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July 31, 2015

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
Suite 2700
Toronto, Ontario, M4P 1E4

Dear Ms. Walli:

Re: EB-2015-0040 - Consultation on the Regulatory Treatment of Pensions and Other Post-Employment Benefit Costs - Written Comments of the London Property Management Association

On May 14, 2015, the Ontario Energy Board ("Board") announced its intention to review the regulatory treatment of pensions and other post-employment benefits ("OPEBS) costs in the electricity and natural gas sectors.

For the initial round of submissions, interested parties were invited to provide written comments on a number of issues included in the Board's May 14, 2015 letter. Interested parties were also encouraged to supplement their submissions with views on other issues which they believe warrant the Board's attention at this time.

These are the comments of the London Property Management Association ("LPMA") with respect to the questions posed in the Board's May 14, 2015 letter.

General Principles

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

LPMA submits that a number of principles should be adopted in addressing pension and OPEB issues. These principles should be applied consistently across all regulated entities in Ontario including gas and electric, distributors, transmitters, IESO and OPG.

A key principle for LPMA is intergenerational equity. Future ratepayers should not subsidize current ratepayers and current ratepayers should not subsidize future ratepayers.

Another principle that is important is stable and sustainable cost levels that reflect an efficient level of costs for ratepayers. This is especially important with respect to the costs associated with pension and OPEB costs which have been rising at significant rates for several years and are, in the view of LPMA, unsustainable.

Throughout these comments, LPMA emphasizes the need to benchmark pension and OPEB costs against not only the industry, but against the private sector. This reflects an important function of the Board - to act as a market proxy.

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

LPMA believes that the most suitable analogy for pension and OPEB issues is the treatment of taxes (or PILs) for regulatory purposes. This is because the Board has significant experience with respect to the regulatory treatment of taxes.

<u>Information Requirements</u>

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

LPMA submits that comparing pension and OPEB costs to industry norms is totally insufficient. Pension and OPEB costs <u>and types</u> should be compared to norms within the private sector, not just within the industry.

The type of pensions available (defined benefit, defined contribution) should be benchmarked against the availability of these pension plans in the private sector. Similarly the type of OPEB plans should be benchmarked against private sector plans.

With respect to costs, both pensions and OPEB need to be benchmarked against private sector plans in terms of how rich the plans and programs are. Further, there has to be benchmarking as to the sharing of the costs between the employer and employees, given that the employer costs are paid by ratepayers.

<u>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?</u>

As noted above, LPMA believes that the relevant information is benchmarking to private sector plans. This includes the types of plans available, the cost of plans available and the division of the costs between employer and employees. This is all relevant because the Board must evaluate the costs of these plans ultimately paid for by ratepayers and whether such costs would be sustainable in a competitive market.

Account and Recovery in Rates

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

Yes. As noted above, a standard approach should be used for regulatory purposes across all regulated entities, both electricity and gas. The establishment of accounting and recovery methods would form the basis of such a standard approach.

LPMA believes that the use of a standard approach would also enhance the benchmarking of distributors against one another because it would eliminate differences due to different accounting and/or recovery methods.

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

A number of criteria should be considered in determining the appropriate approach. These criteria would include stability of costs and intergenerational equity. It would also include a review of the costs paid for by ratepayers with respect to benchmarking pension and OPEB plans across the private sector, not just in the industry.

5. 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?

LPMA supports the use of the cash basis. This method best matches costs paid by ratepayers to when they are paid by the utility, thereby minimizing intergenerational inequities.

In addition, the cash basis for both pension and OPEB costs appears to provide a more stable level of costs over time. As the Board knows, stable rates for ratepayers are a key finding from customer surveys in terms of what customers want. Stable rates are only achievable if costs are stable. The cash method appears to provide more stability than the other methods at this point in time. This is because the other methods are significantly influenced by discount rates and with historically low interest rates, even a small change can result in a significant change in the discount rate .

The accrual basis recognizes the costs when the entitlement to the pension and OPEBs is earned, not when the regulated entity has to pay the costs. This raises the issue of intergenerational equity. Today's ratepayers should not be paying for future benefits. Those future benefits should be paid for by future customers.

In addition, LPMA submits that there is no good reason why ratepayers should pay for entitlements before the regulated entity actually pays them.

