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File 23907

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

Dear Ms. Walli,

**Re: Regulatory Treatment of Pensions and Other Post-Employment
Benefit Costs (EB-2015-0040)**

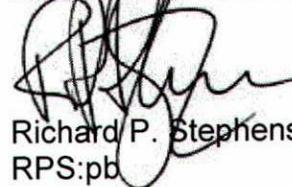
The Power Workers' Union ("PWU") represents a large portion of the employees working in Ontario's electricity industry. Attached please find a list of PWU employers.

The PWU is committed to participating in regulatory consultations and proceedings to contribute to the development of regulatory direction and policy that ensures ongoing service quality, reliability and safety at a reasonable price for Ontario customers. To this end, please find the PWU's comments with regard to the Board's initial set of questions regarding the regulatory treatment of pensions and OPEB which are organized into three areas: general principles, information requirements and accounting and recovery in rates (EB-2015-0040).

We hope you will find the PWU's comments useful.

Yours very truly,

PALIARE ROLAND ROSENBERG ROTHSTEIN LLP



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RPS:pb

Encl.

c: John Sprackett
Kim McKenzie

Doc 1566224 v1

List of PWU Employers

Algoma Power
AMEC Nuclear Safety Solutions
Atlantic Power Corporation - Calstock Power Plant
Atlantic Power Corporation - Kapuskasing Power Plant
Atlantic Power Corporation - Nipigon Power Plant
Atlantic Power Corporation - Tunis Power Plant
BPC District Energy Investments Limited Partnership
Brant County Power Incorporated
Brighton Beach Power Limited
Brookfield Power Wind Operations
Brookfield Renewable Power - Mississagi Power Trust
Bruce Power Inc.
Canadian Nuclear Laboratories
Compass Group Corporation of the County of Brant
Covanta Durham York Renewable Energy Ltd.
Entegrus
Erie Thames Powerlines
Erth Corporation
ES Fox
Great Lakes Power
Grimsby Power Incorporated
Halton Hills Hydro Inc.
Hydro One Inc.
Independent Electricity System Operator
Inergi LP
Innisfil Hydro Distribution Systems Limited
Kenora Hydro Electric Corporation Ltd.
Kinectrics Inc.
Kitchener-Wilmot Hydro Inc.
Lake Superior Power Inc. (A Brookfield Company)
London Hydro Corporation
Milton Hydro Distribution Inc.
New Horizon System Solutions
Newmarket Hydro Ltd.
Norfolk Power Distribution Inc.
Nuclear Waste Management Organization
Nuvia Canada
Ontario Power Generation Inc.
Orangeville Hydro Limited
Portlands Energy Centre
PowerStream
PUC Services
Rogers Communications (Kincardine Cable TV Ltd.)
Sioux Lookout Hydro Inc.
SouthWestern Energy
The Electrical Safety Authority
TransAlta Generation Partnership O.H.S.C.
Vertex Customer Management (Canada) Limited
Whitby Hydro Energy Services Corporation

**Regulatory Treatment of Pensions and Other Post-Employment
Benefit Costs**

Comments of the Power Workers' Union

I. INTRODUCTION

On May 14, 2015 the Ontario Energy Board (“OEB” or the “Board”) issued a letter indicating the beginning of a consultation on rate-regulated utility pensions and other post-employment benefits (“OPEBs”) in the electricity and natural gas sectors. The Board has invited all interested parties to provide comments on an initial set of questions organized into three areas: *general principles, information requirements and accounting and recovery in rates*. Stakeholders are encouraged to also comment on other issues which they believe warrants the OEB’s attention.

a. Background

Historically, the OEB has addressed pension and OPEB issues on a case-by-case basis. The Board’s letter indicates that the Board’s objectives are to develop standard principles to guide the OEB’s review of pension and OPEB costs in the future, to establish specific information requirements for applications that will be incremental to current filing requirements, and to establish appropriate regulatory mechanisms for cost recovery which can be applied consistently across the gas and electricity sectors for rate-regulated entities. In conducting this consultation, the OEB indicates that it will also take into consideration the Government of Ontario’s ongoing review of pensions and any

actions which arise from that initiative that may overlap with the OEB's consultation.

