

September 20, 2016

Ontario Energy Board
Attn: Kirsten Walli, Board Secretary
PO Box 2319
27 Floor
2300 Yonge St
Toronto, ON, M4P 1E4

**Re: Consultation on the Regulatory Treatment of Pensions and Other Post-Employment
Benefit Costs Board File Number EB-2015-0040**

Dear Ms. Walli,

The Electricity Distributors Association (EDA) represents the collective voice of Ontario's local

distribution companies (LDCs) that deliver electricity to homes
the distribution sector as a whole employs 10,000 people
s, and makes hundreds of millions of dollars annually in direct
and provincial revenues.

on rate-regulated utility pensions and other post-employment
part of this consultation process, EDA submitted its initial
to address some specific questions asked by the Board. In
EDA participated at the Board's stakeholder forum on July 19
views on an appropriate accounting and cost recovery
B costs. EDA acknowledges and appreciates the opportunity to
on this topic to the Board following the stakeholder
ing comments have been developed through the feedback
te from the EDA's Finance and Corporate Issues Council.

of August 10, 2016, our response will focus on the following

ould adopt for purposes of assessing pension and OPEB costs
ling any principles the OEB should adopt in considering the
sms for cost recovery;
ms for cost recover; and

approximately 66 of the local dist
and businesses across Ontario. Th
directly, holds \$19 billion in asset
contributions to both municipal a

The OEB initiated a consultation
benefits (OPEBs) in May 2015. As
responses to the OEB in July 2015
continuation of this consultation,
and 20, 2016 and presented its vi
mechanism for pension and OPEB
submit its views and information
consultation process. The followi
received by our consultant Deloit

As requested in your web posting
aspects of this topic:

- Principles that the OEB sh
in rate applications, includ
appropriate rate mechan
- Options for rate mechanis

- Considerations around the KPMG proposals for set aside mechanisms (without repeating concerns already articulated on the first two, being internally segregated accounts and retirement compensation arrangements)

At the outset, we should note that this submission will focus on these questions as they relate to OPEBs. As was noted during the stakeholder session, most, if not all, of our members participate in the OMERS multi-employer pension plan. We believe that there was general agreement at the stakeholder session that cost recovery mechanisms should follow the accounting principles to set customer rates for these types of multi-employer plans. Due to the nature of the plans, IFRS, which most, if not all of our members follow, requires that an entity should recognize the cost of pensions provided under a multi-employer plan on the same basis as the payments made to fund the plan. We are comfortable with the conclusion that the cost recovery mechanism should follow the accounting treatment for recognition of multi-employer pension expense and indeed believe this to be the only viable alternative.

In gathering information for this submission we conducted a survey of our members, a sample of whom have provided high level information about their OPEBs. Their summary responses are incorporated into this submission.

Rate mechanisms for cost recovery and assessing OPEB costs in rate applications

The two methods under consideration are the cash basis, whereby the amounts to be included for rate setting purposes would be the cash payments in any given period to retirees, versus the accrual accounting based method. As we will discuss below, the EDA believes that the accounting accrual basis method generally best achieves the objectives of rate regulation and intergenerational equity. However, we believe that there should be room for judgment in the rate setting process and one size may not fit all.

In our survey of 26 of our members, 20 reported that they are currently under the accrual basis method for rate setting purposes. Our stated preference for using the accrual based method should in no way be taken as a criticism of situations where the cash method is currently being followed. In fact, due to difficulties with transition between one method and another, we believe that consistency of method over time for a given utility is likely also a very important principle.

How do the two methods align to the principles of rate regulation?

A well-known principle of rate regulation is that regulators seek to regulate rates such that utilities recover justified and prudent costs of providing their services as well as a reasonable return on their investment. Inherent in this principle is that the costs get borne by the appropriate generation of customers; in other words, current customers do not underpay for the services they receive at the expense of future customers and vice versa. In addition, rate regulation will seek to achieve stability and predictability of rates and to avoid rate shocks.

As is common with other utilities, LDCs in Ontario have some very long term assets and liabilities. An ongoing challenge of accounting frameworks such as IFRS is to appropriately allocate the cost associated with these very long lived and long dated items. For example, investments in property, plant and equipment (PP&E) require estimates of useful lives of the PP&E so that the upfront cost of the assets may be allocated to the appropriate future periods that benefit from use of the assets.

The obligation to make OPEB payments pose similar challenges. At its heart, the OPEB promise is a form of deferred compensation. Current employees have agreed to provide their services in exchange for current wages as well as the promise of benefits to be paid in the future (e.g., the OPEBs). Accounting seeks to allocate the eventual cost of these benefits to the working lives of the employee group. We believe that this accounting objective aligns very well with the objectives of rate setting to allocate costs to the appropriate generations of customers. This point was made by the EDA and others in the stakeholder session.

