in Ontario.

The following views represent The Society's initial position on the questions posed by the Board in its May 14 letter. However, The Society reserves the right to revise or adjust its positions in response to additional information and other parties' views arising from the consultation process which the Board has initiated.

II Consultation process

The Society notes that the Board has not provided a detailed road map or timetable for how it sees this consultation developing. This is reasonable as the process and direction would appear to be to some extent contingent on the initial and evolving positions of the affected parties. Also, as the Board's May 14 letter notes, the Province of Ontario has a separate process underway which may impact on the management of pension plans for some of the utilities within the scope of the consultation.

The Society believes that the preferred path forward would be to adopt and mirror the process previously used in the Board's successful industry consultation on the "Transition to International Financial Reporting Standards" (IFRS) i.e. EB-2008-0408. This consultation involved all major stakeholders of the gas distribution and electric generation, transmission and distribution utilities. It was facilitated by Board staff and it involved the Board's external technical experts, representatives from the various affected utilities, represented employees, and other major intervenors. Process steps included information gathering from the utilities and by the external expert, development of general principles, frank and open discussions to identify and understand issues, utility presentations, and a transcripted session before the Board itself. In The Society's opinion, this consultation was successful because time was taken to establish consensus principles at the beginning of the process. These principles provided an effective framework against which specific issues could be discussed, understood and evaluated. This was particularly useful given the technical complexity of the IFRS issues identified. That technical complexity is paralleled and perhaps exceeded by the employee future benefits topic. The Society expects that the establishment of an agreed set of principles at the commencement of this new consultation will be a key factor in achieving a successful outcome and gaining stakeholder buy-in. The Society is pleased that the Board seems to have set the groundwork for this approach in the first question in its invitation letter of May 14.

III Consistency imperative?

The Society recognizes that the Board has communicated an apparent preference for consistency in accounting and rate treatments for employee future benefits costs among the entities it regulates. Complete consistency would have the fairly obvious advantage of increasing the Board's ability to benchmark financial results. In addition, consistency is appealing because it would appear to reduce regulatory complexity by allowing various stakeholders a greater opportunity to understand a very technically complex accounting topic.

It is possible that greater consistency may emerge through the identification of a preferred practice through this consultation process. However, The Society is not convinced that it is a foregone conclusion that consistency for its own sake is necessarily in the best interests of the various stakeholders. The Society would group stakeholders of this issue into three broad groups: utility customers; utility shareholders; and utility employees, both past and current. While The Society accepts that it is reasonable for the Board to approach this generic issue with a presumption that consistency is the preferred outcome, The Society does not accept that consistency should be stated as the single most important goal of the consultation prior to the commencement of the process. It would however be appropriate to include consistency as one of the general principles against which various options can be tested or discussed.

The Society has identified several factors that may constrain the attainment of consistency in the regulatory treatment of pension and other post-employment (OPEB) costs across all companies involved in the transmission, distribution and generation of electricity and the distribution of gas. The Society expects that there may be other factors that could also have an influence on the achievement of consistency among the Board's regulated utilities. The Society has identified the following factors:

- Nature of pension and OPEBs
- Information constraints
- Differences in accounting framework
- Inter-industry benchmarking

These factors are more fully addressed as follows.

Nature of pensions and OPEBs

There is a temptation to consider pension and OPEB as virtually the same in character. This is logical as OPEB obligations are accounted for using a defined benefit pension model. This makes sense considering the need to actuarially estimate the obligation to make future payments. However, there are important differences. For example, OPEB obligations are generally not separately funded by the sponsoring utility, although that possibility appears to be within the scope of this consultation. In addition, important differences exist between pensions and OPEBs with respect to the existence or extent of statutory regulation; the comparative size of the obligations; employee groups covered; length of future period until expected settlement of the obligations; and the nature of the actuarial inputs utilized to calculate the obligation, including the specific economic drivers for future growth in costs. Given these differences, it may be reasonable to accept a different accounting and rate treatment for pensions versus OPEB within a single regulated entity. For example, Hydro One Networks (HONI) currently recovers pension costs on a cash (i.e. funding) basis while it recovers OPEB costs on an accrual basis. The Society does not accept as a given paradigm the view that the accounting for pensions and OPEBs should necessarily be identical.