II. POWER WORKERS' UNION'S COMMENTS

a. General Comments

The PWU is of the view that the generic consultation on the appropriate regulatory treatment of pensions and OPEB will be comprehensive and complex, the outcome of which can have significant financial, legal, and regulatory ramifications. The PWU shares the views of OPG and SEC¹ that the consultation should expect a range of views about the appropriate regulatory treatment of pensions and OPEBs and that the various positions of stakeholders will have to be thoroughly tested through an interrogatory process and cross-examination of witnesses.

It is in this context and consistent with the intent of the Board's letter, which is the gathering of initial views from stakeholders that the PWU provides the following responses to selected questions of the Board. These responses reflect the PWU's initial views which may evolve over the course of this consultation as new evidence unfolds.

BOARD QUESTIONS

General Principles

- 1. What principles should the OEB adopt in addressing pension and OPEB issues? Potential principles include: consistency across the gas and electricity sectors; intergenerational equity; financial protection for future ratepayers; ensuring the most efficient level of costs for ratepayers; stable cost levels; pension costs which are comparable as measured by other benchmarks, etc.***

In the PWU's view, most of the principles that the Board identifies in the question such as intergenerational equity, financial protection for future ratepayers, and

¹ OPG and SEC letter to the Board

most efficient and stable level of costs for ratepayers are reasonable, and should be pursued to the extent they are practically and legally achievable.

However, the other two principles, specifically, “consistency across the gas/electricity sectors” and “comparable pension costs as measured by other benchmarks” require caution.

- **Consistency across the gas and electricity sectors:**

Consistency can have some value in that it allows utilities, the Board and other stakeholders to compare financial information, and in some cases help compare the performance, of utilities. In this respect, consistency in accounting methods may be desirable, at least directionally. However, this does not mean that consistency should be considered as a necessary requirement that should be imposed on businesses. The variation among utilities within a sector such as electricity, let alone variation across sectors, is significant due to a host of factors. Utilities vary in the type of pension and OPEB plans – funded/unfunded, defined benefit/contribution, single/multi-employer, accounting method, etc. Many of these distinctions have deep historical roots within the various different utilities. The objective of consistency, while desirable directionally, should not be pursued in disregard of such important differences.

Put another way, consistency as between sectors, unlike, for example, intergenerational equity, has no inherent value as a goal: its desirability turns on whether, based on circumstances, it achieves a desirable outcome. It is a means to an end, not an end in itself. To seek consistency in the face of different sets of facts (for example, differences in labour markets, terms and conditions of employment in the different utility sectors) and without regard to the outcome of forced consistency would be foolish, if not counterproductive and dangerous.

- **Pension costs which are comparable as measured by other benchmarks:**

Like the principle of consistency, benchmarking is a means that may be useful in achieving a desirable goal. Whether it is useful depends on the circumstances. Benchmarking that is based on apples-to-apples comparison and undertaken at reasonable cost can be helpful to compare performances and encourage utilities towards good practice. Benchmarking that is based on flawed comparison of pension and OPEB costs of different utilities that are dissimilar in many respects is unreasonable, unfair and misguided. Benchmarking is most useful when conducted at the macro level. Total cost benchmarking can be a useful exercise. Benchmarking of segregated components of a utility's costs can be of no use whatsoever, or even worse, fundamentally misleading, because it does not take into account the effects of trade-offs and business choices between cost categories.

Benchmarking of costs can also be misleading and counter-productive if it is not accompanied by equal dedication of resources to measurement and monitoring of system and customer metrics, such as asset condition, service quality, reliability and customer satisfaction. Improved cost performance achieved at the expense of these other metrics is no indication of improved efficiency. It simply represents the triumph of one priority over others, with no apparent net benefit.

Moreover, as discussed below, benchmarking studies are already filed with respect to the various components of a utility's cost such as compensation (wages, pensions, overtime, etc.), vegetation management, productivity, etc. Further benchmarking on even more segregated components of utilities' cost of service would only increase the cost of service itself.