Following a cash basis for rate setting purposes would not achieve the principle of intergenerational equity as, under this method, current customers would actually be paying for OPEBs that were provided as compensation to past generations of workers.

In terms of the impact of the two methods on rate stability, it may be difficult to generalize. However, some observations can be made. Cash payments will be random in the sense that they can fluctuate based on life events and health of the retiree group while they are in retirement.

On the other hand, accrual accounting based costs will be subject to estimation uncertainty and true ups that need to occur over time. Estimates include a variety of demographic assumptions about the employee group and market interest rates, since accounting applies a discount factor to these costs due to their long term nature. It is a requirement under IFRS that the OPEB obligation be true up periodically for these changing assumptions. Virtually all of our 26 survey respondents reported doing these true ups every three years. Under IFRS, the impact of these true up adjustments goes not to the income statement but directly to equity; these adjustments can be positive or negative. These true ups can be a significant source of volatility in the recorded amount of the OPEB obligation at any point in time. We will discuss our observations on how this volatility may be addressed in rate setting further below.

Leaving aside the true up question, on balance, we believe that the accounting method is designed to lead to better stability of costs due to the accounting objective of allocating the ultimate cash costs over the employees' service lives using a rational and systematic method.

Finally, we considered the question of assessing OPEB costs in rate applications. Linking back to the objectives of rate regulation, we conclude that prudence and justifiability of these costs will be important considerations here. In this context, we considered which method (cash or accrual basis) would provide the most meaningful information to aid in the assessment of prudence.

Because the cash payments are made to retirees, these payments will reflect the compensation decisions related to past generations of workers. Current changes in compensation policy will not be reflected in cash payments until many years in the future.

The current accounting approach to OPEBs has only been in place for the last 15-20 years, depending on the jurisdiction. Prior to the introduction of this accounting, OPEB costs were recorded on a cash basis. Increasingly, stakeholders became concerned about the growing liabilities from these OPEB promises that were not recorded on corporations' balance sheets, nor where the increasing costs of these plans would be included in income statements. As a result, expensive compensation promises would go unnoticed in current operating results.

With this background, the EDA submits that, generally speaking, cost applications that include the full accrual cost of these benefits would better facilitate the assessment of an LDC's costs and benchmarking among entities since OPEB policies will vary company to company and are only one, relatively small, component of cost.

Based on the reasons discussed above, the EDA believes that the accounting accrual based method generally meets that objectives of rate regulation better than the cash basis. However, we do also believe that there should be some room for flexibility as individual situations may differ. And consistency of method over time for one LDC may be more important than the method itself.

Collection of OPEBs on the accrual basis versus the cash outlay

In spite of our conviction that the accrual based method is often preferable from a technical standpoint, we do recognize that this method will often result in cash being collected from customers in advance of the cash outlay to pay the benefits and we understand the source of concerns for this situation.

Our members take seriously their responsibilities as participants in the regulated electricity sector in Ontario. As such, the EDA has considered the impact on customers of the possibility that OPEB costs are being collected before they need to be paid. Based on our survey, of 21 reporting LDCs on this point, 16 reported that the accrual based cost was higher than the cash outlay for OPEBs in their most recent fiscal year, four reported that the cash outlay was higher and one reported that the amounts were approximately equal.

Therefore, it is fair to generalize that these costs are being collected in many instances before the cash is needed. In considering this situation, the EDA believes it is important to consider the overall quantum of cash versus accrual amounts and the impact on customer bills of these timing differences. Our survey results on this point are summarized below.

Based on our survey responses, we analyzed the average customer bill impact of OPEBs by dividing each LDC's OPEB cost for accounting purposes by the number of the LDC's rate payers. The results for 17 LDCs reporting cost data are as follows:

Annual impact < \$3 per customer	Annual impact between \$3 and \$5 per customer	Annual impact > \$5 per customer	Total
8	5	4	17

This data shows that the average impact on a per customer basis of the accrual accounting based OPEB cost is relatively insignificant, with more than 75% of respondent LDCs having a less than \$5 impact per customer in the most recent fiscal year. It is interesting to note that a number of our respondents reported recent cost mitigation strategies, such as extending the service period to earn eligibility for the benefits and changing the eligibility from benefits being available for the retiree's lifetime to ceasing at age 65. Recent cost mitigation was reported for all of our 4 respondents at the higher end of the cost spectrum, as well as for some of the others. For most of our respondents, current plans now restrict the OPEB eligibility to age 65. We note that these benefits appear to be more restricted than those provided by other Ontario utilities outside the LDC group.

In order to further analyze the situation, the EDA's consultant looked at the per customer difference between OPEBs on an accrual basis and OPEB cash payments in the most recent fiscal year. Of the 17 LDCs noted above, four reported that the cash outlay was higher than the accrual accounting based cost. For the remaining 13 where the accrual cost was higher, the savings on a per customer basis would be relatively insignificant: for 10 of these 13, the savings by moving to a cash basis would be under \$2 on an average per customer basis per year. We would also note that moving to a cash basis for an LDC that currently uses an accrual basis for rate setting purposes is not without cost. The added administrative costs of transitioning from one method to another and maintaining a different method for rate setting purposes than for accounting purposes would reduce the average savings in any given period such that the costs would likely outweigh most if not all of the cash benefit to the customer.

