uniongas
A Spectra Energy Company

September 22, 2016

Ms. 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 Costs
Board File No. EB-2015-0040

The following are the submissions of Union Gas Limited (Union) to the Ontario Energy Board (Board) as follow-up to the Stakeholder Forum held July 19-20, 2016 in connection with the consultations related to the Regulatory Treatment of Pensions and Other Post-Employment Benefit Costs in the electricity and natural gas sectors.

Union has organized its submissions under the following topics:

- Union's current practices
- principles that the Board should adopt for purposes of assessing pension and OPEB costs in rate applications;
- options for pension and OPEB cost recovery;
- KPMG's proposed Modified Funding Contribution concept to determine pension contributions to be recovered in rates;
- KPMG's proposed adjusted pay-as-you-go cash payments method for OPEB; and
- KPMG's proposed set-aside mechanisms for OPEBs if accrual accounting is used for rate setting.

<u>Union's Current Practices</u>
Union's total compensation program is designed to be competitive across its comparator companies. Union's pension and other post-employment benefits (OPEB) programs are designed to be responsive to and reflect Canadian pension and benefit trends.

Union maintains registered and non-registered, contributory and non-contributory defined benefit (DB) and defined contribution (DC) pension plans as well as OPEBs. Union's registered pension plans are single employer pension plans for which Union is responsible for the balance of costs over and above any employee contributions.

For accounting purposes, Union elected to follow Generally Accepted Accounting Principles, in particular those adopted by the U.S. Securities and Exchange Commission (US GAAP), which prescribe that entities recognize and amortize the costs related to pensions and OPEBs over the period during which services are rendered by the employees covered by the plans. Annual net benefit costs are determined on an accrual basis and year-end obligations are determined as the actuarial present value of obligations accrued to the reporting date. These amounts are determined based on actuarial assumptions adopted by Union management, on the advice of its actuary.

In Union's view, moving from an accounting accrual method to a cash funding method would both increase the costs allocated to current ratepayers and result in added administrative expense with no offsetting benefits.

As is explained in more detail later in this submission, through the end of 2015, Union has contributed $235 million more to its registered pension plans than has been included in rates. To date, Union has not received any 'value for money' for these additional contributions. At the same time, Union has over-recovered approximately $65 million for OPEBs and approximately $26 million for supplemental employee retirement plans (SERPs).

Union has implemented extensive pension and OPEB governance policies and procedures in order to fulfill its duties to plan members and other stakeholders with independent audits completed by 3rd parties on a regular basis. There does not appear to be any benefit to adding supplemental governance processes.

The accounting net benefit cost for Union's DB pensions and OPEBs is determined in accordance with the U.S. Financial Accounting Standards Board's Accounting Standards Codification (ASC) 715 – Compensation – Retirement Benefits which provides guidance on the disclosure and other accounting and reporting requirements related to single-employer plans[1]. Requiring additional reporting and filing requirements will increase administrative expenses with no apparent benefit.

In summary, Union submits that continuing with its current practices is in the best interests of its ratepayers and the Board should not require rate regulated entities to adopt a "one size fits all" approach to accounting for pensions and OPEBs.

[1] Union's 2013 cost of service rates application (EB-2011-0210) was filed on the basis of US GAAP. Union applied for and received Ontario Energy Board approval to adopt US GAAP for regulatory purposes in the Decision on Preliminary Issue dated March 1, 2012.

General Principles

The Board has requested submissions on the principles it should adopt for purposes of assessing pension and OPEB costs in rate applications, including any principles the Board should adopt in considering the appropriate rate mechanisms for cost recovery.

Union submits that the following principles be adopted by the Board in assessing pension and OPEB issues:

- Compliance with existing pension and OPEB accounting standards and regulations;
- Long-term stability of pension and OPEB costs is desirable in order to support intergenerational equity and stability of rates.
- Intergenerational equity (i.e., no negative impacts on future generations due to decisions made today) is critical as it applies to pension and OPEB costs charged to ratepayers, with each generation being allocated a reasonable share of costs.
- The value of pensions and OPEBs needs to be considered within the benchmarking of total compensation programs.
- A single cost recovery method is not appropriate for all circumstances as pension and OPEB plan designs and financing arrangements are not consistent among utilities.
- Differences in plan designs and accounting bases among rate regulated entities require that the costs, recovery and reporting related to pensions and OPEBs be considered on a case-by-case basis.

It is Union's view that emphasis on benchmarking of pension and OPEB costs across the utility sector would provide little or no value. However, if benchmarking is to be required, significant care will be needed to ensure that comparisons are commensurable and take into account differences in employee demographics, pension and OPEB design, governance arrangements and allocation of costs between the employer and the plan members.

Options for Pension and OPEB Cost Recovery

Within the context of the recovery of pension and OPEB costs, Union submits that the following key objectives are appropriate from a rate setting perspective:

i. Long-term stability of pension and OPEB costs is desirable in order to support stability of rates and intergenerational equity between ratepayers; and
ii. Costs should be recognized in rates when the employee services that give rise to these costs are rendered.

There are a variety of methods that may be used to determine the cost recovery of pensions and OPEBs, including a cash basis, a modified funding contribution basis or an accrual accounting basis. A single cost recovery method is not appropriate for all circumstances as the plan structure, plan design and funding vehicles employed by rate regulated entities are not consistent. Union submits that the Board should address these differences on a case-by-case basis.

Union has recovered the costs of its pensions and OPEBs on an accrual accounting basis since the introduction of post-retirement accrual accounting standards in Canada. Cost recovery from Union's ratepayers has been consistently determined. Union does not see any benefit to changing from these practices.

