OEB STAFF INTERROGATORY 13

6.0 Pensions and Other Post-Employment Benefits (OPEBs) Costs

6.1 Is the IESO's treatment of pensions and other post-employment benefits costs appropriate?

6.1 Staff – 13

INTERROGATORY

Reference: Exhibit A-2-2, p.11

Preamble:

The above reference indicates that pension and other post-employment benefits (OPEBs) expense increases in the planning period are due to a lower discount rate, which increases future liabilities, and reduced asset valuations resulting in a higher funding requirement. The higher expenses are partially offset by increases in the management group pension contributions and pension benefit changes, which take effect in 2017.

Questions:

a) Please provide the 2017 pension amount and the 2017 OPEB amount respectively, that are built into the 2017 Business Plan.

b) Provide a table that compares the 2017 pension and OPEB amounts as provided in a) above to the actual pension and OPEB expenses per the audited financial statements for the last five historical years.

c) Please provide the actuarial valuation that underpins the estimate of the 2017 pension and OPEB expense that is built into the 2017 Business Plan.

   If the balance in the actuarial valuation is different from what is being sought in rates, then please provide an explanation supporting why the amount in rates is more appropriate.

RESPONSE

a) The 2017 Pension and OPEB amounts built into the 2017 budget are $8.6 million and $7.6 million respectively.

b) The table below compares the 2017 pension and OPEB amounts as provided in part (a) above to the actual pension and OPEB expenses per the audited financial statements for the last five historical years.

Expense Type	**2012 Actual ($M)**	**2013 Actual ($M)**	**2014 Actual ($M)**	**2015 Actual ($M)**	**2016 Actual ($M)**	**2017 Business Plan Budget ($M)**
Pension - IESO	12.0	10.8	13.8	12.0	11.6	8.6
Pension - OPA	1.9	2.0	2.0			
OPEB - IESO	6.5	6.9	8.2	6.9	8.1	7.6

c) The response in part a) is based on the actuarial valuation that formed the 2017 budget in the business plan. The report has not been provided to protect the IESO's interests as an employer in future labour negotiations as it contains confidential information related to staff compensation & benefits.

OEB STAFF INTERROGATORY 14

6.0 Pensions and Other Post-Employment Benefits (OPEBs) Costs

6.1 Is the IESO's treatment of pensions and other post-employment benefits costs appropriate?

6.1 Staff – 14

INTERROGATORY

Reference: Exhibit A-2-2, p.12

Preamble:

The above reference indicates that the IESO has made changes, including revisions to the management pension and compensation structure; and, to the negotiated contracts with its unions in order to manage the IESO's overall costs in the longer term.

Questions:

a) Please explain the changes that were implemented with respect to pensions and OPEBs, if any

c) What amount of savings in pension and OPEB costs are being reflected in the 2017 Business Plan as a result of these changes?

e) What is the expected Employer to Employee contribution ratio for pensions in 2017?

RESPONSE

a) In 2015, the IESO announced both employee pension contribution increases and pension plan design changes for its non-represented employees: Non-represented employee contributions increased on September 1 in three consecutive years (2015, 2016 and 2017), bringing employer/employee contributions to an approximate 50/50 ratio. In addition, plan design changes for non-represented employees who were hired prior to January 1, 2007 came into effect on January 1, 2017. The following changes applied to service after the effective date: change from rule of 84 to rule of 90; change from highest 3 years average earnings to highest 5 years; and change from 100% indexing of the pension benefit to 75% indexing. The pension plan design for non-represented employees hired after December 31, 2016 already included all of the preceding design features (i.e. rule of 90, best 5 years and 75% indexing). In 2016 bargaining between the Society of Energy Professionals and the IESO, the parties agreed to higher employee pension contributions and to plan design changes similar to those bargained at Hydro One and Ontario Power Generation. The following changes will be effective in 2025 for future service: from rule of 82 to rule of 85, and from highest 3 years to highest 5. The IESO is currently bargaining for a renewal of its collective agreement with the Power Workers Union, and any changes to the PWU pension plan is subject to the outcome of those negotiations.

c) The annual savings related to management pension plan revisions have been combined with other benefits cost drivers in IESO's budgeting process and are not available as discrete amounts.

e) For 2017 pension's cash contributions, the employer expects to contribute $13,086,000 and the total employees expect to contribute $6,671,000 (a ratio of 1.96 to 1.00).