Information constraints

Ontario electricity local distribution companies (LDCs) that are members of the OMERS defined benefit pension plan currently recover their pension costs by recording costs consistent with their contributions to the fund. Their pension costs are recognized on a funding basis for accounting as if OMERS was a defined contribution pension fund, even though it is actually a defined benefit fund. This is acceptable under generally accepted accounting principles (GAAP) because the OMERS plan is a multi-employer pension plan for which auditable individual member information, required to perform accrual accounting, is not available on a timely and cost efficient basis. For this reason, the adoption of accrual accounting as a basis for regulating OMERS pension costs is likely not a realistic option. If the Board's goal is consistency in accounting across all regulated industries in Ontario, the OMERS constraint described above would logically require all other companies to adopt the funding approach for their pension plans and OPEB obligations to conform to the method used by OMERS members. However, the majority of current and past employees of OEB regulated companies are in individual company pension plans, not a multi-employer plan like OMERS. It would be inappropriate to change the rate recovery methodology for the majority to match the special accounting treatment necessary for the minority in OMERS simply to meet a goal to be consistent.

Differences in accounting framework

There are several different financial accounting frameworks in use for both financial accounting and rate setting amongst the rate regulated entities covered by the scope of the Board's consultation process. The Board has determined that rate regulated enterprises in Ontario will be regulated based on IFRS, subject to specific modifications determined through the EB-2008-0408 consultation. This modified IFRS (MIFRS) framework is the default in Ontario. However, the Board has also accepted that, subject to specific criteria being met, it is in the public interest to allow certain utilities to be regulated under other financial accounting frameworks, such as United States generally accepted accounting principles (US GAAP) or Canadian GAAP for public sector entities set by the Public Sector Accounting Board (PSAB).

Electricity LDCs in Ontario generally account for their operations under IFRS and are regulated based on MIFRS. However, HONI and OPG both use US GAAP as a basis of accounting for their transmission, distribution, and regulated generation operations. The two major gas companies also use US GAAP. The Independent Electricity System Operator (IESO), uses PSAB guidance. Toronto Hydro Electric System Limited (THESL) has used US GAAP but is transitioning to MIFRS. There are compelling public interest reasons for the continued use of inconsistent accounting frameworks for rate regulation. Each entity has met the Board's tests where long-term approval to use a non-MIFRS basis of accounting for rate setting has been granted. Given this, the continued existence of inconsistent financial accounting and rate setting frameworks should be considered a given.

The Board could introduce a regulatory accounting policy treatment to increase consistency whatever the financial accounting system in use. However, such a regulatory accounting policy would prove to introduce significant complexity in financial reporting and in the internal accounting for costs given that the large regulated utilities capitalize a significant portion of their benefits costs.

The Society considers that the Board's previously approved use of inconsistent account frameworks should be considered as a potential constraint on the use of a completely consistent rate setting framework for employee future benefits costs.

Inter-industry benchmarking

The Society recognizes the emphasis the Board has always put on utility benchmarking and the even greater importance of this tool under its renewed regulatory framework. To be relevant, the Board needs to conduct benchmarking at the appropriate level and with the appropriate comparators. Total cost and OM&A benchmarking are frequently targeted. To carry out effective and relevant comparisons, it is important that the nature of the costs be considered and be normalized for factors such as consistency of accounting system, nature and complexity of operations, and nature of labour force.

Although inter-industry benchmarking of certain aspects of employee benefits costs may yield some useful information (e.g. pension fund return percentages), The Society considers that the results of inter-industry benchmarking, for example between gas and electric distributors, will likely be less relevant to rate making than benchmarking within a sector (e.g. electricity distribution) between analogous companies with similar benefits.

The natural comparators for gas companies and for electricity distributors are other distributors. Finding electricity transmission and generation comparators presents an issue due to the dominance of HONI and OPG in these sectors of the Ontario industry. Benchmarking of pension costs between OMERS utilities is relatively easy given they are members of the same plan, which is managed on consistent assumptions. While some macro benchmarking between other companies' benefits costs can be accomplished, care must be used in recognition that employee benefits are a single element available to a company in its compensation strategy. In addition, care should be taken not to just benchmark benefits given that different companies may provide different mixes of benefits and cash remuneration.

In conclusion, The Society suggests that the objective of consistency not be established as the goal of this consultation. Rather a consistency should be set as one of the principles that are used to weigh the relative pros and cons of various options identified in the consultation process. To illustrate the challenges in reaching consistency, The Society has included in the Appendix a summary of the different methodologies utilized by the four OEB regulated companies who employ Society represented staff to recover and report on pension and OPEB benefits costs.

IV Response to Board questions

The Society has responded below to each of the Board's specific questions included in its May 14 letter:

1. General principles

As noted above, The Society believes that the most efficient and effective first step to determining and evaluating options for the rate treatment of employee future benefits would be to establish a set of general principles against which options can be measured. It may be appropriate to divide such principles into two broad categories: general regulatory principles and other considerations that are specific to the topic at hand.

i) Regulatory Principles

The Society suggests the following general regulatory principles be considered:

Prudence – In the context of employees' future benefit costs, such as pensions and OPEBs, the rate regulated entity should be entitled to recover costs that are prudently incurred to provide customers with service in a given period. Customers have the right to expect that they will pay no more and no less than the just and reasonable cost of providing them with service.

