



**SOCIETY of
UNITED PROFESSIONALS**
IFPTE 160

26th June, 2019

Chris Graham
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2239 Yonge St
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VIA Canada Post, email and RSS Filing

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

**Re: EB-2019-0122 Hydro One Networks Inc. (HONI)
EB-2019-0122 Motion to Review and Vary EB-2017-0049 Decision and
Order dated March 26, 2019
Society of United Professionals' Submissions**

Dear Ms. Walli,

Please find attached the Society of United Professionals' (SUP) Submissions in the Hydro One Networks Inc. EB-2019-0122 Motion to Review and Vary the Board's EB-2017-0049 decision in respect of the treatment of pension contributions.

Two (2) hard copies of this submission have been sent to your attention.

Sincerely,

[Original signed by]

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Copy by email: interested parties



SOCIETY *of*
UNITED PROFESSIONALS
IFPTE 160

Society of United Professionals'
SUBMISSIONS

EB-2019-0122 Hydro One Networks Inc.

**Motion to Review and Vary EB-2017-0049 Decision
and Order dated March 26, 2019**

26th June, 2019

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EB-2019-0122: Society of United Professionals' Submissions

Introduction:

These are the submissions of the Society of United Professionals (SUP) related to Hydro One Networks Inc.'s (HONI) Motion to Review and Vary the OEB's decision in respect of the recoverability of pension contributions for HONI's Distribution Business during the rate-setting period 2018-2022 (EB-2017-0049).

The Society has an interest in OEB decisions impacting the recoverability of HONI's pension contributions for obvious reasons. However, SUP also has concerns on this matter from the perspective of rate-payer interest, the integrity of regulatory principle and the stability of future rates.

In its procedural order for the current proceeding, the OEB laid out two issues that it requested submissions on. Specifically, "the OEB has determined that it will receive written submissions as to (1) whether the Motion to Review and Vary meets the threshold test as specified in the Rules; and (2) if the threshold test is met, whether the grounds cited of change in circumstances and an error in the Decision and Order are justified."

SUP submissions are organized to deal with these two matters in sequence.

The Threshold is Met

SUP has reviewed the concept of threshold as described in rule 43.01 of the OEB's Rules of Practice and Procedure. "In respect of a motion brought under Rule 40.01, the Board may determine, with or without a hearing, a threshold question of whether the matter should be reviewed before conducting any review on the merits."

No guidance is provided in the rules on how such a threshold question should be evaluated in advance of any consideration of the merits of the motion. However, SUP has reviewed HONI's submission on this matter and agrees that the regulatory precedents identified by HONI support a view that a reasonable threshold test would be to determine whether the issue involves (a) new circumstances; (b) an error and (c) an evaluation of materiality of the impact.

It is clear to SUP that significant new circumstances have arisen since the decision given the issuance of new pension regulations by the Financial Services Commission of Ontario (FSCO). The likelihood of upcoming future regulatory changes was discussed in the evidentiary portion of the EB-2017-0049 proceeding but there was not enough information at that time to assess the outcome with certainty.

The additional new circumstance of HONI deciding to repatriate its former Inergi/Vertex call centre staff, with the resultant transfer of pension assets and

obligations, creates another new circumstance that HONI claims impacts the effective date of the new pension rules.

There is also a reasonable case that a regulatory error has occurred given that disallowed pension costs are essentially no different than those which have been found to be prudently incurred in past HONI Distribution and Transmission hearings. In addition, it appears clear to SUP that HONI's contributions are effectively non-discretionary under law and collective agreements. Given these facts, the OEB's presumption that a pension contribution holiday was possible for 2018 and the subsequent four years of the rate setting period, predicated on the existence of going concern and solvency basis surpluses in HONI's pension plan, is erroneous. Disallowance of these legally required costs appears to have been based on a faulty assumption on the part of OEB staff of what future pension regulations would look like. This is just the sort of speculation that OEB staff accused HONI of in its submission [OEB staff argument, dated 20180803, p126].