For ratemaking purposes, Union collects costs for pensions and OPEBs from ratepayers based on the projected annual net benefit costs in accordance with US GAAP.

Through the end of 2015, Union has:

- under-recovered approximately $235 million for registered pension plans;
- over-recovered approximately $65 million for OPEBs; and
- over-recovered approximately $26 million for SERPs.

The amount included in Union's rates for registered pension plans has consistently been determined on a financial reporting basis (i.e., on an accrual accounting basis) but the amount contributed to the registered pension plans has been determined based on the funding requirements under Ontario's *Pension Benefits Act*.

There are two key reasons why registered pension plan contributions have exceeded the amounts included in rates:

1. The *Pension Benefits Act* requires that registered pension plans be funded on a solvency basis. In the economic environment that has prevailed since 2000, for non-indexed plans (all of Union's pension plans are non-indexed), the solvency liability has been considerably higher than the accounting obligation. Therefore, the funding target (solvency liability) has been considerably higher than the accrual accounting target (accounting obligation).

2. The Ontario funding regulations require that the solvency liability be funded over 5 years. This is a much shorter time frame than the period over which actuarial losses are recognized for financial reporting purposes. For financial reporting purposes, actuarial losses that fall within the 10% Corridor are not recognized at all and actuarial losses that fall outside of the Corridor are amortized over the Expected Average Remaining Service Lifetime (EARSL), which is currently ~11 years.

One component in the determination of the net benefit cost under US GAAP is the expected return on assets which is equal to the expected rate of return on assets times the market related value of assets. The net benefit cost is reduced by this amount (i.e., the cost of pensions is offset by the returns expected to be earned by the pension fund).

The expected return on assets is the long-term expected return based on the asset allocation in the pension plan. Based on the asset allocation of the Union plans, the assumption adopted by Union for 2016 was 7.15%.

The fact that Union has contributed $235 million more to the pension funds than it has collected in rates means that the expected return on assets is expected to be $17 million

($235 million x 7.15%) higher in 2016 compared to a situation where the pension funds only included amounts collected in rates. Therefore, for 2016, the amount included in rates for Union's registered pension plans would have been $17 million higher if Union had only remitted contributions to the pension fund equal to the amounts collected in rates.

Union has not been provided with 'value for money' in respect of the excess amounts contributed to the registered pension plans over the amount collected in rates.

The fundamental objectives of accrual accounting for pensions and OPEBs include:

i. The costs of pensions and OPEBs should be allocated in a rational and systematic manner;
ii. The compensation cost of employee pensions and OPEBs should be recognized over the period that an employee renders service; and
iii. Prior service costs, including actuarial gains and losses, are amortized over the expected average remaining service life of employees.

ASC 715 mandates a standard method for measuring net benefit costs that is intended to improve comparability and understandability by recognizing the compensation cost of an employee's pension over that employee's service period and by relating that cost more directly to the terms of the covered plans.

In promulgating the use of revised accounting standards, the US Financial Accounting Standards Board stated:

> *"The Board believes that the understandability, comparability, and usefulness of pension information will be improved by narrowing the past range of methods for allocating or attributing the cost of an employee's pension to individual periods of service. The Board was unable to identify differences in circumstances that would make it appropriate for different employers to use fundamentally different accounting methods or for a single employer to use different methods for different plans."*[2]

More recently, International Financial Reporting Standards (IFRS) have changed to recognize prior service costs immediately.

In Union's view, ASC 715 is preferable to IFRS as it more closely aligns with the principles for the cost recovery of pensions and OPEBs by rate regulated entities.

Union submits that the costs of pensions and OPEBs should be recognized in rates based on the annual accrual accounting net benefit cost used for financial reporting purposes determined using ASC 715 based on the following:

Pension Plans

i. The cash basis and funding basis do not allocate pension and benefits costs in a rational and systematic manner to the periods when services are rendered by

[2] FASB Statement No. 87 - Employers' Accounting for Pensions (Issued 12/85)

employees. In particular, the funding regulations under Ontario's *Pension Benefits Act* result in volatility of contributions, counter to the goal of stability of pension costs.

ii. Due to the solvency funding rules under Ontario's *Pension Benefits Act*, the use of a cash or funding basis would lead to the overcharging of the current generation of ratepayers to the benefit of future generations of ratepayers, and the accumulation of a significant pre-paid pension asset, counter to the goal of intergenerational equity.

iii. Accrual accounting is a method that allocates the cost of pensions in a rational and systematic manner to the period when services are rendered by employees.

iv. Under ASC 715, net actuarial gains (losses) and past service credits (costs) are amortized over the Expected Average Remaining Service life (EARSL) of the active employees. This is an appropriate length of time to support the principles of intergenerational equity (i.e., costs are not unreasonably deferred to future ratepayers) and rate stability (costs are not unreasonably allocated to current ratepayers).

v. Union already calculates pension costs under ASC 715 so there are no additional expenses associated with determining the appropriate costs to be recognized in rates.

vi. As the costs of pensions provided to employees of Union have already been recognized under accrual accounting (including ASC 715) for a considerable period of time, additional expense will be incurred in transitioning to a new method of recognizing costs in rates. Additional expense in transitioning to a new cost recognition method would involve both the expense of calculating different amounts on an ongoing basis and the expense associated with establishing appropriate deferral accounts to reflect differences in past and future cost recognition methods.