Additional principles:

- **Financial wellbeing of utilities and their ability to meet their pension and OPEB liabilities/obligations:**

Standards, principles, and policies relating to the rate recovery of pension and OPEB costs should not negatively impact the financial health of utilities and jeopardize their ability to fulfill their plan obligations over time. The OEB cannot, in the name of cost control, seek to subvert other public policy and legal priorities. The provision of stable, secure and adequate retirement income and benefits is not a social ill, it is a provincial priority. Working women and men have nothing to apologize for when they act collectively to improve incomes and working conditions. Society has placed such value on these rights so as to enshrine them, not only in provincial labour and pension legislation, but also in the *Charter of Rights and Freedoms*. The OEB has neither the mandate, nor the authority to seek to halt, let alone to roll back, the product of constitutionally protected collective bargaining, including fair compensation and retirement security for workers and their families.

- **Legality of Board's potential standards, principles and policies relating to pensions and OPEBs**

Any imposition of standards, principles and policies must be undertaken within the jurisdiction and the legal authority of the Board. Both customers and utilities are entitled to rates which are just and reasonable. Board imposed standards, principles and policies cannot have the indirect effect of denying a utility the ability to recover its prudently incurred costs or to effectively interfere in the legally and constitutionally protected free collective bargaining processes.

2. Are there other types of costs previously considered by the OEB that provide suitable analogies for the consideration of pension and OPEB issues? (for example: deferred taxes; asset retirement obligations; site restoration costs)

No comment.

Information Requirements

3. Should the applicants be required to compare their pension and OPEB costs to industry norms and/or other benchmarks? (Note: It is the OEB's expectation that the next phase of the consultation will consider the development of a complete set of new or incremental information that should be filed in applications seeking cost recovery for pensions and OPEBs).

Benchmarking is viewed by some as a near panacea for regulators. For others, it is perceived as a useful tool.

The PWU does not agree that benchmarking results, standing alone, can provide the Board with sufficient evidence upon which it can make an assessment of whether the costs in question were, or were not, reasonably or prudently incurred. At most, it is the starting point of the examination, not its conclusion.

Benchmarking of any subcategory of costs is a dangerous exercise. It overlooks the historical trade-offs that management may have made within the particular circumstances of their firm, to achieve a balance of priorities that meets its particular needs. Viewing and comparing one item in isolation is unhelpful at best, and could be misleading and harmful at worst. An efficient firm may well have relatively higher costs in a specific area because it reflects a priority for that firm. The PWU has filed evidence in prior proceedings regarding the dangers of subcategory benchmarking, in particular the dangers of OM and A benchmarking, rather than total cost benchmarking.²

Using benchmarking in a prescriptive way (i.e. as a basis for disallowances) is also inappropriate in circumstances where management has little or no ability to control the relevant costs over the short to medium term. The cost of special pension payments is a perfect example of this. By definition, these payments are required by law in order to fulfill historical pension obligations. The amount of these payments can vary, depending on factors outside the control of

² EB-2010-0379. PWU Submission filed on April 20, 2012, Attachment A: Assessing Distributor Incentives and Performance: 2000 TO 2012. F. J. CRONIN

management, eg. discount or mortality rates. By statute, the amounts must be paid. Any cost variances (a) reflect historical, not present management decisions; (b) arise from factors outside management control; and (c) cannot legally be avoided. In these circumstances, precisely what purpose is served by benchmarking?

In the case of multi-employer pension plans, costs may be driven by the terms of the plan, which an individual employer may have little or no power to alter or even influence. In some cases, the multi-employer group will include some firms which are regulated by the OEB, and many of which are not.

In many cases, some or all the employees of the employer are unionized, and the terms and conditions of their employment are determined by the provisions of the applicable collective agreement. The terms of the pension and OPEB plans are often, but not always, incorporated into the collective agreement. In such cases the employer has no legal ability to make any unilateral change to the terms of the pension plan. No change can be made without the agreement of the bargaining agent (i.e. the employees collectively). The ability of an employer to negotiate favourable pension or OPEB terms is a complex question, and will ultimately turn on the bargaining power of the employer relative to the bargaining agent.