Finally, the concept of materiality, while it does not explicitly appear in rule 43, has been raised by HONI in its review of OEB precedents. SUP agrees that a materiality test should be applied before a Motion to Vary is considered. However, although no specific guidance is provided on materiality in the OEB's rules on Motions, a close analogy can be drawn between this matter and the concept of the "Z factor," as discussed in the OEB's July 14, 2008 Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors. Both can be triggered by the identification of new circumstances.

On page 36 of that 2008 report, the Board noted that for an extraordinary treatment for a Z Factor unforeseen event to be considered, "the materiality threshold will be as follows:

- \$50 thousand for distributors with a distribution revenue requirement less than or equal to \$10 million;
- 0.5% of distribution revenue requirement for distributors with a revenue requirement greater than \$10 million and less than or equal to \$200 million; and
- \$1 million for distributors with a distribution revenue requirement of more than \$200 million."

The amounts in question for this proceeding potentially impact annual capex, and ultimately annual rate base, by \$20 million in each year of the rate setting period. As a result of the related impact to depreciation and return on rate base, the annual revenue requirement would therefore be impacted in excess of the \$17 million in annual pension costs that HONI attributes to OM&A. Given these numbers, it would be difficult to see this matter as being of immaterial consequence.

Given the points discussed above, SUP is convinced that this matter meets the threshold to warrant full consideration of the merits of HONI and intervenor arguments by the OEB.

The EB-2017-2017 Decision Should be Varied

Changed Circumstances

Accepting that the impact of the pension disallowance is material to rates, the question of whether or not the decision should be varied comes down to the question of whether new circumstances have arisen and/or whether or not the OEB erred in its original Distribution decision. The existence of either could and should provide the basis for a revision to the prior decision.

SUP will not repeat HONI's detailed and convincing description of the new circumstances that have arisen since the date of the OEB's decision. HONI is in the best position to enumerate these and they have done so convincingly and extensively in their argument. Suffice to say that SUP agrees that the law and related regulations governing defined benefit pension contributions have both changed significantly from those that were in effect at the commencement of the Distribution hearing. The fact that this change process was underway was clearly referenced by HONI witnesses during the hearing and even more clearly in the argument stage.

In addition, HONI's decision to repatriate its call center operations from Inergi/Vertex introduces another significant uncertainty over the operative date of the new pension regulations. This operative date will to a large extent be contingent on when a transfer order for the Inergi/Vertex pension assets and liabilities is received, which is largely extent outside of HONI's control.

To summarize, it is clear that the issuance of new and final pension funding regulations under the Pension Benefits Act and related regulations represents a significant and material change in circumstance, which could be seen as analogous to proposed and subsequently enacted changes in taxation statutes. The process to initiate this change, which was initially signaled by the provincial government in May 19, 2017, was explicitly noted by HONI to be underway during the hearing and the related uncertainty of outcome was explicitly spoken to by the relevant HONI witness. While changes were expected, the specific nature of those changes were not known until approved and communicated by FSCO.

In SUP's opinion, the existence of these significant regulatory changes meets one of the OEB's Review and Vary criteria.

The OEB erred in its Distribution Decision

SUP is of the opinion that the OEB erred in its Distribution decision with respect to its treatment of HONI's pension contributions. Admittedly this is a complex subject area, even when rules and regulations are not in flux. Based on a review of the evidence and the OEB's Decision, including any rationale where it was provided SUP does not believe that the OEB could have fully or correctly considered the facts and circumstances faced by HONI. SUP considers that the OEB decision is based on a presumption that HONI had options available to it which were not in fact available. For example, the OEB seems convinced that HONI could have avoided pension contributions entirely by taking a contribution holiday. It is apparent to SUP that the evidence indicated clearly that no such path was or is currently available to HONI under the law or under existing collective agreements. This should have been apparent to all from the evidence.

