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BY COURIER & RESS

Ms. Kirsten Walli, Board Secretary
ONTARIO ENERGY BOARD
2300 Yonge Street, 26th Floor, P.O. Box 2319
TORONTO, ON M4P 1E4

Re: Board File No. EB-2015-0040
Consultation on the Regulatory Treatment of Pensions and Other Post-Employment Benefit Costs

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Dear Ms. Walli:

Attached please find KWHI's comments with respect to the Consultation on Pensions and Other Post Employment Benefit Costs.

KWHI's submission has been electronically filed through the Board's web portal, and three (3) hard copies have been couriered to the Board's offices.

Respectfully submitted,

Original Signed By:

Margaret Nanninga, MBA, CPA, CGA
Vice President Finance & CFO

lm/attachments

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.

> KWHI submits that all of the principles listed above should be used to guide potential future OEB policy. Of considerable note is cost stability for rate payers as electricity rate payers have been subject to many cost increases over recent years from various sources.
>
> In addition, consideration should be given to the levels of risk faced by the various entities. Pension cost issues facing the entities in the "*Report on the Sustainability of Electricity Sector Pension* Plans" are unique to those entities, and not those LDCs that are members of the OMERS Pension Plan. OMERS is a Jointly Sponsored Pension Plan (JSPP) where risk is spread across all of the member employers. The others have Single Employer Pension Plans (SEPPs) where the entire risk of funding falls on the employer. In each case, the risk exposure is quite different.

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)

> The examples given are similar in that they are future costs that are expensed in the current period. The difference between the listed costs and Pension and OPEB costs is that the latter are reviewed by a third party and actuarially valued.

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).

> KWHI submits that it might be beneficial for applicants to compare their pension and OPEB costs to other utilities. Pension costs for LDCs who are members of OMERS should be similar and thus comparable. The difficulty lies with who those entities with SEPPs are to compare themselves to when there are few (if any) comparators.
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> LDCs typically offer employees post-retirement benefit packages as part of the compensation package. The benefits offered by LDCs in the province likely vary as post-retirement benefits are typically negotiated through collective agreement and are therefore a management decision. Since the benefits vary from LDC to LDC, so do the costs. This cost difference will be due to many factors including varying levels of wages and benefits between LDCs and composition of staff complement.

Benchmarking may be a useful tool to take these additional factors into consideration beyond simple cost. Isolating the OPEB costs without considering the entire compensation package; however, may not be an adequate benchmark.

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?

- Balance of compensation and OPEB (i.e. lower wages may be accepted for increased OPEB)
- Funding risks facing the plan
- Changes to the plan within management's control since the last rebasing
- Changes to the plan that are outside of management's control (i.e. interest rates, mortality rates, etc.)
- Effect of the changes on the value of the plan
- Actuarial gains/losses

Accounting and Recovery in Rates

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

Yes, the OEB should establish accounting and recovery methods across the utility industry for consistency. Standardization of accounts, accounting methodology and inclusion/exclusion for rate making purposes would be appropriate and assist the OEB with benchmarking and utility comparisons.

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

The criteria to be considered for determining the appropriate approach should be:

- Fairness
- Ease of administration
- Timeliness of cost recovery
- Customer rate impacts

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)

• "Pay-as-you-go" cash payment: is equal to the benefit payment to the plan beneficiaries, as specified by the terms of the plan

• Funding contribution: 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 (PBA), and related rules and regulations

• Accounting cost: this is the accrued cost determined by accounting rules (in accordance with a given accounting framework) and recognized and reported in general purpose financial statements (ultimately split between capital expenditures and operating expenditures)

Option #1 - For pension contributions, the pay-as-you-go cash payment is appropriate. For OPEB, this option would not be the preferred method as it would be susceptible to significant increases. The costs for OPEB are expected to increase over the next few years as an aging workforce retires.

Option #2 – Minimum legal contributions methodology is not the preferred method as the recoveries should reflect the utility's actual costs. Recovery of less than what is being paid could threaten the financial viability.

Option #3 - Accounting cost would be the preferred method and is the current one in practice. This accrual method is confirmed by a third party (the actuary of record) and is accepted by the International Accounting Standards Board as the accepted method to include future costs in current rates. These costs are recoverable in current rates because they are considered to be part of current staff's compensation. Including these accrued costs in current year rates should reduce the likelihood of rate volatility as pension and OPEB costs increase in the future. KWHI submits that the accounting cost method is the fairest way to determine costs.

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

No, there should be no difference between the methods used for recovering costs regardless of the type of plan.

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

Yes, the OEB should consider financial reporting, legal and tax matters.