OEB STAFF INTERROGATORY 15

6.0 Pensions and Other Post-Employment Benefits (OPEBs) Costs

6.1 Is the IESO's treatment of pensions and other post-employment benefits costs appropriate?

6.1 Staff – 15

INTERROGATORY

Reference: Exhibit A-2-2, p.13
Preamble:

The above reference indicates that the IESO is seeking to recover approximately $18.4 million in amortization expense for 2017.

Questions:

a) Please provide the asset continuity schedule that underpins the amortization amount being sought for recovery in rates. Please ensure that the opening balances for 2017 presented agree to the December 31, 2016 continuity presented in the audited financial statements.

b) Please provide a five-year historical comparison between the amortization expense that was sought in rates compared to the actual amortization expense for each year.

d) How often does management review the reasonableness of their depreciation policies?

f) Has the IESO compared its depreciation policies to the useful lives recommended by the July 8, 2010 Asset Depreciation Study performed by Kinectrics Inc. on behalf of the OEB, and which forms the basis of the OEB's depreciation policy for most regulated utilities.

RESPONSE

a) The table below shows the 2017 amortization and net book value of assets

2017 Budget Amortization	
Details	**2017 ($ millions)**
Net Book Value of Tangible Capital Assets as at Dec 31'st 2016	93.4
Construction-in-progress as at Dec 31'st 2016	11.6
Total Assets	**105.0**
2017 Budget Capital Envelope	25.0
Opening construction-in-progress (ending 2016)	11.6
Estimated capital spending during 2017	22.5
Estimated assets in-service during 2017	21.0
Estimated closing construction-in-progress	**13.1**
Estiamted Net Book Value of Tangible Capital Assets as at Dec 31'st 2017	107.7
Estimated Construction-in-progress as at Dec 31'st 2017	13.1
Total Assets	**120.8**
Amortization	
Amortization on existing capital assets	17.0
Amortization projected on additions during the year	1.4
Total	**18.4**

b) The table below provides a five-year historical comparison between the amortization expense that was sought in rates compared to the actual amortization expense for each year. Variances are caused primarily due to the timing of capital asset additions.

($ million)	2012	2013	2014	2015	2016
Actual Amortization	17.4	17.2	16.6	17.9	19.6
Budget Amortization	19.1	17.4	20.1	18.7	17.5
Variance	**(1.7)**	**(0.3)**	**(3.5)**	**(0.8)**	**2.1**

d) The IESO amortization policy is found in the notes to the audited financial statements under Summary of Significant Accounting Policies (ref: Exhibit A-3-1, page 37). As described, the estimated service lives of tangible capital assets are reviewed periodically, with the most recent review being completed in 2016.

f) No, the IESO has not compared its amortization policy to the useful lives recommended by the July 8, 2010 Asset Depreciation Study performed by Kinectrics Inc.

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OEB STAFF INTERROGATORY 16

6.0 Pensions and Other Post-Employment Benefits (OPEBs) Costs

6.1 Is the IESO's treatment of pensions and other post-employment benefits costs appropriate?

6.1 Staff – 16

INTERROGATORY

Reference: Exhibit B-4-1, p.2

Preamble:

The above reference indicates that the IESO has historically over-collected on OPEB costs compared to the actual benefit payments made.

Questions:

a) Please complete the following table, one table each for pension and OPEB costs respectively.