SERPs and OPEBs

i. All SERPs and OPEBs provided to employees of Union are single employer sponsored plans where all financing risks are assumed by Union.

ii. There is no tax effective method to pre-fund SERPs or OPEBs.

iii. Accrual accounting is a method that allocates the cost of SERPs and OPEBs in a rational and systematic manner to the period when services are rendered by employees.

iv. Under ASC 715, net actuarial gains (losses) and past service credits (costs) are amortized over the Expected Average Remaining Service life (EARSL) of the active employees. This is an appropriate length of time to support the principles of intergenerational equity (i.e., costs are not unreasonably deferred to future ratepayers) and rate stability (costs are not unreasonably allocated to current ratepayers).

v. Since Union already calculates the costs of SERPs and OPEBs under ASC 715, there are no additional expenses associated with determining the appropriate costs to be recognized in rates.

vi. As the costs of Union's SERPs and OPEBs have already been recognized under accrual accounting (including ASC 715) for a considerable period of time, additional expense will be incurred in transitioning to a new method of recognizing costs in rates. Additional expense in transitioning to a new cost recognition method would involve both the expense of calculating different amounts on an ongoing basis and the expense associated with establishing appropriate deferral accounts to reflect differences in past and future cost recognition methods.

KPMG's Modified Funding Contribution Concept

KPMG's Modified Funding Contribution (MFC) concept introduces an additional layer of administrative complexity and regulatory disclosure, and would increase costs to Union's current ratepayers for no apparent benefit.

Union has three main criticisms with respect to KPMG's MFC concept compared to the current approach where Union's rates are established based on accrual accounting under US GAAP:

1. KPMG's MFC concept would inappropriately accelerate the recognition of costs in rates.
2. KPMG's MFC concept would increase the variability of costs recognized in rates.
3. KPMG's MFC concept would be complex to administer.

Recognition of Costs

As indicated in Union's presentation at the Stakeholder Forum, there are two key reasons why adoption of KPMG's MFC concept would accelerate the recognition of the costs of registered pension plans for Union's ratepayers compared to the existing accrual accounting method under US GAAP.

1. **Funding Target vs. Accounting Target**

   While the timing of cost recognition in rates depends on many factors, the factor with the greatest influence is the ultimate target inherent in the cost recognition method (i.e., the total amount that would have been included in rates under the method if all costs were immediately recognized).

   Methods that are based on cash have an ultimate funding target equal to the greater of the solvency liability and the going concern liability. Methods that are based on accrual accounting have an ultimate funding target equal to the accounting obligation. The higher the target, the greater the costs that are expected to be allocated to current generations of ratepayers.

   Under Ontario's *Pension Benefits Act*, a pension plan must be funded to the greater of the going concern liability and the solvency liability. In determining the solvency liability, the *Pension Benefits Act* permits plans to exclude the value of any contractual indexing. On the other hand, the value of contractual indexing must be included in the going concern liability.

Many Ontario-based rate regulated entities provide contractual indexing. As the value of indexing is included in the going concern liability but not the solvency liability, the going concern liability generally exceeds the solvency liability and the funding target is usually the going concern liability. The justification for KPMG's MFC concept appears to be based on such plans. In particular, the KPMG MFC concept envisages that plans are generally funded on a going concern basis, but occasionally are required to make solvency special payments.

None of Union's pension plans provide any contractual indexing. Therefore, in the environment of low interest rates that has prevailed since 2000, the solvency liability for Union's registered pension plans has consistently exceeded the going concern liability by a significant margin. Accordingly, for Union, since 2000 the funding target has been the solvency liability.

For Union's registered pension plans, in the current economic environment, the funding target (i.e., the solvency liability) is significantly greater than the accounting target (i.e., the accounting obligation) for the following reasons:

i. The discount rate used to determine the solvency liability is lower than the discount rate used to determine the accounting obligation. A full description of the manner in which discount rates are determined under solvency and accounting is beyond the scope of this submission. However, as an example, for Union's registered pension plans, as at December 31, 2014:
    - the average discount rate for determining the solvency liability was approximately 2.8% per year; and
    - the discount rate for determining the accounting obligation was 4.0% per year.

   If the discount rate used for accounting as at December 31, 2014 was decreased to 2.8% per year, the accounting obligation would have increased by approximately $150 Million.

ii. The Ontario solvency funding regulations require that statutory wind-up benefits be included in the solvency liability whereas such benefits are excluded under accrual accounting standards. For example, the solvency liability must assume that all members whose age plus service total at least 55 years will ultimately retire at the optimal retirement age and benefit from any plan early retirement subsidies even though they are not yet eligible for these benefits.

In summary, for Union, the funding target is considerably greater than the accounting target and moving from an accrual accounting method to a funding method for rate setting purposes would significantly increase the target and accelerate the costs to be included in rates.

Union would not object to a different method of determining rates if that method was more consistent with rate making principles (i.e., if the target for inclusion in rates was consistent with the principle of inter-generational equity). However, in Union's view, the solvency liability inappropriately allocates the costs of registered pension plans to today's generation of ratepayers as opposed to future generations of ratepayers and is inconsistent with the principle of inter-generational equity.

The KPMG MFC concept attempts to mitigate the effects of having to fund to the solvency liability target by delaying the recognition of solvency special payments in rates. However, KPMG still advocates that these costs be included in rates, as they state in page 5 of their report ("*…be recovered in rates in a future period as determined by the OEB."*). So, although KPMG's MFC concept tries to lessen the impact of moving to a funding method, eventually their method would result in all cash costs being included in rates.

2. Expected Rate of Return on Assets

Accrual accounting under US GAAP uses two separate interest rates (a discount rate and an expected rate of return on assets) whereas funding is based on a single interest rate. The use of separate interest rates under US GAAP provides ratepayers with a net interest credit that would not be provided under KPMG's MFC concept.