In its Decision, the OEB determined that 100% of HONI's pension contributions for 2018 and subsequent years should be disallowed for recovery. On p. 94 of its Decision, the OEB found that HONI "has a significant surplus in its pension plan and there is no justification for continued inclusion of additional pension contributions in rates."

In its discussion of the pension contributions issue and its summation of arguments, (p. 107 -110 of the Decision), the OEB noted that "OEB staff argued that the amount of pension costs being sought for the test period should be reduced to zero, or limited to the amount that it is obligated to contribute pursuant to its collective bargaining agreements, because the actuarial valuation that underpins the test period pension costs indicates that the pension plan is in a surplus position and therefore does not require any employer contributions to be made. OEB staff further argued that Hydro One currently has a variance account that will make them whole should the pension circumstances change during the term of the application."

On p. 96 of the Decision regarding Pension Costs, which appears before the discussion above, the OEB found that "although Hydro One's pension plan has been in a significant surplus position for some time (current surplus is more than \$434 million), Hydro One is seeking to recover \$37 million from ratepayers in 2018 (\$17 million in OM&A and \$20 million in capital). The OEB denies Hydro One's request to recover the \$37 million (\$17 million in OM&A and \$20 million in capital) based on the magnitude of the current surplus. For future rebasing applications, the OEB directs Hydro One to provide justification for the inclusion of any additional pension contributions in rates given the current surplus."

SUP is concerned that the OEB provided no discussion of or rationale for its decision to ignore the evidence presented by HONI related to the pending changes in pension rules. HONI stated clearly that these changes would likely make a pension contribution holiday impossible for both 2018 and subsequent rate years.

On Hearing Day 4 (Transcript ref. p.78), HONI witness Mr. Chhelavda noted that “there are some challenges with this (i.e. taking a contribution holiday), so there are new pension rules that have come out in 2018, I believe, in the month of May -- April, May, which changes the funding ratio, so this may be true for, we think, for '18, but we're not sure if it holds beyond that, and the new rules, what they do is, the pension plan has to be in a stronger financial position to be able to take a contribution holiday, so this may not be applicable for the full test period, and it may not even be applicable for 2018.”

Mr. Chhelavda also noted that “there are estimated member contributions, and if you recall earlier in the day, I did mention that Hydro One does not have -- the way our union contracts are written, Hydro -- the employer contributions cannot be less than the employee contribution, so given those set of constraints that we have, I -- my view is I do not believe Hydro One could take a full funding holiday. You would still have to contribute equal to the employees' contribution.” (Transcript ref. p.78)

In HONI's reply argument, its likely inability to take a contribution holiday was discussed even more fully, as by that time the likely direction of the proposed regulatory changes was much clearer and closer to be final. In addition, HONI's inability to reduce its pension contributions below employee contribution levels was affirmed given the constraints in existing collective agreements.

In its reply argument, HONI noted: “As indicated at the oral hearing, Hydro One has made a commitment under its collective agreements to contribute at least an amount equal to the employee contributions and therefore, at this point in time, Hydro One's contributions cannot be reduced to \$0 regardless of the minimum required legislation. Importantly, however, in regard to what is permitted by the applicable legislation, pension regulator FSCO recently communicated its position with respect to the application of new funding rules which limit the use of a contribution holiday beyond 2018. Even though the December 31, 2017 actuarial valuation indicates that the minimum employer contribution requirement for 2018-2020 is zero, the actuarial valuation also states that the Application of Surplus amounts shown reflect the funding rules in force at the time the current valuation was filed. The actuarial valuation also states that this is subject to the preparation of a cost certificate at the beginning of each year confirming the level of available surplus that may be applied for 2019 and 2020. In August 2018, FSCO issued their position which states that for a contribution holiday to be taken in 2019 and beyond a cost certificate will need to be filed certifying that, at the beginning of the year, the assets of the plan exceed the windup liabilities by 5%. Based on this, it is extremely unlikely that Hydro One will be able to take a contribution holiday in the near future, as assets would have to outperform windup liabilities by more than \$2.7 billion to first cover the windup deficit and then further exceed windup liabilities by 5%.” (HONI Argument p.129).