Labour is not a “commodity” for which commoditized pricing is available to an employer. An employer cannot seek to reduce labour costs (including pension/OPEB costs) by replacing its current employees and “going out to market” to find new employees at a lower price. Unlike situations where there is free substitutability for an input, there is no automatic or inevitable harmonization of labour costs across firms. To the contrary, labour markets reflect significant and permanent cost variances between firms. The existence of sustained variances is a reflection of the specific circumstances of that relationship and its dynamics. It is no reflection that the employer was somehow “unreasonable” or “imprudent” in the negotiation of any particular agreement.

In addition, in cases where pension and/or OPEBs are embedded in a collective agreement, the Board must be mindful that:

- (a) Collective bargaining is a multi-factorial exercise, where the ultimate outcome reflects myriad trade-offs, both express and implicit. Both the union and the employer are concerned about the overall value of the total package, with the various elements meeting the priorities of their respective constituencies;
- (b) The contours of any collective agreement are a function of the (often long) history of prior negotiations and settlements. Absent an existential crisis, there are two fundamental realities of collective bargaining:
 - (i) Changes to the status quo are incremental, not fundamental; and
 - (ii) Absolute take-aways are exceedingly rare.

As a consequence, it is fundamentally inappropriate for the Board to order a disallowance on the basis that a cost category is “too high” unless it is able to conclude, on the evidence in a particular case that the utility had a reasonable and realistic opportunity to achieve a lower cost, and failed to do so.

There are a number of additional reasons why benchmarking of pension/OPEB costs offers little value:

- Pension and OPEB costs are complex, and are explained by various factors and circumstances relevant to each utility. Apart from various legacy factors, the variation in the type of plans –single or multi-employer, defined benefit or defined contribution, funded or unfunded, registered or unregistered, etc. makes data collection and analysis difficult and renders the conclusion of little value.
- Utilities already do benchmarking and industry good practice with respect to cost. In many cases individual components of total costs are already benchmarked and filed—for example compensation (which includes pension and OPEBs) and vegetation management, productivity, etc. It is

costly and unhelpful to do benchmarking for every item of cost that the utility files.

4. What other relevant information should the Board evaluate in order to effectively assess the pension and OPEB costs that a rate-regulated entity is seeking to be included in the rates charged to customers?

- Current filing requirements – actuarial reports, discount rates, etc.
- In the event that this consultation culminates in the setup of a trust fund for excess revenue collected in OPEB, the interest, tax, revenue, and administrative cost related data and analyses need to be filed. Such information would help to determine if the fund is cost efficient compared to the alternative of not having a trust fund.

Accounting and Recovery in Rates

5. a) Should the OEB establish accounting and recovery methods for both the electricity and gas sectors?

Directionally, there is value in encouraging utilities across the gas and electricity sectors to move towards consistent, similar and comparable accounting and recovery methods. However, consistency alone is not a sufficient reason to impose this or that type of accounting and recovery method on all utilities. A one-size-fits-all approach is not helpful. The PWU submits that the different methods, including the two major ones – cash and accrual, in the final analysis result in the same amount of cost, save for short-term, minor differences such as those relating to the treatment of tax liability. The issue is simply a matter of timing. It would be wrong to propose changes to methods simply based on short-term ratepayer interests. Most of the concern over the rate impact of pension and OPEBs costs so far is not related to the accounting method used by utilities. In general, the Board should approve the accounting method proposed by a utility. The Board has the power to ensure the interests of ratepayers are protected within the context of the proposed method and within its mandate.

In this regard, it is important to note that utilities may need to change their accounting method dictated by the accounting standard they choose to use or are required to use.³ It is important to note that pension and OPEB costs are a function of a number of factors, such as actuarial valuations and forecasts related to discount rates that are beyond the control of the utility. These factors can cause pension/OPEB cost instability regardless of the accounting method employed by the utility. Given that pension/OPEB costs based on cash or accrual methods overtime result in similar costs, such occasional cost fluctuations should be tolerated.