For example, at 2015 year-end, Union adopted an accounting discount rate of 4.0% per year and an expected rate of return on assets of 7.15% per year. With assets and obligations of approximately $840 million, the net interest cost under US GAAP was *negative* $26 million ((4.0% - 7.15%) x $840 million). If the same rates were used for both the assets and the obligations, the net interest cost would have been approximately $0.

The use of different interest rates under US GAAP is rooted in the timing of recognition of the equity risk premium. Union's pension funds are invested in a mix of equities and fixed income investments. By investing in equities, Union expects that the pension fund will earn greater investment returns than by investing solely in fixed income investments. Under US GAAP, the expected benefits of the equity risk premium are recognized when they are expected to be earned. Under solvency funding, the equity risk premium is only recognized after it is earned.

Union submits that delaying recognition of the equity risk premium inappropriately allocates the benefits of investing in equities to future generations of ratepayers rather than to the current generation of ratepayers.

In summary, moving to KPMG's MFC concept would inappropriately allocate the cost of registered pension plans to Union's current ratepayers by increasing the ultimate amount to be included in rates to the solvency liability and by delaying recognition of the equity risk premium.

Volatility of Costs

The full details of KPMG's MFC concept are not known, so it is not possible to definitively state whether the recognition of costs in rates would be more or less volatile than the recognition of costs in rates using accrual accounting under US GAAP.

On page 5 of KPMG's Report, the following comment is made with respect to the MFC concept:

> *"Any other special payments required under the PBA that an employer chooses to make would be recorded in separate deferral accounts, and be recovered in rates in a future period as determined by the OEB."*

By *"any other special payments"*, KPMG is referring to special payments in excess of those that would be required under the going concern funding regulations under the *Pension Benefits Act*.

At the Stakeholder Forum, KPMG clarified that this statement was intended to apply to all contributions in excess of those determined under the KPMG MFC concept and that an appropriate period for the Board to allow such costs to be included in rates may be the Expected Average Remaining Service Life (EARSL) of the plan members.

If the Board were to adopt such an approach, it would clearly result in increased volatility in rates for the following two reasons:

i. the 10% Corridor that applies for accrual accounting under US GAAP would not apply to *other special payments*; and
ii. under US GAAP, actuarial gains (losses) are re-amortized over the EARSL each year, whereas under KPMG's MFC concept, the *other special payments* remitted each year would be amortized in a straight line basis over the EARSL.

Finally, Union notes that any alternative method based on funding would also introduce additional volatility in times of favourable experience. While accrual accounting under US GAAP amortizes positive experience in the same manner as negative experience, the *Pension Benefits Act* permits plans to take contribution holidays if they have sufficient actuarial surplus. Therefore, for funding purposes, positive experience may be recognized immediately thereby further increasing volatility.

In summary, Union submits that KPMG's MFC concept would increase the volatility of the costs to be included in rates compared to the current US GAAP accrual accounting approach used by Union, which would be contrary to the ratemaking principle of stability in rates.

Administrative Complexity

Whether rates are established based on accrual accounting or cash funding, these amounts are included in financial statements and are therefore clearly known and determinable. However, the amounts under KPMG's MFC concept would create a third set of numbers that are neither easily calculated nor verified.

KPMG's MFC concept envisages that the contribution requirements under the going concern valuation and the contribution requirements under the solvency valuation are independent and separately known. The amounts included in rates would then be determined as:

- the contributions required under the going concern valuation; plus
- additional special payments required under the solvency valuation, recognized in a manner to be determined by the Board.

Without detailing the full complexities of the minimum funding requirements under the *Pension Benefits Act*, a key stumbling block of KPMG's MFC concept is that the contributions required under the going concern valuation are not independent of the contributions remitted under the solvency valuation. If a plan sponsor remits solvency special payments to a plan, these solvency special payments serve to reduce the required future going concern special payments. So, in practice, the contributions that would be required under the going concern valuation if no solvency valuation was undertaken are not known.

While in theory it would be possible to track the payments that would be required under the going concern valuation in the absence of solvency special payments, this would be an administratively onerous task. In addition, this calculation would have no other formal use and would not be subject to oversight by either the Financial Services Commission of Ontario (FSCO) or Union's auditors. It would therefore be necessary for the Board to provide oversight on the methods and assumptions to be used in such a calculation.

In summary, KPMG's MFC concept would inappropriately allocate additional costs to our current ratepayers and would increase the volatility of costs, both of which are contrary to the rate making principles of inter-generational equity and stability. In addition, it would be onerous to determine amounts under KPMG's MFC concept and it would be difficult for the Board to verify these amounts. Therefore, Union submits that the Board should reject KPMG's MFC concept for determining cost recovery for registered pension plans.

KPMG's Proposed Adjusted Pay-As-You-Go Cash Payments Method for OPEB

The KPMG report indicates that the majority of the rate regulated entities in Ontario currently recover OPEB costs using an accrual accounting method and a few rate regulated entities use the 'pay-as-you-go' cash payments method where cash payments are equal to the cash amount ultimately paid to or on behalf of beneficiaries as benefits specified by the terms of the plan.

KPMG has suggested that an adjusted ‘pay-as-you-go’ cash payments method could be developed to recover OPEB costs in rates charged to customers based on actual ‘pay-as-you-go’ cash payments, adjusted by an additional amount that the Board establishes to be just and reasonable based on an entity’s facts and circumstances.

In Union’s view, the adjusted ‘pay-as-you-go’ cash payments method:

- is contrary to the ratemaking principle of inter-generational equity;
- would be overly complex to apply; and
- would require complex transitional provisions.