It is customary to evaluate prudence of previously incurred costs without the benefit of hindsight and by taking into account the only information available to management when the costs were incurred. This has significant relevance in the area of employee future benefits as the company must estimate future cash outflows using a multitude of accounting, demographic and economic estimates. For this reason external expert actuaries are usually engaged to provide or to advise on the appropriateness of estimates to be used for current period cost and liability recognition. Use of such independent expert advice contributes to a prudent estimate being made.

Due to the number and nature of the estimates that must be made to determine the current period accounting cost of defined benefit plans, it is normal to see significant true-ups in later periods for differences between actuarial assumptions and actual results. These differences, which can be increases or decreases in estimates, are treated differently for accounting purposes under IFRS and US GAAP and under a funding or an accrual model. It is important that prudence tests be carried out considering management's initial estimates, and not applied with the clarity of hindsight to the later actuarial adjustments required to true up to actual results.

Intergenerational equity – Under the regulatory concept of intergenerational equity, customer generations (i.e. rate years) should only be charged for the costs they cause or benefit from as service is provided. Where costs cannot be charged in a manner that fully meets the requirements of the concept of intergenerational equity, there is a general expectation that they will be charged in a manner that at least minimizes any resultant inequity. This is sometimes accomplished by spreading a large transitional adjustment or true-up from estimated to actual cost over several rate years.

As employee future benefit costs are incurred as labour is consumed and service is provided to customers, a portion of such costs pertains to labour that is used to construct or develop long lived tangible and intangible assets. These assets are included in the rate base as they will provide a service benefit over lengthy future periods. However, it is normal to evaluate the prudency of such benefits costs before the assets they contribute to are added to rate base. Each of the accounting frameworks (e.g. US GAAP, PSAB, IFRS) and specific models available to the Board (e.g. accrual, funding, pay-as-you-go) would continue to see benefits costs being capitalized.

As noted under the prudence discussion above, for defined benefit pensions and OPEBs, it is recognized that future periods will experience cost adjustments due to changes in actuarial estimates.. This has the effect of making the achievement of perfect intergenerational equity virtually impossible. Nevertheless, the principle of intergenerational equity is an important one that regulated entities and the regulator should strive to meet to the extent possible.

Rate stability – for customers and the utilities, it is generally preferable that rates be set so as to encourage stability, or at least to minimize instability, between rate periods. The use of a rate smoothing philosophy may conflict with the principle of intergenerational equity, where each rate period is accountable for it own service costs. However, rate smoothing is an important concept to be taken into account when perfect intergenerational equity cannot be achieved.

US pension accounting's continued optional use of the corridor method inherently spreads actuarial gains and losses over the average remaining service life of active employees, thus contributing to smoothing if this is reflected in rate setting. This aligns well with a rate setting principle that seeks to avoid inter-period volatility. The other option under US GAAP is one of immediate recognition, which would likely increase expense volatility, reduce intergenerational equity and offend the rate stability principle.

IFRS changes effective in 2013 saw the corridor method being discontinued and being replaced by a treatment whereby actuarial gains are accumulated in other comprehensive income. These amounts are not recycled to the profit and loss or retained earnings.

Cost of service model and capital recovery – It is a basic premise of the regulatory compact between customers and regulated enterprises that regulated companies should have the right to recover their prudently incurred costs of providing service, including a reasonable return of and on capital invested. For employee future benefits, this right refers to the recovery of future benefits costs of providing pensions and OPEBs for a given period, including subsequent adjustments for actuarial estimates made in prior periods. As a portion of these costs may be capitalized, recovery of these costs occurs through the recovery of period costs in revenue annually and through the recovery of asset depreciation over constructed assets' service lives.

