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Our File No. 339583-000209

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July 31, 2015

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
27th floor
Toronto, ON M4P 1E4

Dear Ms. Walli,

Re: Consultation on the Regulatory Treatment of Pensions and Other Post-Employment Benefit ("OPEBs") Costs
Board File #: EB-2015-0040

These are the Initial Written Submissions of Canadian Manufacturers & Exporters ("CME") on the Board's Consultation on rate regulated utility pensions and other post-employment benefits ("OPEBs") in the electricity and natural gas sectors (the "Consultation").

As the Board has identified in its correspondence of May 14, 2015, to date, the Board has addressed pension and OPEB issues on a case-by-case basis. As the Board is aware, CME has participated in a number of applications in which pension and OPEB issues have arisen, including Ontario Power Generation's ("OPG's") 2014-2015 Payment Amount Application (EB-2013-0321) and Hydro One's ("H1's") Distribution Rate Application for the Years 2015-2019 (EB-2013-0416).

CME supports the premise of this Consultation, as well as the objective to develop standard principles to guide future review of pension and OPEB costs. CME also supports the establishment of appropriate regulatory mechanisms for cost recovery to be applied consistently across the gas and electricity sectors for rate regulated entities. In saying this, CME is cognizant of the fact that the circumstances for one regulated utility may be very different from the circumstances of another. For this reason, we urge the Board to build flexibility into its regulatory mechanisms.

In preparing these Initial Written Submissions, CME has relied upon the submissions of Board Staff in the OPG 2014-2015 Payment Amount case (EB-2013-0321). We urge the

Board to review these submissions in the context of this Consultation. In particular we find Board Staff's assessment of the accrual basis for accounting for Pension and OPEB costs to be persuasive – when compared to the cost basis approach for ratemaking purposes, the accrual basis places an unnecessary burden on today's ratepayers.

CME has also relied upon the *Report on the Sustainability of Electricity Sector Pension Plans to the Minister of Finance,* prepared by the Special Advisor Jim Leech on March 18, 2014 (the "Leech Report"). This report was filed with the Board on EB-2013-0416. For ease of reference, we attach a copy of the Leech Report to these Initial Written Submissions.

The terms of reference for the Leech Report tasked the Special Advisor to provide advice to the Government on potential changes to the single employer pension plans at H1, OPG, the Independent Electricity System Operator (the "IESO") and the Electrical Safety Authority (the "ESA") that would result in plans that are both affordable to employers and ratepayers, as well as sustainable for the members who will rely on them for their retirement. While we recognize that the Leech Report specifically addresses pension issues associated with these plans, we believe that many of the observations and recommendations made in the Leech Report address the broader issues being considered by the Board in this Consultation.

With the above considerations in mind, we have prepared the following responses to the Board's list of questions:

General Principles

1. *What principles should the OEB adopt in addressing pension and OPEB issues?*

In developing standard principles to guide future review of pension and OPEB costs, it is imperative that sustainability of the plans be assessed by the Board.

The Leech Report concluded that the pension plans it reviewed were far from sustainable. They have a high total cost, volatile/unpredictable contribution rates and have yet to incorporate new actuarial mortality assumptions. Furthermore, they have no flexibility to absorb the effect of future adverse events. The Special Advisor wrote:

> It is critical that the plans build flexibility into their structures so that they are able to accommodate shocks in the future. Because so much of the pension liability is already accrued, and changes can only affect future service, benefit changes that provide flexibility must be adopted sooner rather than later to have a meaningful impact.[1]

[1] Leech Report, page 20.

Moreover, in developing standard principles, we urge the Board to establish mechanisms to meaningfully compare the pension and OPEB costs of rate regulated utilities.

One of the key conclusions of the Leech Report is that pension benefits – at least for some utilities – can be "generous and costly".[2] The comparison of costs for regulated utilities will allow the Board to assess the market reasonableness of pension and OPEB costs, and to disallow pension benefit costs for those utilities which exceed what is reasonable in the market.