Pensions and OPEBs	**First Year of recovery to 2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Amounts included in Rates							
OM&A							
Capital							
Total	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Actual contributions (pensions) / benefit payments (OPEBs)							
Net excess amount included in rates relative to amounts actually paid.	$ -	$ -	$ -	$ -	$ -	$ -	$ -

b) The IESO proposes an alternative mechanism for providing value to ratepayers from the over-collection of pension and OPEB costs than what is prescribed in the OEB's May 18, 2017 Report on the Regulatory Treatment of Pension and Other Post-Employment Benefit costs. Management has indicated that over-collection of OPEB expenses have historically been used to reduce IESO's debt.

i. Has the IESO also historically over-collected on pension costs?

ii. If so, please describe how the IESO has used pension recoveries in excess of pension contribution requirements.

iii. Should potential over-collections associated with pensions also be considered in the IESO's proposed alternative approach, if not, please explain why?

c) When justifying why the policy outlined in the OEB's May 18th, 2017 Report on the Regulatory Treatment of Pension and OPEB Costs should not apply to the IESO, management has highlighted the unique structure of the IESO in that it is a not-for-profit entity and that its core operations are funded through the annual fee that the OEB approves. Currently the IESO recovers its pension and OPEB costs on an accrual accounting basis.

i. How will the IESO fund it its pension and OPEB requirements in years where the accrual based amount for pension and OPEB costs is less than the actual cash requirements (i.e. what is collected in rates is in fact less than what is required)?

ii. If the IESO expects to use debt to fund the shortfall, would that require ratepayers to fund the interest on the related debt?

<u>RESPONSE</u>

a) The presentation of tables is slightly amended to show total pension and OPEB expense as per IESO audited financial statements with a split for amounts included in the IESO usage fee and those not included; capital, smart metering expenses, customer education and market enforcement expenses.

Pension (in thousands $)	**First Year of recovery to 2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Amounts							
Operating & Admin (in rate)		$11,135	$9,904	$12,820	$10,719	$10,628	$8,552
Capital et al (not in rate)		$850	$ 896	$ 957	$1,251	$ 982	$ 871
Total	$ -	$ 11,985	$ 10,800	$ 13,777	$ 11,970	$ 11,610	$ 9,423
Actual contributions (pensions)		$ 25,313	$ 17,261	$ 11,973	$ 12,851	$ 13,052	$13,086

Net excess amount included in rates relative to amounts actually paid.	$ -	($14,178)	($7,357)	$ 847	($2,132)	($2,424)	$ (4,534)

1

OPEBs	**First Year of recovery to 2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Amounts included in Rates							
Operating & Admin (in rate)		$6,022	$6,334	$7,599	$6,180	$7,440	$7,586
Capital et al (not in rate)		$ 460	$ 573	$ 567	$721	$ 687	$1,035
Total	$ -	$ 6,482	$ 6,907	$ 8,166	$ 6,901	$ 8,127	$ 8,621
Actual benefit payments (OPEBs)		$ 1,768	$ 2,093	$ 2,321	$ 2,314	$ 2,377	$2,400 (estimate)
Net excess amount included in rates relative to amounts actually paid.	$ -	$ 4,254	$ 4,241	$ 5,278	$ 3,866	$ 5,063	$ 5,186

2

b) (i) The IESO has adopted formal pension funding policies to maintain discipline and guidance on annual employer's contributions to help assist the IESO with having sufficient assets to meet ongoing benefit payments. The IESO has utilized the Canadian Association of Pension Supervisory Authorities "CAPSA" Guideline #7[1] in establishing robust IESO funding policies. CAPSA is a national interjurisdictional association of pension regulators whose mission is to facilitate an efficient and effective pension regulatory system in Canada. It develops practical solutions to further the coordination and harmonization of pension regulation across Canada. Therefore, the IESO looks to its formal policies in deciding on annual employer's pension contributions. As provided in the table above, in general for the recent net aggregate past few years, the IESO has collected less than the actual IESO contributions (i.e. under-collected). In some years, e.g. 2014, the IESO over-collects, whereas in other years, e.g.2012, the IESO under-collects. For 2017, the IESO plans to under-collect.