Inter-Generational Equity

Union submits that all costs related to pensions and OPEBs should be allocated in a rational and systematic manner over the period during which employees are expected to render service. This methodology is consistent with the principles of inter-generational equity and stability.

Pay-as-you-go cash costs bear no relationship to the services rendered by employees. To develop rates based in any part on pay-as-you-go cash costs is unfair to current ratepayers (who would be paying for the costs of employees who rendered services on behalf of prior generations of ratepayers) and to future ratepayers (who would bear the costs for employees who render services on behalf of the current generation of ratepayers).

An additional concern with basing rates on pay-as-you-go cash funding is that the benefits of any changes to manage OPEB costs are not realized by current ratepayers but are passed on to future ratepayers. For example, starting in 2004, Union closed its legacy defined benefit OPEBs for future retirees and introduced a redesigned OPEB program based on a Health Care Spending Account. The new plan results in lesser benefits being paid to future retirees than would have been paid under the previous plan. But, if rates were determined on a pay-as-you-go basis, current ratepayers would effectively receive no benefit for this plan change. Rather, the benefits of this plan change would flow to future ratepayers only.

While there are many mechanisms available to rate regulated entities to manage the cost of OPEBs provided to future retirees, there are few mechanisms available to manage the current costs of OPEBs provided to existing retirees. Basing costs on pay-as-you-go would provide a disincentive for rate regulated entities to manage the costs associated with current active employees since the benefits of such savings would not be realized for many years.

Complexity

It is difficult to comment on the “adjusted” portion of KPMG’s adjusted pay-as-you-go method since it is not clear how the adjustment would be determined by the Board. If the intent is that the adjustment is expected to result in the amount allocated to rates being similar to the amount determined under accrual accounting, then Union questions why the Board would adopt a complex method that ultimately would result in a similar allocation of costs.

If the intent is to limit the amount collected in rates to some number between the pay-as-you-go costs and the accrual accounting costs, then it is not clear how the Board would determine the appropriate amount to be included in rates and how it would be communicated and verified.

In Union's view, KPMG's adjusted pay-as-you-go method is too arbitrary to apply in practice and would result in additional confusion and complexity that is unwarranted.

Transition

If KPMG's adjusted pay-as-you-go method were to be adopted, the issue of transition would be a vital concern. Since the adoption of accrual accounting in Canada for OPEBs in 2000, Union has consistently recognized the cost of OPEBs in rates based on accrual accounting.

The following issues would need to be considered if Union were to change from an accrual accounting method to KPMG's proposed adjusted pay-as-you-go method for recognizing the cost of OPEBs in rates:

- Would the change be on a prospective or retrospective basis?
- Would amounts already collected from previous ratepayers be somehow repaid to current or future ratepayers?
- How long would the transition period be?
- How would the "adjustment" in KPMG's adjusted pay-as-you-go method be determined and how long would it take to get to this amount?

Union submits that KPMG's proposed adjusted pay-as-you-go method is contrary to the ratemaking principle of inter-generational equity, would be overly complex to administer and would create complex transitional issues.

It is Union's view that issues related to collecting amounts for OPEBs from ratepayers in advance of using these amounts to fund the OPEBs are best addressed by value for money options.

KPMG's Proposed Set-Aside Mechanisms for OPEBs

In its report, KPMG states that if accrual accounting net benefit cost is used to incorporate OPEB costs into utility rates, alternatives for possible set-aside mechanisms could also be developed in order to provide customers with 'value-for-money' on the cash that is collected in advance of cash payments being made on OPEB obligations (i.e., excess recoveries), while at the same time safeguarding customers' money that will be directed to settling the OPEB obligations in the future.

Union submits that set-aside mechanisms are not required and create unnecessary administrative burden and costs. Set-aside mechanisms restrict the use of excess recoveries for capital or operating expenses which leads to additional borrowing and higher interest costs. There is also additional time and cost required for set up and ongoing administration. A change in source of funding for capital and operations impacts credit risk and investment profile which in turn negatively impacts borrowing costs.

KPMG identified 4 alternatives for possible set-aside mechanisms for OPEBs:

i. Internally segregated accounts (e.g., separate bank account, restricted cash account);
ii. Retirement compensation arrangements (e.g., a trust that would trigger tax implications);
iii. Excess recoveries reduce rate-base; and
iv. Continue with the current practice, but record any excess recoveries in a tracking account that is monitored by the Board.

Concerns related to the first two options (internally segregated accounts and retirement compensation arrangements) were identified by KPMG in its report. In particular, internally segregated accounts do not optimize utility funds and may result in the need to raise additional debt to replace the funds that are set aside. Retirement compensation arrangements are tax inefficient and could have a negative implication on rates.

At the stakeholder forum, KPMG agreed that there was some tax inefficiency with the internally segregated accounts mechanism since 50% of tax benefit is held by Revenue Canada until cost is incurred.

Should the Board determine that a set-aside mechanism for OPEBs is required, Union submits that excess recoveries (or under recoveries) could be recognized in utility rate base through an adjustment (reduction or increase) to working capital. This approach is similar to the treatment of Agent Billing and Collection (ABC) receivables (which reduce Union's working capital requirements) or gas in inventory (which increases Union's working capital requirements). Recognition of OPEB over-recoveries through a rate base reduction would provide ratepayers 'value for money'.

Should OPEBs excess recoveries not be recognized through a reduction to rate base, Union submits that a tracking or deferral account (accruing interest) could be used to provide ratepayers 'value for money'.