Consistency – As discussed earlier, there are some clear benefits in regulating all participants in Ontario's rate regulated electricity, and gas industries on a consistent basis. This would theoretically reduce complexity by reducing the accounting treatments in use and it could increase comparability. However, as previously discussed, there are significant barriers to achieving consistency in the accounting models to be used to regulate Ontario electricity and gas utilities. Given these barriers, The Society proposes that the concept of consistency not be treated as the primary goal but instead that it be adopted as a principle in this consultation. The relative benefits and costs of achieving consistency should be balanced with the other principles adopted.

ii) Other Considerations
The Society also suggests that the following additional considerations specific to employee future benefits be considered in the consultation:

Fairness to all stakeholders – Regulatory discussions usually focus on balancing fairness between shareholders and the customers. However, in the specific area of employee future benefits, there is a third major stakeholder, namely employees. This has been specifically recognized in other jurisdictions when the issue of rate recoverability of benefits costs has been discussed at the principles level. Current and past utility employees are potentially indirectly impacted by the rate treatment adopted for employee future benefits. For example, actuarial gains and losses may lead to current period cost increases or reductions that are essentially true-ups for costs of services that have already been contracted. These costs relating to previously rendered employee services should generally be recoverable by the utility, which must continue to act in response to its legal and good faith obligations. Denial of recovery by the utility of prudently incurred costs could place undue risks on the payment of contracted benefits to employees who have already provided services in good faith.

Element of balanced remuneration – Provision of pension and OPEB benefits will generally be considered part of a balanced remuneration package for employees in the industry sectors within the scope of this consultation. Specific benefits provided, and cost responsibility for these costs, needs to be considered taking into account overall total remuneration, the impact and nature of the collective bargaining process, as well as necessary staff qualifications given the complexity of work, attraction and retention issues and demographics. For example, professional staff working for larger utilities are often required to be expert in multiple technical disciplines (for example many HONI staff service both the transmission and distribution businesses) and in working with highly complex technologies (for example OPG staff involved in the nuclear business). This fact needs to be taken into account when appropriately benchmarking the costs of remunerating utility staff against those of smaller and potentially less complex regulated and unregulated companies.

Legal constraints - Benefits are provided to a utility's represented and unrepresented staff, whether working on regulated or unregulated business. Benefits arrangements are covered by several aspects of law and government regulation, including those governing labour, pension funding and rate regulation itself. For represented staff, benefits are paid as part of a wider balanced remuneration package, usually through the negotiation of collective agreements. Legally, management cannot unilaterally change benefits and other remuneration arrangements outside of the collective bargaining process. Once the parties have entered into the collective agreement, they have committed to these costs. This was recognized by the Court Of Appeal for Ontario in its June 4, 2013 Decision.[1].

2. Suitable analogies & precedents for the employee future benefits issue

The Board has suggested several potential analogies where the recovery of cash from customers will be either advanced or deferred in comparison to the recognition of accounting cost under GAAP. For example, rate recovery of a company's income tax expense can be regulated on either a cash or accrual method. The two methods result in different exposures of future customer generations to true-ups of deferred charges/gains. This regulation of income taxes, including the treatment of recovery or refund of deferred tax amounts, would appear to be somewhat analogous to the employee benefits issue.

Asset retirement obligations represent another possible useful analogy, given the potential for timing differences between the collection of costs on a cash-versus-accrual basis in rates. With the exception of the nuclear decommissioning and used fuel accounting issues at OPG, The Society expects that the Board may have had limited experience dealing with cash and accrual differences relating to asset retirement obligations. The past decisions of other regulators in other jurisdictions may provide useful information.

The Society expects that Board staff, its expert KPMG, and the major utilities are best positioned to research, identify and evaluate the relevance of historical precedents and analogies to the benefits subject area, both in Ontario and in other comparable jurisdictions in North America. Any evaluation of the regulatory treatment of analogous accounting and regulatory issues should take into account inherent differences between these subject areas and employee future benefits. An identified analogy may indicate useful information but should not be applied blindly as a precedent.

3. Information requirements - industry norms and benchmarks

The Society recognizes the reasonableness of the Board's desire to compare or benchmark utility pension and OPEB information. Comparison of costs may be more difficult given the factors already discussed, specifically: different accounting regimes; the fact that benefits plans are part of a balanced remuneration package and that their terms and costs may be proportionately different between utilities with similar total per capita compensation costs, and; the fact that some costs are related to the true-up of actuarial differences on service costs consumed in prior periods.

[1] In December 2014, the Supreme Court of Canada heard the appeal in Ontario Energy Board v. Ontario Power Generation Inc., et al. A decision is pending.

Nevertheless, stakeholders should be aware of useful information such as major benefits plan parameters, employee demographics and financial assumptions and results. The Board has noted in its May 14 communication that it will determine in the next phase of the consultation a complete set of incremental information requirements to be included in future applications seeking recovery of employee benefits costs. Given the inconsistent timing of such filings, the Board may also wish to consider what annual information requirements should be made part of periodic RRR reporting to assist it in assessing comparability.