(ii) Where the IESO has a net under-collection for pension, the IESO will borrow funds to make any net pension contributions. Where the IESO has a net over-collection for pension, the IESO will pay down debt which reduces debt interest expense cost. For OPEB, the IESO has in general over-collected in recent years, and the IESO has paid down debt which reduces debt interest expense cost.

(iii) The IESO manages its cash-flows in a careful and efficient manner. The IESO utilizes pension funding policies (see b(i) above) and a formal Treasury policy to help with proper cash management. Where an over-collection of amounts is received for pension and/or OPEB, the IESO reduces total debt levels, which in turn reduces IESO debt interest costs.

c) (i) Please refer to the response in parts b.(ii) and b.(iii) above.

(ii) Yes, as the IESO is a not-for-profit corporate entity, any debt utilized by the IESO would require the ratepayer to fund the debt interest expense.

[1] https://www.capsa-acor.org/en/init/prudence/Pension_Plan_Funding_Policy_Guideline.pdf

ENERGY PROBE INTERROGATORY 21

Issue 6.1

INTERROGATORY

Reference: Exhibit B Tab 4 Schedule 1 Page 3

Preamble: The IESO seeks the Board's approval to continue to apply any over-collection between OPEB expenses and OPEB benefit payments in a given year to the IESO's debt, with any resulting decrease in interest charges benefitting Ontario's ratepayers. The IESO believes that this alternative mechanism meets the spirit of the Report while acknowledging that the IESO is a not-for-profit corporation.

Please file a copy of the Accounting Order for the variance account to track the difference between the forecasted accrual amount and actual cash.

RESPONSE

The Board provided for the establishment of the variance account on pages two and nineteen of the May 18, 2017 Report of the Ontario Energy Board Regulatory Treatment of Pension and Other Post-employment Benefits (OPEBs) Costs[1]:

> Page 2: *This Report also provides for the establishment of a variance account to track the difference between the forecasted accrual amount in rates and actual cash payment(s) made, with an asymmetric carrying charge in favour of ratepayers applied to the differential.*

> Page 19: *The OEB provides for the establishment of the Pension and OPEB Forecast Accrual versus Actual Cash Payment Differential variance account on a generic basis in this Report.*

[1] https://www.oeb.ca/sites/default/files/uploads/OEB-Report_OPEB_20170518.pdf

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SOCIETY INTERROGATORY 4

6.1 Is the IESO's treatment of pensions and other post-employment benefits costs appropriate?

6.1 Society#4

INTERROGATORY

Reference: Exhibit B-4-1, Pages 2, 3.

> ***As stated in the IESO's September 2016 submission, any difference between OPEB expenses and OPEB benefit payments in a given year has historically been an over-collection and has subsequently been applied to the IESO's debt with any resulting decrease in interest charges benefitting Ontario's ratepayers.*** *If the IESO is required to track interest on any over-collection at the CWIP rate with ultimate disposition in favour of the ratepayer, there would ultimately be no additional benefit for the ratepayer. Any interest charges on the over-collection paid to the IESO's ratepayers will need to be recovered from those same ratepayers that the interest charges would be paid to as the only means the IESO has to recover the cost of its operations is through its fees. If the Board is supportive of the IESO's proposed approach, to continue to apply any over-collection between OPEB expenses and OPEB benefit payments in a given year to the IESO's debt, the IESO submits that the "Pension & OPEB Forecast Accrual versus Actual Cash Payment Differential Carrying Charges" sub-account, as specified in the Board's Report, is not required.*

In a table, for each of 2015 actual, 2016 actual and 2017 proposed, please estimate and provide the following:

a) The over collection of OPEB benefit payments as compared to OPEB expenses.

b) The reduced interest expenses on debt if the values calculated in a) above are applied to the IESO's debt.

c) The interest expense on the values calculated in a) above if the OEB approved CWIP rates are applied.

d) The difference between the values calculated in b) and c) above.

e) The over collection of pension payments as compared to pension expenses

f) The reduced interest expenses on debt if the values calculated in e) above are applied to the IESO's debt.

g) The interest expense on the values calculated in e) above if the OEB approved CWIP rates are applied.

h) The difference between the values calculated in f) and g) above.