If the Board determined that a set-aside mechanism for OPEBs is required and excess recoveries either reduce utility rate base or are recorded in a tracking or deferral account, Union submits that similar treatment should be implemented for under recoveries (i.e., over contributions) to registered pension plans.

To the end of 2015, while Union has excess recoveries of approximately $65 million for OPEBs and $26 million for SERPs, it has under-recovered approximately $235 million for its registered pension plans. Currently, the under recoveries of registered pension plan costs are not recognized in Union's rate base or through a tracking/deferral account. In Union's view, the rate regulated entity should be offered the same opportunity as ratepayers to receive 'value for money' or earn a return on any over-contribution to its pensions or OPEBs. It is important that any set-aside mechanism developed by the Board treat ratepayers and the rate regulated entity in a consistent and equal manner.

<u>Excess recoveries reduce rate-base</u>
KPMG proposed that excess recoveries could be tracked in a separate regulatory account that is used to reduce rate base. While this option provides ‘value for money’ to ratepayers by providing them with a specified, predictable and regulated return on any funding that they provide for costs that will be settled well into the future, this option could change a rate regulated entity’s investment and credit risk profile which in turn could reduce the rate regulated entity’s credit rating and/or borrowing capacity (or increase its borrowing rates).

<u>Tracking account to record any excess recoveries</u>
KPMG suggested that the Board could choose to continue with the practice of using the accrual accounting cost for ratemaking purposes, but also add a new requirement for any excess recoveries to be tracked in a separate regulatory account that would attract interest as specified by the Board. To avoid double entry bookkeeping, KPMG suggested that the excess recoveries would have an ‘offsetting mirror account’. However the amount that is recorded in such an ‘offsetting mirror account’ would not attract interest.

Union submits that this option is administratively burdensome and results in higher costs for ratepayers.

KPMG Information Disclosure Requirements

Since the Board has indicated that information requirements and transitional issues will be addressed at a later time, Union will save its related comments for a subsequent submission.

Summary of Union’s Submissions

Union submits that the following principles be adopted by the Board in assessing pension and OPEB issues:

- Compliance with existing pension and OPEB accounting standards and regulations;

- Long-term stability of pension and OPEB costs is desirable in order to support intergenerational equity and stability of rates.

- Intergenerational equity (i.e., not negatively impacting future generations with decisions being made today) is critical as it applies to the inclusion of pension and OPEB costs charged to ratepayers, with each generation being allocated a reasonable share of costs.

- The value of pensions and OPEBs needs to be considered within the benchmarking of total compensation programs.

- A single cost recovery method is not appropriate for all circumstances as pension plan designs and financing arrangements are not consistent among utilities.

- Differences in plan designs and accounting bases among utilities require that the costs, recovery and reporting related to pensions and OPEBs be considered on a case-by-case basis.

It is Union's view that emphasis on benchmarking of pension and OPEB costs across the utility sector would provide little or no value. However, if benchmarking is to be required, significant care will be needed to ensure that comparisons are commensurable and take into account differences in employee demographics, pension and OPEB design, governance arrangements and allocation of costs between employers and plan members.

KPMG's Modified Funding Contribution concept introduces an additional layer of administrative complexity and regulatory disclosure that increases costs to ratepayers for no apparent benefit.

KPMG's adjusted pay-as-you-go cash payments method is contrary to ratemaking principles, would be overly complex to apply, and would require complex transitional provisions.

Set-aside mechanisms specifically for OPEBs are not required and could create unnecessary administrative burden and costs. Should the Board determine that a set-aside mechanism for OPEBs is required, Union submits that excess recoveries (or under recoveries) could be recognized in utility rate base through an adjustment (reduction or increase) to working capital.

If the Board determines that a set-aside mechanism for OPEBs is required and excess recoveries either reduce utility rate base or are recorded in a tracking or deferral account, Union submits that similar treatment should be implemented for under recoveries (over-contributions) to registered pension plans.

Should you have any questions, please do not hesitate to contact me.

Yours truly,

[Original signed by]