The Society expects that stakeholders would find some additional information on benefits plans of use as background. Examples of useful general information elements would include:

- Plan terms and conditions;
- Numbers and demographics of plan members – both active and inactive;
- Registered plan? Funded? Managed internally or externally?
- Nature of plan – e.g. defined benefit, defined contribution, multi-employer;
- Funded status (if applicable); information on historical rates of return on plan assets;
- Highlights of actuarial assumptions (historic and recent);
- Whether or not benefit plans are subject to collective bargaining.

This sort of information would allow stakeholders to better understand and compare the levels of employee future benefit costs between different utilities under the Board's jurisdiction. This type of information may or may not be available on a company-specific basis for the large number of electricity LDCs that are members of the OMERS multi-employer plan; it may be impossible to provide such information on a timely basis if at all.

With respect to the above, The Society would also ask that the Board take care in setting informational requirements so as not to create excessive incremental reporting requirements that trigger undue incremental costs. In addition, in setting information requirements, there is a natural tendency to ask for too much detail. This can result in a level of detailed information that may trigger red herring discussions or which may not provide for relevant comparisons. The Board should ensure that there is a valid regulatory use for any incremental information requested. One test may be to determine whether comparable information is available from other similar North American utilities or unregulated businesses that also have significant benefits plans. Historical and trend information is important. Many utility plans have been in existence for many years. As they govern the terms of long-term obligations, focusing on the results of a short period may not result in appropriate conclusions being drawn. For example, a utility may experience a poor rate of return on plan assets in a given period while exceeding industry averages in the long term. The long term experience would likely be the more appropriate information for stakeholders to draw conclusions from.

To avoid duplication of effort, the Board may also wish to take notice of the available actuarial, demographic and financial information that is already provided within the footnotes to the large utilities' annual audited financial statements and in their other public securities filings.

The Board should also be mindful that employee future benefits is a highly technical and specialized accounting and actuarial topic area. It is legitimate to question whether all stakeholders will have sufficient expertise to assess the underlying causes for apparent inconsistencies in plan design, actuarial assumptions and financial results. The engagement of a specialist in an advisory capacity may become necessary or optimal from time to time to assist stakeholders' staff and the Board in interpreting differences. Given the inter-relationship of the various underlying factors used to determine defined benefit plan costs, and given the materiality of these amounts in revenue requirements, it is important that no misconceptions occur.

4. Information requirements - other relevant information

In addition to information periodically provided by regulated utilities in their rate applications or RRR filings, the Board may wish to access other information from other rate regulated entities in other jurisdictions or from unregulated enterprises with comparable benefits plans. The Board may wish to access general information related to the financial markets on actual medical and dental cost trends, projected costs for salaries, industry and company employee demographics, and projected medical and dental costs.

5. Accounting and recovery options

a) The Board has asked whether it should establish accounting and recovery methods for the electricity and gas sectors. Clearly the Board already has the power and obligation to determine the appropriate regulatory accounting and rate setting approach to be adopted by any entity it regulates. Presumably the Board's question refers to whether or not it should adopt a single consistent methodology to be applied to all rate regulated enterprises in the various regulated sectors of the gas and electricity industries. The Society's views on the need for consistency and on the barriers to achieving it are laid out in detail earlier.

The Society assumes that the Board is raising the issue of which regulatory accounting method is to be used as the Board previously said that it has no power to determine the financial accounting to be used by a rate regulated enterprise in the preparation of its financial reports.

The Society's view is that the best method to be used for setting rates for employee future benefits costs should be determined taking into account the general principles and other considerations established for this consultation, ideally to be established in the early stages of the process. Any proposed policy positions should also take into account any identified constraints, such as inconsistent regulatory accounting models in use already and the nature of the benefit plans, for example the limited availability of information to LDCs who are members of OMERS.

b) The Society would take the position that it is too early in this process to recommend the preferred alternative of rate setting for pension and OPEB plans. Given The Society's preference to first develop and agree on appropriate principles against which the options can be tested, making recommendations now would be inconsistent with that approach. However, The Society is not yet convinced that status quo is not a sustainable option given that the need for complete consistency has not yet been established.

c) The Board is probably aware that the three general accounting options it has outlined are not currently available for pensions and OPEBs. For example, a pay-as-you-go basis for pensions is unlikely to meet any regulatory objectives. In addition, it would be very difficult to recover costs matching payments of benefits by an external trustee. In many cases such payments are made decades after the utility has made contributions to the fund and employees' services to customers have been rendered. The Society's view is that the only realistic choices for regulating pension costs are either a funding basis or an accrual basis. The Society takes note of the fact that an accrual basis is unlikely to be possible for the many Ontario LDCs that are members of the multi-employer OMERS plan. So again, the Board will have to assess whether the consequences of fulfilling the principle of consistency is worth the cost to ratepayers.