From this and oral evidence provided, it should have been clear to the OEB that HONI was highly unlikely to be legally able to reduce its pension contributions by

way of a contribution holiday for 2018 or for subsequent years in the rate period. Disallowing contributions based on a faulty presumption that a holiday was available would constitute a significant regulatory error in the opinion of SUP.

The suspicion that an error was made is magnified by the fact that the OEB did not provide any discussion in its decision as to why it had set aside HONI's evidence that it was constrained from reducing its pension contributions to zero by emerging law and by collective agreements. In fact, the OEB went further than recommended by its own Staff and some intervenors in their respective arguments. Staff had noted HONI's contention "that a full employer funding holiday may not be possible as a result of existing union agreements. Under such a scenario, it is not unreasonable to allow Hydro One to recover what it is required to contribute as a result of their collective agreements. However, OEB staff notes that currently there does not appear to be any information on the record that breaks out the total employee (member) contributions between the distribution and transmission businesses in order to calculate what the test period employer contribution would be under the above noted scenario. If the OEB decides that recovery of contributions will be allowed and limited to the amounts embedded in the collective agreements, then Hydro One could provide those amounts as part of the draft Rate Order process."

In response, despite Staff's invitation to reduce allowable pension levels to those mandated by collective agreements, the OEB disallowed 100% of HONI's pension contributions and did not provide any recognition of the necessity of HONI continuing to make contributions under those agreements. No request for additional information, as suggested by Staff, was made. No rationale for the OEB's harsh decision was provided in the Decision.

OEB staff further submitted that "Hydro One already has a variance account in place to capture the difference between the pension costs built into rates and what is actually paid out. Therefore, in the event that something does change during the application term, Hydro One will be made whole for the difference through this variance account."

Under the terms of the Board's decision, future use of the pension variance account would seem to be unavailable to HONI unless the OEB authorized it by varying its decision. A variance account cannot generally be used to track, or record costs explicitly disallowed for recovery by the regulator. Once a cost is disallowed it must be charged to the shareholder and it is not available for future litigation or consideration. Thus, if HONI is correct that it cannot take advantage of a contribution holiday, any pension contributions it is forced to make over the five-year rate setting period will have to be treated as non-recoverable OM&A to the shareholders' account. This is irrespective of whether such costs would normally be classified as capital or OM&A had recovery been approved. The OEB's decision would see \$100 million in prudently incurred and non-discretionary capital expenditures being written off to operations.

It is concerning that the OEB did not explicitly communicate its thoughts on these issues and arguments in its Decision. As such, SUP is left with the unhappy presumption that the issues and related evidence were not given due consideration by the OEB. This would provide compelling evidence of the existence of a regulatory error.

Other matters

In its March Motion, HONI asked that the OEB either reverse its decision and include the pension contributions in rates or allow HONI to record its contributions in a variance account for future recovery in a subsequent rate period after 2022. Discussion of this second alternative is absent in HONI's argument filed June 5. SUP considers that the variance account alternative is better than the existing disallowance but much inferior to the correct solution, which is inclusion in 2018 to 2022 rates.

A simple variance account approach would have the effect of converting all recoverable pension contributions, whether capital or OM&A, into OM&A when ultimately included in rates after 2022. Given that more than half of HONI's expected contributions will be of a capital nature, should the OEB vary its decision and decide to follow the variance account approach, it would be preferable to structure this account to capture the revenue requirement impact of pension contributions for which recovery is being delayed. As such, capital pension contributions should be still added to rate base in 2018 to 2022 and a calculation of the revenue requirement impact of the capital and OM&A pension contributions (i.e. OM&A, depreciation, return etc.) should be recorded in the variance account. While this is more complicated, there is precedent for such an approach to be found in the OEB's smart meter accounting guidance.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED ON THIS
26th DAY OF JUNE, 2019**