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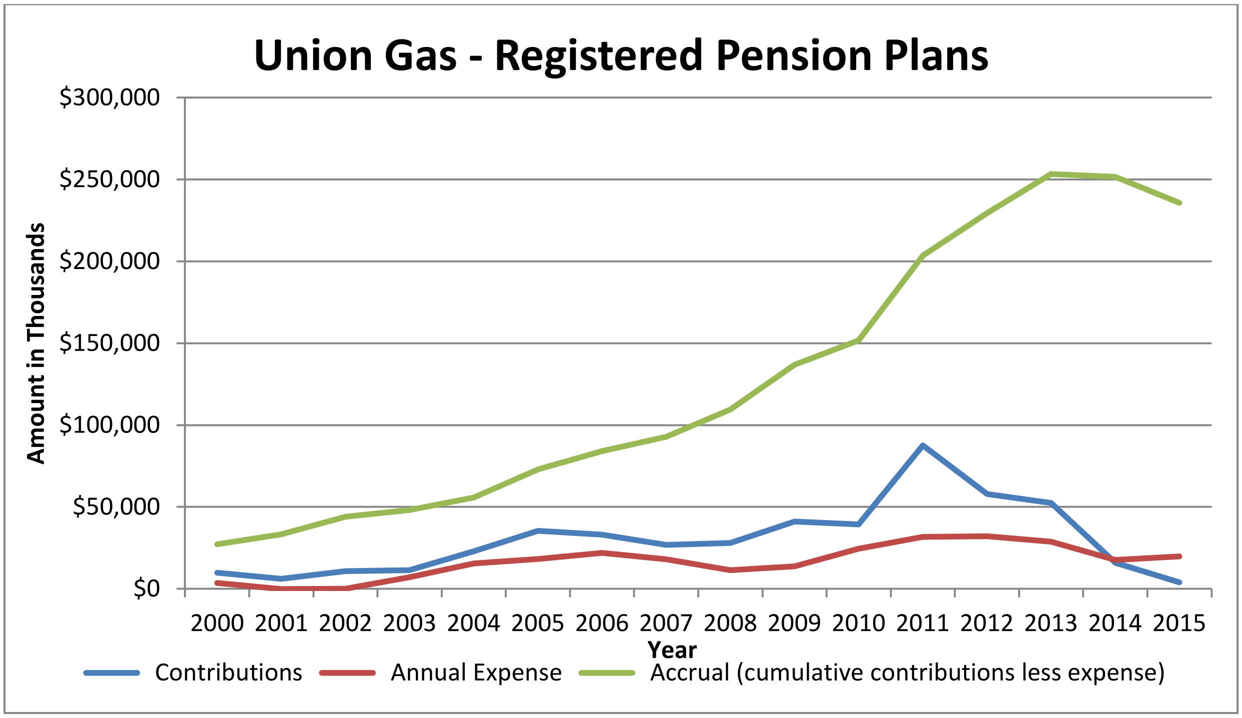
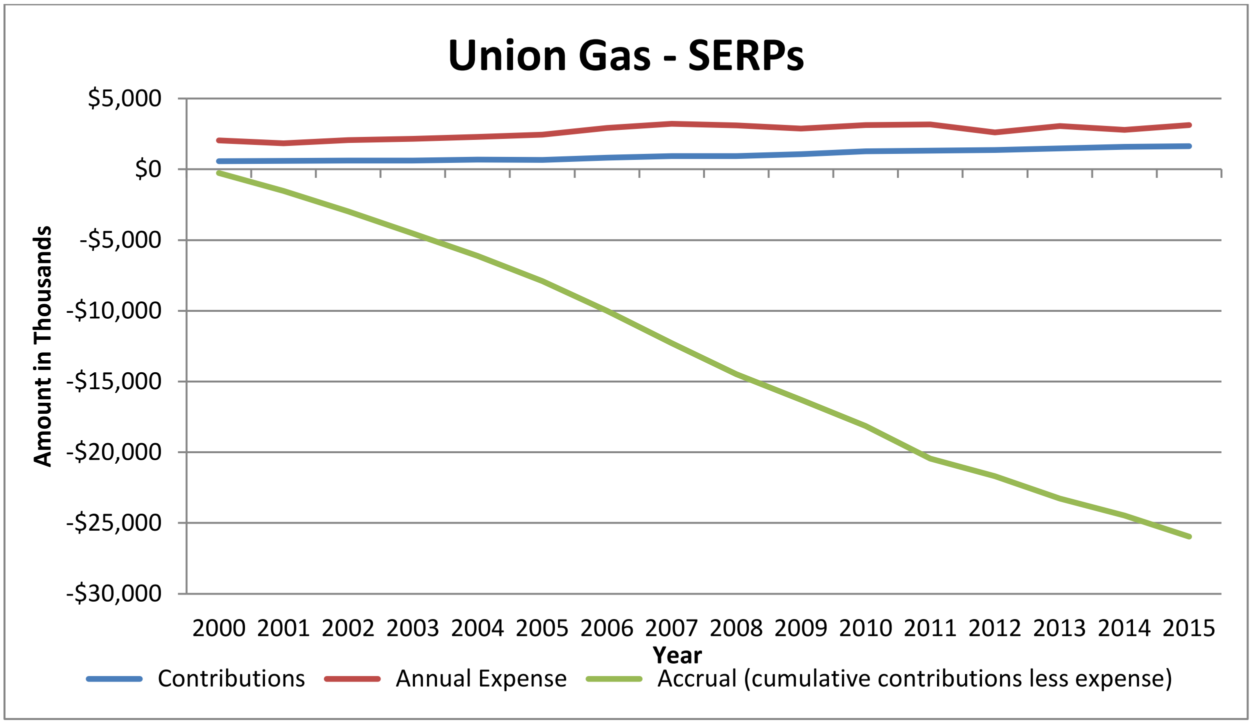
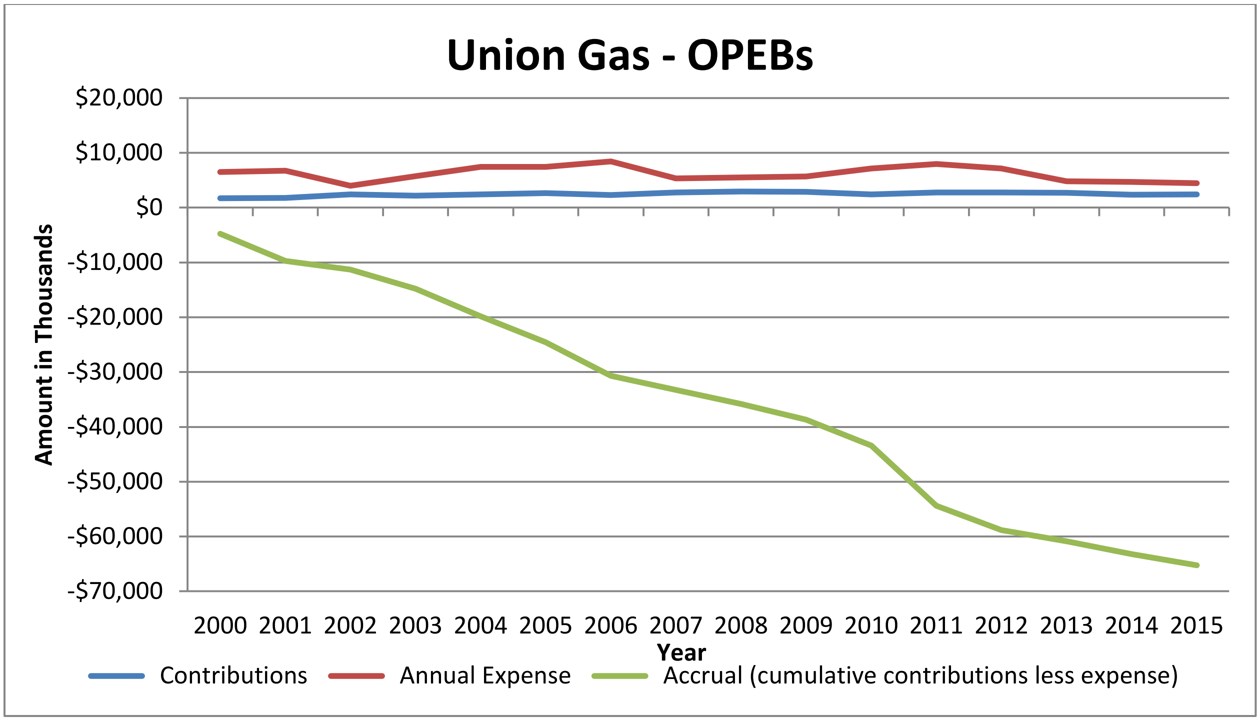
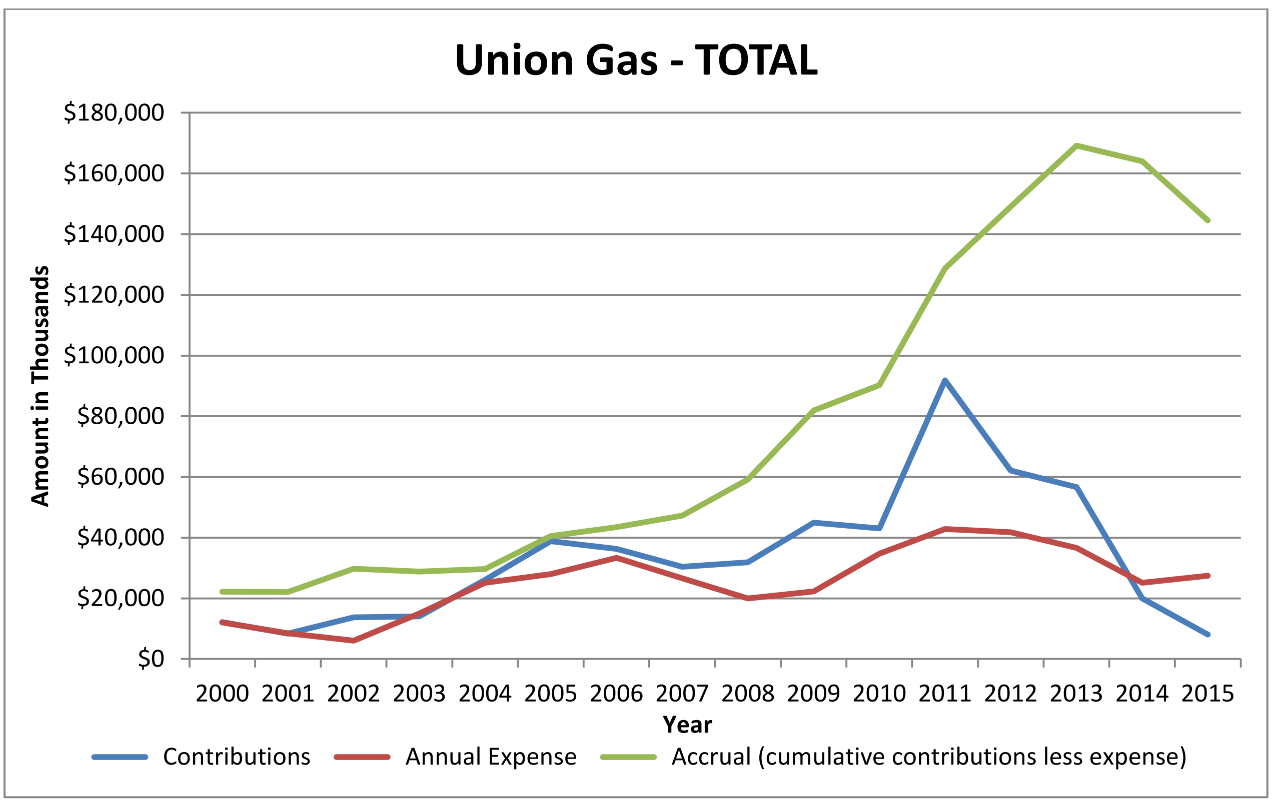
Appendix

The following charts illustrate the historical annual expense, annual contributions and accrual for Union's registered pension plans, supplemental employee retirement plans (SERPs), other post-retirement benefits (OPEBs), and in total.






Union Gas - OPEBs
$20,000
$10,000
$0
-$10,000
-$20,000
-$30,000
-$40,000
-$50,000
-$60,000
-$70,000
Amount in Thousands
2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015
Year
Contributions
Annual Expense
Accrual (cumulative contributions less expense)


Union Gas - TOTAL
$180,000
$160,000
$140,000
$120,000
$100,000
$80,000
$60,000
$40,000
$20,000
$0
Amount in Thousands
2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015
Year
Contributions
Annual Expense
Accrual (cumulative contributions less expense)