<u>RESPONSE</u>

a) & e) The tables below provide the over collection of pension payments as compared to pension expenses and the over collection of OPEB benefit payments as compared to OPEB expenses for each of 2015, 2016 and 2017 (estimated).

Pension (in thousands $)	**2015**	**2016**	**2017**
Amounts			
Operating & Admin (in rate)	$10,719	$10,628	$8,552
Capital et al (not in rate)	$1,251	$ 982	$ 871
Total	$ 11,970	$ 11,610	$ 9,423
Actual contributions (pensions)	$ 12,851	$ 13,052	$13,086
Net excess amount included in rates relative to amounts actually paid.	($2,132)	($2,424)	$ (4,534)

OPEB (in thousands $)	**2015**	**2016**	**2017**
Amounts included in Rates			
Operating & Admin (in rate)	$6,180	$7,440	$7,586
Capital et al (not in rate)	$721	$ 687	$1,035
Total	$ 6,901	$ 8,127	$ 8,621
Actual benefit payments (OPEBs)	$ 2,314	$ 2,377	$2,400 (estimated)
Net excess amount included in rates relative to amounts actually paid.	$ 3,866	$ 5,063	$5,186

b) & f) : Note: The IESO is a non-profit entity and therefore there are no net income taxation calculations to consider for the amounts below.

Assuming that any capital costs (or non-operating and administrative costs) are amortized fully in the current year, for simplicity, any over-collection difference is accumulated at the beginning of the year, and only debt is reduced (vs. any net excess cash is invested). Therefore, the total annual difference is estimated to have reduced debt interest expense by:

(000's unless stated otherwise)

2015: Pension + OPEB difference = $11,970+$6,901-$12,851-$2,314 = $3,706,000 net over-collection

Therefore 2015 reduced debt interest expense is approximately = $3,706,000 * 1.91% = **$70,785.00**

2016: Pension + OPEB difference = $11,610+$8,127-$13,052-$2,377 = $4,308,000 net over-collection

Therefore 2016 reduced debt interest expense is approximately = $4,308,000 * 2.046% = **$88,142.00**

2017: Pension + OPEB difference = $9,423+8,621-$13,086-$2,400 = $2,558,000 net over-collection

Therefore 2017 forecast reduced debt interest expense is approximately = $2,558,000 * 1.88% = **$48,090.00**

c) & g): OEB's prescribed historic CWIP is has been taken from the OEB website[1]:

Q1-2015: 2.89%, Q2-2015: 2.28%, Q3-2015: 2.55%, Q4-2015: 2.55% = average full year: 2.57%

Q1-2016: 2.92%, Q2-2016: 2.92%, Q3-2016: 2.92%, Q4-2016: 2.45% = average full year: 2.80%

Q1-2017: 2.81%, Q2-2017: 2.81%, Q3-2017: 2.53%, estQ4-2016: 2.53% = average full year assumed: 2.67%

Assuming that any capital costs (or non-operating and administrative costs) are amortized fully in the current year, for simplicity, any over-collection difference is accumulated at the beginning of the year, and only OEB's CWIP rate is utilized. Therefore, the total annual difference is estimated:

Therefore if CWIP rates are applied to **2015** = $3,706,000 * 2.57% = **$95,244.00**

Therefore if CWIP rates are applied to **2016** = $4,308,000 * 2.80% = **$120,624.00**

[1] https://www.oeb.ca/industry/rules-codes-and-requirements/prescribed-interest-rates

Therefore if CWIP rates are applied to **2017 forecast** = $2,558,000 * 2.67% = **<u>$68,299.00</u>**

d) & h): The difference between reduced debt interest expenses and OEB's CWIP cost is:

2015: = -$24,459.00

2016: = -$32,482.00

2017 forecast: = -$20,209.00