Unless a decision is taken to require that OPEB obligations be funded, the choices available for setting rates for OPEBs are either a cash basis (pay-as-you-go basis) or an accrual basis. A funding basis cannot be reasonably used without the establishment of a separate segregated fund.

The Board's letter also uses the term "accounting cost" in its description of the accrual option. The Board notes that accounting cost is reported in the general purpose financial statements and that it is generally split between capital and OM&A. The Society believes that this terminology is potentially confusing and should not be used. Rather the term accrual should be used to differentiate this option from the two cash-based methods (i.e. pay-as-you=go and funding). For entities that report under US GAAP or IFRS (assuming they have elected to continue the use of regulatory accounting by adopting IFRS 14 "Regulatory Deferral Accounts"), the cost on whichever accounting basis is used for rate regulation (whether funding, cash or accrual) will arguably be considered to be its accounting cost under rate regulated accounting. In addition, under any basis of regulating employee future benefits that is adopted, companies will continue to split their benefits costs between capital and OM&A. The reference to this practice in the description of the accrual option incorrectly implies that a capitalization of labour costs only occurs under the accrual accounting option. The Society suggests that this element be dropped from the description of the accrual option.

The Society also believes that it is important to develop the descriptions of the available options fully and clearly. With respect to the funding contribution option, the Board's May 14 letter, in describing the this option, notes that this represents "the minimum amount of contribution required to be made by a sponsor of a registered pension plan that is subject to the requirements of pension legislation in Ontario under the Pension Benefits Act, Ontario, and related rules and regulations." While the description holds true for a funded pension plan, if it is to be used generically in this consultation process it must also refer to OPEB plans, The Society believes that the description should be generalized to also include either an internally segregated OPEB fund or an externally managed OPEB fund that is not subject to the Pension Benefits Act, Ontario.

d) The Society's positon is that it is perfectly reasonable for the Board to adopt a different basis of regulatory accounting for pensions and OPEBs if this is warranted given regulatory objectives and taking into account the constraints discussed above. For example, as noted in 5c) above, The Society does not consider the same two accounting options to be available for both pensions and OPEBs. In addition, information constraints on LDC pension accounting effectively limit their basis of accounting to a funding basis. If across the board consistency for both pension and OPEB was mandated, this factual limitation would mean that all utilities would have OPEB regulated on a cash basis. The Society would not support this conclusion based on a consistency argument alone.

6. Financial reporting, legal and tax considerations

a) The evaluation of the preferred regulatory methodologies for pensions and OPEBs should definitely take into account the legal and tax consequences of the alternatives as well as the impacts on financial reporting. Legal matters and government regulations should be considered as options are evaluated and discussed. Specialist advice may be required during the consultation to determine any impacts of existing laws and regulations. Similarly, tax impacts and considerations should be taken into account given their potential to impact economics, cash flows, and introduce other complexities. And again, the impacts of satisfying the principle of consistency would have to be assessed.

Employee future benefits costs are accounted for differently by companies under IFRS versus US GAAP. Most utilities will have an ability to apply regulatory accounting if the Board chooses a method that differs from that company's standard GAAP accounting for benefits costs. For example, HONI currently records its pension costs on a funding basis in its US GAAP financial statements even though that is inconsistent with the rules for employee future benefits found in the Financial Accounting Standards Board's (FASB) Accounting Standards Codification. This treatment is consistent with US GAAP due to the use of rate regulated accounting. Utilities that have adopted IFRS 14 will disclose the differences between the Board's rate setting accounting policy and standard GAAP in the regulatory section of their profit and loss and balance sheet. There is no assurance that IFRS utilities will be able to report such differences over the long-term once the International Accounting Standards Board (IASB) completes its project on accounting for rate regulation. The Society understands that the Board puts a great deal of reliance on the audited financial statements of regulated entities under its jurisdiction. As such, the inclusion of audited financial information reflecting the Board's chosen regulatory treatment is beneficial.

b) The Society, like many other parties in this consultation, is not qualified to assess legal and tax consequences of the options under discussion as these issues require the involvement of experts. The Society presumes that the Board will access such expert knowledge through the utilities, its external expert KPMG, and through its own in-house legal staff.

c) The Board must already contend with the fact that the different entities it regulates use different bases of financial accounting for external reporting and for their approved basis of rate regulation. Some use PSAB; some use US GAAP; and some use IFRS, the latter with or without including the impacts of rate regulation depending on whether or not they have elected to adopt IFRS 14. Large utilities generally include accrual and funding information for pensions and pay-as- you-go information for unfunded OPEBs in the notes to their audited financial statements. Extensive additional information is generally provided on other aspects of benefit plans in the financial statements and in other securities filings such as Management Discussion and Analysis and the Annual Information Form. For example the notes to financial statements will usually include detailed comparative information such as actuarial estimating parameters and on capitalization of benefits. The Board should look at the information currently provided in utility audited financial statements under various accounting frameworks before establishing incremental reporting requirements to ensure that it has the necessary information to appropriately compare utility employee future benefits costs.