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

The recording of actuarial gains/losses is of particular note. The recording of actuarial gains/losses under IFRS requires that the entire actuarial gain or losses be accounted for in "Other Comprehensive Income" in a plan revaluation year (typically every three years). This entry can have a significant impact on earnings and create "lumpiness" in earnings. With CGAAP, actuarial gains/losses were amortized over the period of the valuation, creating a smoothing effect. KWHI submits that, for rate making purposes, the CGAAP practice of smoothing the effect of the actuarial gain/loss over the valuation period would be appropriate. Differences would be recorded to a regulatory variance account. This would allow a smoothing of regulatory income and rate protection for ratepayers.

The OEB should consider tax matters since pensions and OPEB affect regulatory income regardless of how they are accounted for. In addition, there are differences in the assumptions used in the valuation of OPEB by actuaries between CGAAP and IFRS. If this valuation difference also exists between USGAAP and IFRS, this is another issue that should be considered.

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 mentioned above, actuarial gains and losses under IFRS are recorded and recognized in the year that they occur, creating a "lumpiness" to earnings. This is not seen in other accounting standards resulting in a loss of comparability between rate regulated utilities. If the CGAAP practice of smoothing the gains and losses is adopted, comparability can be maintained.
>
> For the differences in valuation between IFRS and GAAP/ASPE for OPEB, a variance account could be set up by the Board if the differences are of a material nature.

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?

> Yes, the setting up of variances accounts would seem to be appropriate to capture these differences. There are potentially two variance accounts that could be set up (or one variance account with sub-accounts):
>
> 1. For an LDC that has adopted IFRS, a variance account could be used to smooth the effect of the revaluation of the OPEB plan actuarial gains and losses.
>
> 2. A variance account could be set up to record the differences in assumptions used to value the liability for IFRS/USGAAP/ASPE – i.e. interest rates, mortality rates etc. Using standard assumptions may value the plans on a comparable basis.

b) How should the account(s) operate?

> In general, the variance accounts should operate the same as any other variance accounts, for consistency and simplicity.
>
> For the first variance account which would record OPEB actuarial gains and losses, it would be appropriate for the utility to record the full amount of the actuarial gains or losses in the variance account and cleared over the valuation period evenly on an annual basis (typically three years). The balance at the end of the valuation period would be zero with no recovery required.
>
> For the second variance account that would track the differences between IFRS/USGAAP/ASPE, the Board would first need to decide which accounting standard would be accepted as the basis of which variances are calculated. When this decision is completed, the recording of the balances would only apply to those utilities that do not use the accepted basis of valuation. Utilities could apply for recovery of material balances or it could remain a rolling total.

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

The recording of interest would not be required to be applied to these accounts as the accounts are a non-cash liability.

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 transition should be applied prospectively. This methodology is consistent with any accounting pronouncements. This method is transparent and easy to understand. Catch-up adjustments for prior periods may not be acceptable as this could be considered retroactive ratemaking. A transition that is phased in does not allow a utility to recover its costs as incurred.

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

A generic approach is preferable because there would be consistency and comparability across the sector. If the situation warrants, the Board should still consider transitions on a case-by-case basis.

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?

This approach may provide a level of protection for utilities with SEPPs. For smaller LDCs, a segregated fund or similar mechanism is unlikely to be material enough to justify set up and administration costs.

In addition, the setting up of a segregated fund would be inconsistent with how other long-term liabilities are dealt with on the balance sheet of a corporation.

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

The biggest issue with this approach is that a segregated fund implies that there would be a cash payout to the fund. This may be financially difficult for a utility with limited working capital. Additionally, the long-term liability that is set up on the utilities' balance sheet recognizes this long-term liability. If forced to set aside funds, utilities may be faced with additional borrowing costs to fund the segregated fund. These borrowing costs would have to be passed on to the customer through rate increases which are not desirable.

The accounting for a segregated fund would not pose difficulties; however, there may be tax implications depending on how the fund is set up from a legal perspective. The legal arrangement for the fund would be the determining factor of the deductibility for tax purposes.

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?

> If a fund is set up, a phased-in approach may be acceptable. The phase-in could be funded with current amounts collected from ratepayers, but not yet paid out, and allow a set period of time to fund the past accrued liability. This would ease the financial burden on the utility.

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

> A generic approach is preferable because then there would be consistency and comparability across the sector. Due to the differences across the utility sector, (i.e. size or sustainability) it may be better to address the issues on a case-by-case basis, if the situation warrants that approach.

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

> If a variance account were to be implemented to track pension and OPEB variances, annual regulatory reporting would be appropriate as part of the RRRs. Additional analysis should be provided as part of a Cost of Service application.