One piece of evidence that arose in OPG's most recent case (EB-2013-0321) merits consideration. Based on 2008-2013 data, OPG employing the accrual accounting method, under collected its pension costs but over collected for OPEB costs. In the same evidence, it was indicated that after some years, the cash method would result in the collection of OPEB over and above what it would be collecting if it applied the accrual method. Utilities should be permitted to choose the approach that fits with their circumstances, including their specific types of plans and consistency with the accounting standard that they choose or are required to use for external reporting.

b) What criteria should be considered to determine the appropriate approach?

Subject to PWU's response to Question 5a, the PWU suggests the following criteria:

- Recognition of pension/OPEB costs as deferred compensation to employees for services that they provide during their working years. That means the costs of providing these benefits are properly included in the revenue requirement during the period that the benefits are earned.

³ The PWU recognizes that the OEB can require the use of a different accounting treatment for regulatory purposes than the utility uses for financial accounting purposes. However, the PWU submits that different treatment should not be required unless there is a compelling regulatory reason for doing so.

- A long-term, not short-term, perspective: The accounting and cost recovery method should not be imposed to achieve short-term relief for ratepayers because doing so would create uncertainty, inconsistency, and cost instability.
- Tax efficiency and ease of administration.
- Transparency and consistency to users of both financial statements for accounting reporting purposes and financial statements for rate making purposes.
- Historical/legacy factors such as collective agreements.
- Variation in types of pension/OPEB plans and the appropriateness of the new approach in mitigating potential adverse impacts on utilities, ratepayers, employees/retirees.
- Administrative and managerial efficiency –ease of integration with accounting standard –i.e. accounting for financial reporting and for rate-making purposes.
- Consistency with the industry trend in accounting standards, i.e., adoption of USGAAP, IFRS, etc.
- How widely is the accounting method currently adopted by utilities across Ontario, Canada?

c) If one method is adopted, what should it be: cash (pay-as-you-go) basis, funding contribution basis, accrual (accounting cost) basis or another method? (please provide details)

Subject to PWU's comment in 5a (directional move to consistent method) and assuming the Board were to decide to adopt one method, the PWU submits that the accrual method is preferred for the following reasons:

- i. Accrual accounting better reflects the retirement benefits an employee earns while working, i.e., accrual accounting more closely aligns the accrual of retirement benefits with the employee's work. The liability and associated expense for pensions and other retirement benefits should be recognized at the time the employee's services are rendered and any part of that cost unpaid at the end of the period should be a liability. This

- matching is the most consistent with the “cost causality” principle of good rate-making;
- ii. The cash accounting approach, on the other hand, is vulnerable to irregularity in the contributions employers make to pension funds and therefore does not accurately reflect the relatively smooth manner in which benefits are earned by employees. This is true not only with respect to the most common pension plans, i.e., registered, defined benefit pension plans but also with respect to OPEBs. As FERC points out, there should be a recognition that:

“measurement of PBOPs for a given rate test is a process of allocating accrued costs between periods in a rational manner so that each period bears its equitable portion of such costs”⁴
 - iii. As FERC points out, “recognition that uniform principles of cost measurements between similarly situated regulated companies and between time periods are beneficial for carrying out the commission’s regulatory programs”. In this regard, the PWU understands that the majority of utilities in Ontario and Canada use the accrual method and therefore adopting the widely used accrual method has benefits. In the case of utilities that currently use both the accrual and cash method, a directional move to the accrual method would mean that they will no longer need to have two books –one for financial reporting and another for rate making purposes thereby avoiding unnecessary additional cost.
 - iv. From a fairness and equity perspective, it makes more sense to attribute pension and OPEB expenses to the periods in which the employees are providing services than burdening the full cost to future customers. The accrual method reflects changes in pension/OPEB obligations and recognizes cost in the reporting period in which an employee has provided the service that gives rise to the benefits. The treatment of pension and OPEB expenses on a cash basis, on the other hand, doesn’t factor in the

⁴ United States of America 61, FERC 61, 330 Federal Energy Regulatory Commission, Post-Employment Benefits Other Than Pensions, Statement of Policy. Issued December 17, 1992.

period in which employee services are rendered, but rather the cash outlay on benefit payments. Further current treatment of recovering pension and OPEB expenses on a cash basis is unfair to current ratepayers as they bear the burden of an accumulation of years of employee services rather than current year employee services.”