7. Deferral and variance accounts

a) Deferral and variance accounts have historically been found useful in regulating pension costs and they may have the same potential for OPEBs, depending on the accounting approach selected. The Board's increased emphasis on incentive rate regulation and the adoption of longer incentive periods will likely increase the argument for use of deferral and variance accounts. This is due to the lack of management's ability to foresee the effects of periodic actuarial revaluations that occur more frequently than and off cycle with rate resets. For example, actuarial revaluations of defined benefit pension plans are due every three years, or more frequently if the sponsor so elects. Significant and relatively short term changes in cost levels can be triggered by such revaluations under either a funding or accrual accounting regime. For instance, as has been seen over the past two decades, short term material swings in the equity or bond markets can materially impact pension fund market values and pension plan funding requirements.

In EB-2008-0408 "Transition to IFRS – Addendum", the Board discussed the possible use of generic deferral or variance account for the transitional adjustment on moving to IFRS from legacy Canadian GAAP. It was noted by the Board that most LDCs are members of OMERS and are therefore subject to different business circumstances than the larger utilities. The Board also noted that most LDCs do not offer OPEB benefits at a scale that will create material obligations on their balance sheets. It was decided that utility-specific deferral or variance accounts could be sought for transition impacts by individual utilities. With respect to this consultation, The Society has not yet taken a positon on whether generic or individually sought deferral and variance accounts would be preferable.

b) At this stage of the proceeding, The Society cannot predict the most useful mechanism of any deferral or variance accounts that may be needed. However, there is no reason to think that deferral and variance accounts would be operated in future in a manner different than analogous existing accounts. Design of any required accounts should await the identification of specific business facts.

Significant transitional adjustments, whether refund or recovery, may need a deferral account treatment to avoid rate shock or non-recovery/refund risk. For example, conversion from an accrual method to funding or vice versa could be very disruptive and significant transitional adjustments could result that could impact intergenerational equity and/or rate stability.

As previously discussed, major periodic actuarial revaluation adjustments within lengthening rate periods may warrant the use of variance accounts where standard criteria regarding prudency, management's ability to foresee and control etc. are met. These have been used in the past by HONI where an actuarial revaluation is known to be scheduled within the test years and the results of that actuarial revaluation cannot be predicted with enough precision to allow the impacts to be included in rates on a forecast basis. There may be other potential uses for a deferral or variance account that will be identified during the consultation.

c) It is a reasonable presumption that interest should always be applied to a deferral or variance account balance, although there are rare exceptions (e.g. Account 1576 which is treated as part of rate base). Whether or not to include interest can be discussed when or if the specific accounts are designed and adopted.

d) It is too early to discuss the appropriate use of deferral and variance accounts as a transition methodology. Transitional treatments should be developed using the same general principles that should be used to choose the most appropriate accounting and rate setting method. Specifically, the rate treatment of material transition amounts needs to ensure the financial soundness of the regulated entity, as well as fairness to customers, shareholders and employees.

8. Funding considerations

a) Defined benefit and defined contribution pension plans in Ontario are generally required to be funded already so the Board's question must be taken as pertaining to the potential establishment of funded reserves for OPEB obligations.

The Society's initial position is that there is no overwhelming need at this time for the major utilities to fund their OPEB obligations. Funding does have the beneficial effect of reducing risk of payment to the beneficiaries in a scenario where a major utility either faces a potential going concern issue or displays bad faith towards its employee population. The occurrence of both of these scenarios on an entity basis is seen as remote by The Society. However, OPG's nuclear business has a defined technical life that is impacted by external decisions on the service lives of existing plants and on potentially building new ones. Without accrual funding, if OPG's nuclear fleet is gradually retired and not replaced, beginning with Pickering and continuing with Darlington, the OPEB obligations for the current and past nuclear staff will fall onto the remaining rate regulated hydro-electric facilities. The cost of service implications of this and the resulting impact on ratepayers would have to be considered by the Board.

When OPEBs are included in rates on a forecast pay-as-you-go basis, funding is essentially occurring in parallel with payments and employee provision of services. Money collected from customers in a given rate year is used to settle the current period's OPEB obligations. When OPEB obligations are included in rates on an accrual basis and are not funded, there is likely an excess cash collection that can be used by the utility to displace the need for other financing, at least temporarily. Once the cash is required to be paid out at some future period, additional borrowing may be required at that time.

