

hydro **One**

**EB-2015-0040 – Consultation on the  
Regulatory Treatment of Pensions and  
Other Post-Employment Benefit Costs**

**Stakeholder Forum Presentation**

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# Agenda

- Hydro One's Position on the regulatory treatment of Pension and OPEB costs;
- The benefits to Hydro One rate payers; and
- Views on recommendations in KPMG Report
  - Pension - Modified Cash Funding
  - OPEBs – Modified Cash Basis
  - Additional Disclosure Requirements
  - Set-aside mechanisms

# Our Position & Benefits to Customers

# Hydro One's Position

- The costs and benefits of any contemplated changes to the regulatory treatment of Pensions and OPEB should be considered, with specific consideration of the specific risks that the Board is seeking to mitigate.
- If the Board identifies risks that justify a changed regulatory treatment, increased controls, or additional oversight, the Board can require these measures on a targeted basis.

## Hydro One's Position – cont'd

- Accounting approach that is principles based and can be consistently applied by segment (distribution, transmission, generation, natural gas) may be more appropriate
- The introduction of a standardized method of cost recovery for pension & OPEB costs is undesirable.

## Hydro One's Position – cont'd

- Benchmarking pension and OPEB costs in isolation would not yield meaningful comparisons, as these are only two elements of an integrated total compensation package.
- Hydro One supports the following basis of recovery:
  - Pension Costs – Cash Basis
  - OPEB Costs – Accrual Basis

# Benefits to Customers

- Fair and balanced approach
- Risks associated with switching methodologies
- Over time – Cash vs Accrual, the same amount will be recovered
- Impact of capitalization of Pension and OPEB costs
- OPEB recovery on a cash basis is not allowed (under US GAAP or IFRS)



# Pension Costs

# Pension – Accrual vs. Cash

## Pension Costs in \$M Accrual vs Cash Recovery

	2015	2014	2013	2012	2011	Total
Accrual Basis <sup>1</sup>	\$163	\$158	\$287	\$207	\$148	\$963
Cash Funding <sup>1</sup>	\$177	\$174	\$160	\$163	\$153	\$827
Difference	\$(14)	\$(16)	\$127	\$44	\$(5)	\$136

<sup>1</sup> Source: Hydro One Audited Consolidated Financial Statements

*Current practice benefits our rate payers*

# Impact of Capitalization - Pension

For the period 2011-2015

Pension Expense:

OM&A \$403M

Capital \$424M

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Total \$827M

Recovered in Rates:

OM&A \$403M

Capital \$ 30M

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Total \$433M

# OPEB Costs

## OPEB Costs in \$M Accrual vs Cash

	2015	2014	2013	2012	2011	Total
Accrual Basis <sup>1</sup>	\$121	\$134	\$133	\$104	\$108	\$600
Cash Basis <sup>1</sup>	\$ 47	\$ 45	\$ 44	\$ 42	\$ 42	\$220
Difference	\$ 74	\$ 89	\$ 89	\$ 62	\$ 66	\$380

<sup>1</sup> Source: Hydro One Audited Consolidated Financial Statements

# Impact of Capitalization - OPEB

For the period 2011-2015

OPEB Expense:	Recovered in Rates
OM&A \$284M	OM&A \$284M
Capital \$316M	Capital \$ 22M
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Total \$600M	Total \$306M

# OPEB – Recovered in rates vs cash benefits paid

For the period 2011-2015

OPEB Recovered in Rates	\$306M
OPEB Benefits paid (Cash)	<u>\$220M</u>
Excess Recovery	<u>\$ 86M</u>

# KPMG Report



## KPMG Report - Pensions

- Pension - Modified cash funding (MFC)
  - Solvency Payments are an integral component of the funding contribution
  - MFC approach introduces unnecessary complexity to an already complex area

## KPMG Report - OPEBs

- OPEBs – Modified Cash Basis
  - Not in keeping with spirit of ASC 980-715-25-5
  - Untested US GAAP interpretation
  - Introduces Complexity

# KPMG Report - Additional Disclosure Requirements

- The report proposes extensive additional disclosure requirements
- These requirements will result in a significant increase in compliance activities and cost
- These requirements are duplicative as there is already significant oversight and governance in place

## KPMG Report - Set Aside Mechanisms

- Not warranted
- Remarkably tax inefficient
- Administratively burdensome
- Results in higher costs for rate payers
- May harm utilities and reduce financial flexibility

# In Summary

- Current Pension and OPEB recovery works for our customers
  - Pension on cash funding
  - OPEB on accrual
- Changes implemented to pension & benefits programs
- KPMG recommendations on Pension and OPEB recovery introduces complexity and uncertainty
- Set aside mechanisms are not required and create unnecessary administrative burden and costs
- Evaluation and assessment should be conducted by Segment

## Final Thoughts

- Hydro One submits the following principles should be considered when addressing pension and OPEB costs:
  - General rate-making principles, specifically:
    - Fairness to ratepayers and utilities and
    - Fairness within the ratepayer population
  - Minimize the regulatory burden on utilities and on the Board to the extent possible.

# Q&A