- v. The accrual method is consistent with GAAP, the cost of service standard and the principle of intergenerational equity.

d) Should the method for recovering costs relating to registered pension plans be different from that used for unregistered pension plans and OPEB plans?

Similar accounting treatment of both registered and unregistered pension/OPEB plans has the advantage of consistency, transparency and understandability. On the other hand individual utilities may have compelling reasons, for example tax related, that make one method preferable to the other for unregistered plans. If one method is adopted, a gradual transition to the new accounting method would help utilities mitigate any potential financial harm.

6. a) Should the OEB take into account impacts on financial reporting (US GAAP, ASPE and IFRS), legal, and tax matters?

Yes (see 6b below).

b) If so, what are the issues that should be considered when determining the appropriate approach?

Impacts on financial reporting (US GAAP, ASPE and IFRS)

In the PWU’s view, there are two issues subsumed under this question:

- i. Differences in the accounting basis/standard used by utilities; and
- ii. Impacts on financial reporting that arise from the Board’s action at the conclusion of this consultation- i.e., a potential requirement to adopt one, uniform accounting method -accrual or cash- by all utilities while at the same time using different accounting standards such as USGAAP or IFRS.

With regard to the first issue, the PWU's understanding is that while some utilities have made the transition to IFRS/Modified IFRS ("MIFRS"), a number of other utilities have been approved by the Board to utilize US GAAP for rate setting, regulatory accounting and reporting purposes following the decision of the Ontario Securities Commission ("OSC") to grant these utilities permission to use US GAAP in their financial statements. The PWU also notes that the Canadian Accounting Standards Board (the "AcSB") has been deferring the mandatory changeover to IFRS. The main reason why many utilities have been requesting an extension of the use of US GAAP or why the mandatory transition to IFRS has been extended appears to be the lack of integration between CGAAP/US GAAP and IFRS/MIFRS on such issues as the treatment of regulatory assets and deferral/variance accounts and the financial and rate impact that would result if the utilities were to use IFRS/MIFRS which is still a work in progress.

Therefore, the impact of the accounting approach such as cash or accrual relating to pension/OPEB on financial reporting by utilities using different accounting standards should be understood as temporary and one that should be dealt with as the IFRS is developed.

The second issue is more crucial, particularly if the Board requires utilities that currently use the accrual method to adopt the cash method. This is very concerning in light of the fact that some utilities have already made the transition from the cash method to the accrual method. The PWU notes that the Board in its letter cited above advised stakeholders that:

The Board will still require all electricity distributors that previously used the "billed" method to adopt the accrual method no later than June 30 of 2012 for regulatory accounting and reporting, regardless of whether IFRS has been implemented for financial reporting.

Should this consultation culminate in the adoption of one method, the PWU submits that the accrual method would be the preferred one because it would minimize impacts on financial reporting because many have already made the transition to accrual method and others could follow suit. In this regard, the PWU calls for the Board's consideration of the following examples relating to potential implications to financial reporting:

