SOCIETY of
UNITED PROFESSIONALS
IFPTE 160

9th April, 2018

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VIA Canada Post and RESS Filing

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Re: EB-2017-0338 Hydro One Networks Inc. (Transmission)
Application for an Accounting Order Establishing a Deferral Account
Society of United Professionals' Submissions

Dear Ms. Walli,

Please find attached the Society of United Professionals' Submissions in the Hydro One Networks Inc (Transmission) Application for an Accounting Order Establishing a Deferral Account, EB-2017-0338.

Two (2) hard copies of this submission have been sent to your attention.

Sincerely,

[Original signed by M. Johnston]

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Society of United Professionals
SUBMISSIONS

EB-2017-0338 Hydro One Networks Inc. (Transmission)

Application for an Accounting Order Establishing a Deferral Account

9th April, 2018

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EB-2017-0338: Society of United Professionals' Submissions

Introduction:

This is the written submissions of the Society of United Professionals in the Hydro One Networks Inc. (Transmission) Application for an Accounting Order Establishing a Deferral Account, EB-2017-0338.

Summary:

The Society of United Professionals supports Hydro One Networks Inc. (Transmission)'s (Hydro One Transmission's) request for an OEB-approved regulatory accounting policy exception to enable it to continue to capitalize accrual-based Other Post-Employment Benefits Costs, on the same basis as it did prior to the effective date of a recently released U.S. accounting standard.

This approach would avoid a material adverse impact on the shareholder for 2018 costs that would otherwise be reclassified from capital to OM&A. It would also be preferable to the option initially requested by Hydro One Transmission, i.e. that of charging the affected costs to a regulatory deferral account for future review and disposition. This is not the Society of United Professionals' preferred approach because it would increase regulatory complexity and it effectively "kicks the issue down the road" for future resolution.

The policy change requested by Hydro One Transmission is consistent with the intended application for rate regulated entities found in the discussion section of the new accounting standard and is consistent with related US guidance provided by the federal regulator, the Federal Energy Regulatory Commission (FERC).

In the view of the Society of United Professionals, any regulatory policy change affecting the regulatory treatment of Other Post-Employment Benefits and Pensions should be made in the context of all affected Ontario regulated entities using US accounting standards as a basis of regulation and only after sufficient study of the impact of the change on rates, costs and information availability. This would be consistent with the approach used by the OEB in its recent comprehensive review of the regulatory treatment of pensions and other benefits (EB-2015-0040 Report on the Regulatory Treatment of Pension and Other Post-Employment Benefits (OPEBs) Costs).

The Society of United Professionals prefers the option of providing a regulatory policy exception but if the OEB rejects this, the requested deferral account should be granted. Hydro One Transmission has met the three criteria of materiality, prudency and causation. In addition, the timing of Hydro One Transmission's request was reasonable and consistent with generally accepted regulatory practice under the circumstances.

Not approving a policy change or a deferral account would unfairly burden Hydro One Transmission's shareholder with unanticipated prudently incurred costs, which would be inconsistent with regulatory norms.

Background:

On November 2, 2017, Hydro One Transmission requested OEB approval for a new deferral account to record other post-employment benefit (OPEB) amounts that were included as planned capital expenditures in its most recent Transmission rate case EB-2016-0160. Effective January 1, 2018, certain of these amounts have been disqualified from capitalization under U.S. generally accepted accounting principles (US GAAP) following an accounting amendment from the Financial Accounting Standards Board (FASB) issued in March 2017. The new accounting guidance is entitled "Compensation - Retirement Benefits. Improving the Presentation of Net Periodic Pension Costs and Net Periodic Postretirement Benefit Cost" and is numbered as Accounting Standards Update (ASU) 2017-07. The new accounting update has been filed by Hydro One Transmission in response to BOMA IR #1.

Hydro One Transmission initially requested a deferral account to record an estimated $11 million financial impact in 2018. This impact is the estimated increase in 2018 OM&A costs that results from implementing the new accounting guidance from FASB. While it would be normal to request that the entity record the net revenue requirement impact in a deferral account, Hydro One Transmission has made it clear in several of its IR responses that the $11 million amount is only the OM&A increase. Secondary impacts such as those related to depreciation, interest and return have not been provided due to the complexity of the modelling requirements. In addition, as Hydro One Transmission makes clear in its response to BOMA IR #3, it is confident that the non-OM&A impacts on revenue requirement in 2018 would be immaterial.