Specifically, CME supports the establishment of filing requirements which permit the Board to compare utility pension and OPEB costs across the province. By establishing this level of common information, the Board can then determine market reasonableness.

Those utilities whose pension and OPEB costs exceed market reasonableness, should not recover excess pension and benefit costs unless extraordinary circumstances are established.

2. *Are there other types of costs previously considered by the OEB that provide suitable analogies for the consideration of pension and OPEB issues?*

CME has no comment on this question at this time.

Information Requirements

3. *Should the applicants be required to compare their pension and OPEB costs to industry norms and/or other benchmarks?*

CME supports the comparison of utility-specific pension and OPEB costs to industry norms and other benchmarks. This will permit the Board to determine whether any utility's pension and OPEB costs exceed market reasonableness.

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?*

In our submission, the level of employee/employer contribution is a relevant consideration for the Board. We encourage the Board to require utilities to file comprehensive information on the employer/employee cost sharing of their pension plan.

Employee contributions can greatly vary from utility to utility. By way of example, the Leech Report recognizes that the employee contribution for plan members for H1, OPG, IESO and ESA are in the range of 6-7% of salary, compared to Toronto Hydro and other

[2] Leech Report, page 24.

local distribution companies in the Ontario Municipal Employees Retirement System (OMERS) sector in which employee contributions are currently around 14% of salary.[3]

We recognize that some cost drivers – such as discount rates, mortality rates of legislative changes - are not under the control of the utilities. However, there are some cost drivers – such as employee contributions, indexing, spousal plans – that are under the control of the utilities. Accordingly, we encourage the Board to include in its filing requirements information on all cost drivers that can be controlled by the utilities.

Accounting and Recovery in Rates

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

Unless there is evidence filed in this Consultation that justifies establishing different accounting and recovery methods for electricity and gas sectors, all rate-regulated utilities should operate within the same framework.

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

CME has no comment on this question at this time.

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?*

As the Leech Report recognizes, pension and OPEB costs which are calculated using the accrual method are highly volatile:

> Pension costs represent a significant risk to prices. It is difficult to predict pension expense as market returns shift, low interest rates continue and mortality assumptions change. This volatility represents a price risk for customers.[4]

Unless there is evidence filed to the contrary, it appears to be commonly recognized that the cash basis model is less volatile than the accrual basis. This is because cash contributions can be subject to statutory and actuarial smoothly mechanisms, whereas accrual amounts can substantially change by alterations in plan returns, discount rates, mortality assumptions, etc.

In this regard, CME relies upon Board Staff's conclusions in EB-2013-0321 that the accrual basis for accounting for pension and OPEB costs places an unnecessary burden on

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[3] Leech Report, page 17.
[4] Leech Report, page 13.

today's ratepayer, and that the best approach to mitigate the impact on ratepayers is to move to the cash basis for ratemaking purposes.[5]

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

CME has no comment on this question at this time.

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

CME has no comment on this question at this time.

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

CME has no comment on this question at this time.

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?*

CME has no comment on this question at this time.

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?*

CME has no comment on this question at this time.

b) *How should the account(s) operate?*

CME has no comment on this question at this time.

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

CME has no comment on this question at this time.

a) *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?

[5] Board Staff Submission filed August 19, 2014 in EB-2013-0321, page 88.

CME has no comment on this question at this time.

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

CME has no comment on this question at this time.

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?*

CME has no comment on this question at this time.

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

CME has no comment on this question at this time.

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?

CME has no comment on this question at this time.

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

CME has no comment on this question at this time.

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

We have set out above specific information that should be reported by the utilities. In our view, reporting should occur on an annual basis.

Yours very truly,

(PER) Vincent J. DeRose
VJD/EFA/kt

cc. EB-2015-0040 Interested Parties
Paul Clipsham and Ian Shaw (CME)

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