Given the above, funding of OPEB would only seem to make sense when an accrual method is used to collect costs in rates and resulting collections from customers significantly exceed amounts being paid out in respect of obligations. Funding can be done either through an internal segregated fund or through a third party managed external fund. An internal fund would likely not trigger additional significant costs but would also likely not materially increase the assurance of cash being available to service OPEB obligations in a bankruptcy situation or where a going concern issue was expected. External funding could result in increased incremental costs to customers. Examples of such incremental costs would include fund administration costs (salaries, commissions, transaction fees, systems costs), audit fees etc.

If economic analysis shows that funding OPEB will likely result in lower costs for customers, The Society would not have a major objection to the Board adopting such an approach.

b) Use of either an internally managed or arm's length external fund for OPEB may create new legal, tax and financial reporting issues and may trigger incremental costs (e.g. potential preparation of separate financial statements and audit for an external fund). Obviously these potential complications and costs need to be identified and quantified before the Board makes a decision. The Society's position is that it makes sense to determine the regulatory benefits of using a fund for OPEB before doing additional work to establish legal and tax consequences of specific options. Specialist advice may be needed and the issues will likely vary depending on whether an internal or external funding approach is being considered.

c) It is too early to discuss transition methodology when there is no indication as to what the nature or size of the potential transition is. Transition treatment should be developed using the same general principles that were discussed earlier in question 1 and which hopefully will be set at the beginning of this consultation. Transition needs to ensure the financial soundness of the regulated entity, be fair to customers, shareholders and employees, and the point at which the relevant stakeholders are in their respective rate processes.

If funding of OPEB is determined to be appropriate path forward, there may be a transitional or catch up funding requirement. It may be premature to discuss the options for transitioning to a funded approach now. Three possible general options would be: (i) Immediate funding of all historic obligations, perhaps through a combination of collection in rates and borrowing; (ii) phased in funding of historic obligations; and (iii) limiting funding to future obligations only. These options would have to be evaluated considering materiality, rate impact, complexity in administration etc.

9. Reporting requirements

The Society considers that it is premature to determine the nature or timing of specific utility reporting requirements at this time. In addition, the Board needs to assess which reporting requirement should be met through filing requirements in periodic cost of service or incentive rate making applications and which should be met through new periodic RRR reporting requirements. The frequency and mechanism to be used in reporting to the Board and stakeholders should be developed once the information requirements discussed earlier in this document are decided upon.

Appendix
Society Employers' Pension & OPEB Treatments

Table 1 – Pensions

Employer	Accounting System +	Regulatory Recovery Methodology	Financial Statement Treatment	Nature of pension plan
Hydro One	US GAAP	Funding	Funding	Individual DB
IESO	PSAB	Accrual	Accrual	Individual DB
OPG	US GAAP	Funding*	Accrual*	Individual DB
THESL**	MIFRS/ IFRS	Funding	Funding	Multi-employer DB

+ The same accounting system is used for both regulatory accounting and external financial reporting.

* As per the OEB Decision in EB-2013-0321, for regulatory recovery OPG is required to utilize the funding methodology as of November 1st 2014 until the end of 2015. Prior to that, OPG utilized the accrual methodology for both regulatory recovery & financial statement treatment. For financial statement treatment OPG continues to use the accrual methodology

** THESL, like many Ontario electricity local distribution companies (LDCs), is a member of the OMERS defined benefit pension plan. All OMERS members currently account for and recover their pension costs by recording costs consistent with their contributions to the fund. Their pension costs are recognized on a funding basis as if OMERS was a defined contribution pension fund, even though it is actually a defined benefit fund. This is acceptable under generally accepted accounting principles (GAAP) because the OMERS plan is a multi-employer pension plan for which the auditable individual member information, required to perform accrual accounting, is not available on a timely and cost efficient basis.

Table 2 – OPEB

Employer	Accounting System +	Regulatory Recovery Methodology	Financial Statement Treatment	Segregated Fund?
Hydro One	US GAAP	Accrual	Accrual	No
IESO	PSAB	Accrual	Accrual	No
OPG	US GAAP	Pay As You Go*	Accrual*	No
THESL	MIFRS/ IFRS	Accrual	Accrual	No

+ The same accounting system is used for both regulatory accounting and external financial reporting.

* As per the OEB Decision in EB-2013-0321, for regulatory recovery OPG is required to utilize the Pay-as –you-go methodology as of November 1st 2014 until the end of 2015. Prior to that, OPG utilized the accrual methodology for both regulatory recovery & financial statement treatment. For financial statement treatment OPG continues to use the accrual methodology