The EDA is aware that costs are sometimes looked at in the rate setting process in relation to the proportion of the revenue requirement that they represent. We also looked at average OPEB costs on an accounting basis from our survey respondents as a percentage of revenue from rate regulated activities. Fourteen of 17 respondents provided this data. Eleven respondents reported that OPEB costs were less than 1% of revenue and three respondents reported between 1-2% of revenue from rate regulated businesses in the most recent fiscal year.

Based on the evidence the EDA has gathered from our members, we do not believe that amounts collected in advance of cash payments are significant in most of our member LDC's circumstances. However, we do recognize the sensitivities around prudently managing costs to electricity customers. We believe that individual circumstances should be monitored through the rate setting process and that flexibility for certain "set aside" mechanisms may be necessary within the process.

Set aside mechanisms

As set out at the stakeholder session, the first two options in the KPMG report, involving segregated accounts or retirement compensation arrangements, pose too many administrative and other difficulties, which we will not repeat in this submission. However, the EDA is open to the other two proposals for use in cases where the significance of the amounts considered to be collected early warrants such actions.

In order to analyze the situation at the various regulated organizations, the EDA believes that some more formalized data gathering may be needed, so we can see a basis for KPMG recommendation d) which is to *"continue with the current practice but records any excess recoveries in a tracking account that is monitored"*. Steps to be taken beyond this, such as using the recoveries to reduce rate base, should be considered only in extreme situations on a case by case basis.

One of the concerns over the accrual basis that was raised in the OEB stakeholder session was that customers were paying twice; first, when they paid excess cash under the accrual method and second when they paid a rate of return on that portion of the rate base that was funded from excess cash. An analogy was drawn to capital contributions for such excess recoveries and argued that such excess cash should be reduced from the rate base.

Any excess cash collected for OPEB costs are fundamentally different because such cash is traditionally used for funding capital investments and operating expenses and forms part of overall cash flow reserve of a utility. Capital contributions in contrast are received from customers under specific agreements over a period of time to construct identified assets and separately monitored for construction in progress and in-service dates. They are reduced from rate base but start earning a recovery in rates through depreciation as assets are placed in service.

Using a similar model for excess cash collection would not be a practicable solution as it will be difficult to track from a generic cash pool how much of excess cash collection is used for capital investment and operating costs. It will also be a complex process to track this excess cash in capital and operating streams year over year considering highly variable assumptions used in the cost allocation process. This could severely impact the reliability of data that forms the basis of rate base calculation. EDA is of the view that if some sort of compensation is given to rate payers for excess cash recovery, it could be in the nature of interest improvement on excess collection. However, this has to be weighed against the administrative burden and cost that would be involved to track the difference between accrual and cash cost of benefits. Given the fact that OPEB costs are an insignificant component of an LDC's total revenue requirement, a separate variance account may not be justified from a cost benefit perspective. Also this will create additional complexities and create questions as to what is an appropriate rate of interest to be allowed, what is the period of disposal of this variance account and what is an appropriate tracking mechanism to measure such excess cash which is already invested in the business.

Approach to true up adjustments that go through OCI

Much of the discussion has been focused on the accrual basis OPEB costs that represent the annual allocation of the estimated ultimate cash cost of OPEBs to employees' working service lives. Our members have also discussed the true up adjustments to the liability that generally occur every three years. Unlike US GAAP, there is no mechanism under IFRS for these true up adjustments to be recorded in profit or in loss. Further these adjustments can be a source of volatility and their recognition will be irregular and unpredictable over time.

The EDA believes that these adjustments should be monitored and dealt with on a case by case basis. For example, a true up adjustment that increases the OPEB liability at a point in time does not necessarily need to be reflected in rates to customers, especially if the LDC is already collecting more than enough cash to satisfy current and near term expectations for payment obligations. Similarly, a true up adjustment that results in a reduction of the OPEB liability does not necessarily mean that a mechanism should be put in place to return funds to customers. Instead, each adjustment should be reviewed in terms of its significance and in relation to the lifecycle of the obligation (e.g., is the plan closed or curtailed such that the obligation is being wound down? How do cash payments and accrual based amounts relate to each other? and so on).

We mention this aspect because it can be a major source of volatility in the accounting based numbers. However, in some many cases we believe that these adjustments need not necessarily flow into rates in every case. Again, flexibility is preferable to having a one size fits all approach to things.

Thank you again for the opportunity to provide comments. We look forward to the next steps in this consultation.

Regards,



Justin Rangooni
Vice President, Policy and Government Affairs