This also leads to the issue that the Board highlighted in the EB-2013-0321 Decision with Reasons dated November 20, 2014 in which it said (page 88):

> *"The Board is concerned that any money collected from ratepayers today, in excess of the cash requirements, is not being used to fund future pension and OPEB cash requirements. The Board has considered both OPG's needs and those of ratepayers. In the absence of a Board policy, the Board will not allow the collection of funds from ratepayers in 2014 and 2015, of an amount higher than OPG's cash needs, when OPG's use of the excess funds is not understood, and the benefit to ratepayers is uncertain."*

With regards to the OPEB expense, the Board also indicated in the EB-2013-0321 Decision (page 90):

> *"The Board is not confident OPG has undertaken the level of cash flow analysis required to ensure it will have sufficient cash available as a corporation, when its cash needs exceed accrued expenses. It would be inappropriate to collect revenues today in excess of cash requirements and then turn to ratepayers in the future, when cash requirements exceed accrued expenses. The Board must ensure ratepayer interests over time are fully considered."*

LPMA agrees with and shares this concern. How do ratepayers know that any amount built into the revenue requirement (or in the case of OPG, the payment amount) for pension and OPEB costs in excess of the cash need is actually going to go towards those future costs? In the absence of a segregated fund or some other Board mandated mechanism for amounts collected from ratepayers before they are paid out, there is no guarantee that ratepayers will not have to pay for this cost again in the future despite having paid for it in the past already.

In the view of LPMA both the accrual basis and the funding contribution basis suffer from the fact that both can change significantly and quickly with changes in market performance and interest rates (discount rates). In today's low interest rate environment, a relatively small basis points change in interest rates can result in significant changes to the accounting costs and can have significant impacts on the funding contribution required to keep a plan solvent.

<u>5. d) Should the method for recovering costs relating to registered pension plans be different from that used for unregistered pension plans and OPEB plans?</u>

No, LPMA believes the cash basis is the best recovery method in each instance.

<u>6. a) Should the OEB take into account impacts on financial reporting (USGAAP, ASPE and IFRS), legal and tax matters?</u>

More information is required on the impacts on financial reporting as well as legal and tax matters.

<u>6. b) If so, what are the issues that should be considered when determining the appropriate approach?</u>

This is likely to depend on what the specific issues are. Once the specific issues are identified, appropriate approaches can be identified and discussed.

<u>6. 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-measuring under IFRS is different to their treatment under USGAAP and ASPE.</u>

It is not clear to LPMA why the basis of accounting should affect regulatory accounting and the recovery of costs in rates.

<u>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?</u>

Yes. In the EB-2013-0321 Decision, the Board approved a new deferral account for OPG to record the differential between the accrual and cash valuations for pension and OPEB expenses. LPMA submits that this is appropriate if the cash basis is used.

In addition the Board approved a further variance account to track any contributions that differ from the cash requirements that were included in the payment amounts. LPMA believes this is also appropriate because the payment amounts can change significantly in a short period of time. The forecast built into an application could be out of date before the application is filed.

7. b) How should the account(s) operate?

See above. The answer will depend on the approach or approaches taken in 5) and 6) above as this will determine the need for and type of accounts required.

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

LPMA submits that interest should not be applied to the account that tracks the difference between the accrual amount and the cash amount because this account does not relate to cash payments.

Interest should be applied to an account that relates to cash payments, such as the variance account between actual contributions paid and the amount included in the revenue requirement.

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

The Board has experience with the transition from deferred taxes to taxes payable in the gas industry. As an example, in 1997, Union changed its accounting for income taxes for utility operations from the tax allocation (or accrual) method to flow-through (or cash-basis) tax accounting. The change to flow-through tax accounting was adopted for rate-making purposes on a prospective basis in EBRO 493/494 (Union's 1997 rate case). The tax allocation method of tax accounting used for rate-making purposes prior to EBRO 493/494 resulted in an accumulated deferred tax balance. In EBRO 499 (Union's 1999 rate case) settlement agreement, parties agreed that the accumulated deferred tax balance would be used to reduce Union's cost of service in future years.

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?

No. This implies an intergenerational subsidy. Rates collected from ratepayers today are paid out at some later point. This violates the principle of intergenerational equity.

Use of the cash basis for regulatory purposes eliminates the need for a segregated fund or some similar mechanism, especially if deferral and variance accounts are also used to true up actual costs with forecast costs.

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

More information is required before this can be assessed.

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

The transition should take place during a cost of service rebasing application. The transition would be too complicated to address as part of an incentive rate change such as a price cap adjustment, which is designed to be as mechanistic as possible.

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

Utilities should provide actuarial reports at rebasing along with forecast costs and plan design details. Given that the production of actuarial reports may not coincide with rebasing applications, the Board should consider giving direction to utilities to adjust the actuarial reporting to provide better information (up to date) filed as part of a rebasing application.

If you require any further information or clarification, please contact me.

Sincerely,

Randy Aiken

Randy Aiken
Aiken & Associates