- The cash basis cannot be used for financial reporting purposes for OPEB under US GAAP
- Given the transition utilities are expected to make to IFRS, the use of the accrual basis for both financial reporting and regulatory purposes would result in consistency between financial and regulatory accounting thereby avoiding the administrative burden of reconciling financial and regulatory accounting
- Under US GAAP, there is a prohibition to record a regulatory asset for Other Post-retirement Benefits (“OPRB”) for the difference between accounting costs and the costs included in rates if OPRB costs underpinning rates are determined on a cash basis (US Accounting Standards Codification 980-715-25-4). As a result of this provision, if the Board required a utility to move from the accrual method to the cash basis method to determine the OPRB costs underpinning the utility’s rates, the utility would be required to write-off regulatory assets for OPRB.⁵
- Should this consultation consider the case of utilities transitioning from US GAAP to IFRS, impacts on financial reporting should be assessed in the context of *IFRS – IAS 19 - Employee Benefits*. The implementation of *IFRS – IAS 19* will significantly affect the reporting of employee benefits. Utilities transitioning from USGAAP to IFRS are required to calculate the changes due to *IAS 19*. The changes may affect defined benefit, multi-employer and defined contribution plans. For defined benefit plans, for example, changes include:⁶
 - Prohibition to delay recognition of actuarial gains and losses and past service-cost. Actuarial gains and losses, the effect of the asset ceiling and the actual return on plan assets (“re-measurements”) will be recognized in the balance sheet

⁵ In EB-2013-0321, OPG submitted that it would need to reverse pension and OPEB regulatory assets of approximately \$1-\$3 billion depending on the manner in which the Board implements such a change. OPG’s Reply Argument, pages 185-186.

⁶ Practical guide to IFRS. IAS 19 (revised) significantly affects the reporting of employee benefits. PWC, February 2013.

immediately, with a charge or credit to other comprehensive income (“OCI”) in the periods in which they occur.

- All past service costs are required to be recognized as profit or loss in the period when a plan is amended.
- Interest expense or income need to be calculated on the net defined benefit liability (asset) by applying the discount rate to the net defined benefit liability (asset). This replaces the interest cost on the defined benefit obligation and the expected return on plan assets and will increase the employee benefit expense for most entities.

Tax Matters

The PWU’s understanding is that the taxes payable method was approved by the OEB for determining rates for regulated electricity utilities as specified in the Electricity Distributors Rate Handbook. Under the taxes payable method, the tax amount included in rates reflects taxes payable under the provisions of the *Income Tax Act (Canada)*, rather than taxes calculated for accounting purposes, and hence future/deferred taxes are not recovered through rates.⁷ As a result, in order to determine the tax amounts associated with pension and OPEB, pension and OPEB costs recorded by utilities for accounting purposes are added back to earnings before tax, while contributions made by utilities to their registered pension plans, as well as payment for OPEB and supplementary pension plans, are reflected as deductions from earnings before tax as they are deductible for tax purposes.

In the PWU’s view, in determining the appropriate approach, the Board should take into account the “tax-effect” resulting from the differences in the timing of the recognition of pension and OPEB expenses for income tax purposes, which are determined by tax laws, and the period in which employee future benefits are recognized for financial and regulatory purposes. In particular, the Board should take into consideration the implications of the “tax-effect” associated with pension

⁷ Ontario Energy Board. 2006 Electricity Distribution Rate Handbook

and OPEB on intergenerational equity. Consistent with the principle of intergenerational equity future income tax impacts should be recognized in the same period as the employee future benefit expense. Such an approach would avoid one generation of customers bearing the cost and another generation receiving the tax benefit.

c) For comparative analysis, how should the OEB address differences that arise from (driven by) the basis of accounting that is used by a rate-regulated utility? For example, the treatment of re-measurements under IFRS is different to their treatment under US GAAP and ASPE.

As indicated in the PWU's response to Question 6b with respect to *impacts on financial reporting* (US GAAP, ASPE and IFRS), such differences will continue to exist as long as utilities are allowed to apply different accounting standards. This problem will be solved with a full integration of GAAP and IFRS. A comparative analysis of data about utilities of varying circumstances is always a difficult task and the results are most often unreliable. In fact, there are a number of other more relevant issues relating to pension and OPEB that make it more difficult to make comparisons.

To the extent that a comparative analysis is required to assess the impact of any accounting method, the PWU suggests that the consultation should provide for the identification and description of the key differences between US GAAP and IFRS relating to pension and OPEB costs and a technical discussion and presentation of financial impacts on utilities and ratepayers in the context of IFRS and US GAAP possibly broken down by type of plan (e.g. defined benefit, defined contribution and multi-employer, single employer, etc.).