In its covering letter to the various IRs asked as part of this proceeding, Hydro One Transmission has updated its request to make a deferral account a secondary request. After discussion with its independent external auditor and review of U.S. regulatory discussions and guidance, especially that of the Federal Energy Regulatory Commission (FERC), Hydro One Transmission now states it would prefer to have a regulatory policy approval from the OEB that allows continued capitalization of the otherwise disqualified OPEB costs. Hydro One Transmission notes that this effectively achieves the same objective without the additional regulatory overhead that results from tracking additions to and dispositions from the deferral account.

Hydro One Transmission notes that the specific US GAAP revision only affects its capitalization of OPEB costs. Its pension costs are unaffected even though some pension contributions do pertain to past service amounts and actuarial revisions. This is because Hydro One Transmission remains on a cash basis for pension accounting as a result of a past regulatory policy decision by the OEB. Pension costs accounted for on a cash contributions basis do not appear to be affected by the capitalization provisions of ASU 2017-07.

In its EB-2016-0160 decision on 2017/2018 rates for Hydro One Transmission, the OEB took note that OEB staff had suggested that a Modified International Financial Reporting Standards (MIFRS)-based capitalization policy would be preferable to the use of the existing USGAAP-based approach. The OEB did not accept OEB staff's argument but it did raise the possibility of beginning a policy review of the continued use of USGAAP as a basis for the capitalization of overhead amounts (Decision and Order - September 28, 2017 p. 82).

Argument:

The Society of United Professionals supports Hydro One Transmission's updated request for a regulatory policy approval allowing it to continue to capitalize OPEB costs that would be disqualified as capital expenditures by the provisions of ASU 2017-07. This position is based on several factors.

In the covering letter to its submission of April 3, 2018, Hydro One Transmission noted that a regulatory policy approval would "achieve the same objective as the requested deferral account without the additional regulatory overhead associated with the ongoing tracking and disposition of balances in the account." The Society of United Professionals generally agrees with this proposal but does note that the detailed financial impacts of continued capitalization under a regulatory policy exception do differ from the impacts of deferral and disposition. This is due to a different interest model used for construction work in progress amounts and regulatory deferrals. Construction in progress amounts are interest accreted on a compound basis at the company's embedded cost of long-term debt rate while regulatory deferral accounts are accreted based on a simple interest model at the OEB's published short term rates. In addition, capitalized costs earn a return once introduced to rate base and the timing of recovery of capitalized/deferred costs differs through the use of depreciation/amortization.

The Society of United Professional considers that the capitalization approach is superior to simple deferral and amortization. If costs are deferred and amortized to a future rate year, material costs previously included in rates will be removed for 2018 and potentially charged to future rate years in addition to those years' share of the same costs. The Society of United Professionals does not consider this appropriate where a reasonable and compelling option exists.

Using a deferral account for 2018 is administratively complex as is evidenced by the fact that Hydro One Transmission cannot present a full revenue requirement impact in response to several IRs requesting it. This is not unexpected as Hydro One's labour costs, including an element of OPEB cost, will be charged directly and indirectly to work programs and projects under a capitalization approach. Allowing the continuance of capitalization avoids the additional accounting effort in removing these costs from capital and tracking and reconciling deferred costs and other revenue requirement impacts. Regulatory simplicity is retained.

Approving an exceptional capitalization policy for regulatory purposes also has the advantage of continuing a rate treatment that is consistent with prior years and consistent with Hydro One Distribution. The importance of year-over-year policy consistency was recognized by the OEB in its EB-2015-0040 Report on the Regulatory Treatment of Pension and Other Post-Employment Benefits (OPEBs) Costs when it noted that "the intended practice of maintaining a consistent method used to determine recovery over time may be one reason for not adopting the accrual method for rate setting." (page 8). Consistency with Hydro One Distribution is important both to limit the introduction of accounting and regulatory complexity given the common and sometimes shared labour forces of the two regulated businesses and the OEB's stated desire to bring together the regulation of Hydro One's Transmission and Distribution businesses in the near future. If a change to the current accounting practice is to be introduced, it would be best to wait for a combined Transmission and Distribution proceeding to study and implement it.