7. a) Would it be appropriate to establish a deferral or variance account(s) in association with the approaches discussed above in numbers 5) and 6) respectively?

The PWU is of the view that a variance or a deferral account should be established to monitor and account for and mitigate the revenue and rate impact of changes that arise from the transition to a different cost recovery method.

b) How should the account(s) operate?

The opening balance of the variance or deferral account should be equal to the impact amount to be recognized by utilities for the recovery of the financial impacts from adopting the new cost recovery method of pension and OPEB costs. The balance of the account would be determined as at the date of implementation of the new cost recovery method.

The amortization period of the variance or deferral account should vary by utility based on the size of the account balance. The selection of the amortization period of the account should balance the objective of rate mitigation with the financial wellbeing of utilities and intergenerational equity.

c) Should interest be applied to the account(s), and if so, why?

Yes. In the PWU's view there is no material distinction between this deferral account and other deferral accounts which routinely are determined to be interest bearing. The reason for interest is to compensate the utility for the costs associated with the time value of money.

d) How should the transition from the current practice to the new method of recovery be addressed?

- i. Should the transition be phased-in, applied retrospectively with catch-up adjustments for prior periods, prospectively with no adjustments for prior periods or a combination of any of these methods?***

The financial and revenue requirement impacts of a potential transition to a new method can be significant. To mitigate the impact, the transition should be phased-in and applied prospectively, consistent with standard regulatory practice.

ii. Should a generic approach be used or should the transition be addressed on a case-by-case basis?

Transition should be on a case by case basis, to recognize that the starting point for each utility will be different.

8. a) Would it be appropriate to establish some form of segregated fund or similar set-aside mechanism for amounts which are collected from ratepayers before they are paid out?

The PWU assumes this question pertains to OPEBs, as it would not appear to be applicable to pension funds.

The PWU would not oppose the establishment of some kind of segregated fund for OPEB, provided that it can be done in a manner that is tax efficient, the cost of set-up and administration is justifiable, and the adverse impact on the revenues and cash flow of utilities are not material.

b) What tax, legal, accounting or other issues arise?

The tax impact of the potential set-up of a segregated fund for OPEB should be clearly understood. This particular issue was raised in EB-2013-0416 (Hydro One distribution rate Application) in which Board Staff asked if Hydro One had considered creating an irrevocable trust for OPEBs to which Hydro One responded:

The tax vehicles to fund OPEB are not tax efficient in Canada. For example, a supplementary executive retirement plan (SERP) is subject to a 50% upfront tax on contributions, which is only refundable when the benefits are paid. In addition, trusts are generally taxable at the highest marginal tax rate applicable to individuals, which is 49.53% for 2014.⁸

This is in contrast to the CRA rules governing registered pension plans. In those cases, contributions are received by the fund on a pre-tax basis, and earnings within the fund are not subject to tax. Taxes are assessed at the time benefits are paid, and are payable by the recipient. This allows for compounded earnings on the gross amount of those contributions. By contrast, in the ordinary course,

⁸ EB-2013-0416, Exhibit I, Tab 4.03, Schedule I1, Staff 73 ©, page 3

contributions to an OPEB trust would be received on an after tax basis, and any income earned on those contributions would be taxable on an annual basis. As a result, much larger contributions would be required to generate a fund of similar size of a registered pension fund, holding all else equal.

c) How should the transition to the new practice be addressed?

- i. Should the transition be phased-in, applied retrospectively with catch-up adjustments for amounts collected from ratepayers to date but not yet paid out, prospectively with no adjustments for prior periods or a combination of any of these methods?***

See responses to Question #7,d, i.

- ii. Should a generic approach be used or should the transition be addressed on a case-by-case basis?***

See response to Question #7, d, ii.

9. What information should the utilities report and how frequently should it be reported?

The type and frequency of information that utilities should file beyond what is required under the status quo will depend on the results of this consultation (see response to Question #4). It is the PWU's view that the practical approach would be to consider issues related to information requirement in the next phase of the consultation.

All of which is respectfully submitted.