Similarly, the potential change to the regulatory status quo with regard to the capitalization of OPEB costs should await the OEB's decision on whether or not it wishes to review the wider issue of the use of USGAAP for capitalization of overheads and other indirects. The Society of United Professionals has very strong views on the potential adoption of MIFRS in place of US GAAP for capitalizing indirect costs. It is strongly against this possible change in policy due to the very material adverse rate impacts on Hydro One customers and due to the fact that no material change in fact has occurred since the OEB approved the use of USGAAP for Hydro One's Transmission and Distribution businesses in the EB-2011-0268 and EB-2011-0399 proceedings respectively. The Society of United Professionals believes that a change in accounting from that previously used to regulate Hydro One's Transmission business would best be assessed in the context of a wider USGAAP/MIFRS policy review, should it occur. In addition, as other large companies in Ontario use US GAAP as the basis for rate regulation, such a policy review would presumably have to be held on a gas/electric industry level and involve all affected companies and stakeholders. In the meantime, it would be prudent to continue the existing regulatory accounting treatment.

The Society of United Professionals also takes note that there appears to be significant U.S. support for the continuance of capitalization of otherwise disqualified benefits costs for rate regulated enterprises. The FASB considered adding a specific exception for rate regulated entities in its revised guidance. It did not do so but as discussed on page 48 and 49 of ASU 2017-07, the FASB was cognizant that certain industries, such as rate regulated utilities, had other avenues to allow the continuance of capitalization. The FASB did not include a specific exception for rate regulated entities because it has a general aversion to providing industry-specific accounting, especially where an existing accounting standard allows for a regulatory accounting exception where specific criteria are met.

As Hydro One makes clear in its April 3 submission, the federal regulator in the US has provided guidance (Docket No. AI18-1-000) for rate regulated entities within its jurisdiction. The FERC guidance referred to by Hydro One Transmission in its cover letter and in its IR responses is found at the following web address: https://www.ferc.gov/enforcement/acct-matts/docs/AI18-1-000.pdf .

Specifically:

"2. CAPITALIZATION OF PENSION AND POST-RETIREMENT BENEFITS OTHER THAN PENSION COSTS

Question: Is it appropriate for jurisdictional entities to capitalize pension and PBOP costs using the method prescribed under ASU No. 2017-07?

Response: Provided that the pension and PBOP costs are based on appropriate labor costs and have a definite relation to construction as required under Electric Plant Instruction No. 4, Gas Plant Instruction No. 4, and Service Company Property Instruction No. 367.52, jurisdictional entities may continue to capitalize the service cost component and non-service cost components of pension and PBOP costs as it has traditionally been the widely accepted practice, or they may elect to capitalize only the service cost component of pension and PBOP costs, as prescribed by ASU No. 2017-07. Both methods are appropriate and are not precluded by the Commission's accounting requirements."

The guidance allows entities under FERC jurisdiction a policy choice to either continue to capitalize pension and OPEB costs consistent with past practice or to adopt the specific provisions of ASU 2017-07. The only proviso is that the labour to which the costs relate is a cost input to assets under construction. Therefore, the Society of United Professionals believes that Hydro One Transmission's April 3, 2018 request of regulatory policy exception is consistent with prevailing U.S. regulatory guidance.

In the event that the OEB does not approve a regulatory policy exception allowing Hydro One Transmission rates to continue to be set using its legacy accounting policy for OPEB accounting, the Society of United Professionals also supports approval of the regulatory deferral account that was requested in Hydro One Transmission's initial application. Hydro One Transmission has referred to this account both as a deferral account and a variance account. The Society of United Professional considers it to meet the criteria to be considered a deferral account.

The Society of United Professionals agrees that Hydro One Transmission has met the OEB's three criteria for a new regulatory account, specifically Materiality, Prudency and Causation. In addition, the Society of United Professionals agrees that it would have been improper for Hydro One Transmission to have introduced this issue into an in-progress rate proceeding at the point in the rate setting process where the issue became known. Treating this new accounting event as a material change outside the wider 2017/2018 rate setting process would seem to be consistent with past practice of not introducing new evidence after the conclusion of oral evidence. In addition, delay has allowed a better understanding of the US industry reaction to the new accounting to be known.

Conclusion:

In conclusion, the Society of United Professionals supports Hydro One Transmission's updated request for a regulatory policy exception to the recent US accounting guidance. This exception should remain in place until any potential wider review of the capitalization of affected benefits costs is completed and effective.

In the absence of such an exception being approved, the OEB should instead approve a new deferral account on the basis originally requested.

ALL OF WHICH IS RESPECTFULLY SUBMITTED ON THIS 9th DAY OF APRIL, 2018