BY EMAIL and RESS

Jay Shepherd
jay@shepherdrubenstein.com
Direct: 416-804-2767

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Our File No. 20190122

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2019-0122 – Hydro One Dx. Motion to Review – SEC Submissions

We are counsel for the School Energy Coalition. Pursuant to Procedural Order #1, this letter constitutes SEC's submissions on the Applicant's Motion to Review.

Background Facts

1. ***The Decision.*** On March 7, 2019, after a lengthy hearing and extensive arguments, the Board made a determination on just and reasonable rates for Hydro One Distribution (the "Decision"). Among the issues the Board addressed was whether the Applicant should include in its revenue requirement $37 million in pension contributions ($17 million in OM&A, $20 million in capital). The Decision states as follows:

> *"Hydro One highlighted its commitment under its collective agreements to contribute at least an amount equal to the employee contributions and therefore argued its contributions cannot be reduced to zero. Hydro One further argued that new rules issued by the Financial Services Commission of Ontario (FSCO) in August 2018 make it extremely unlikely that it will be able to take a contribution holiday as its assets would have to outperform windup liabilities by more than $2.7 billion and then further exceed windup liabilities by 5%. It also argued that pension costs should be viewed over a longer term to minimize the volatility in costs. Also a full funded holiday could result in the company having to make additional payments in the future (going concern /*

> *special payments) if assumptions or conditions change, which could also be perceived as intergenerational inequity."*[1] *[emphasis added]*
>
> *Hydro One's has a significant surplus in its pension plan and there is no justification for continued inclusion of additional pension contributions in rates.*[2]

2. It is to be noted that the Decision was made with full understanding of the very arguments the Applicant is making now about the availability of a contribution holiday. It should also be noted that the reduction in pension recovery was determined by the Board in the context of an analysis of reductions required due to compensation levels that are higher than the Board believes are appropriate.

3. At no time did the Board state, directly or indirectly, that the pensions should be removed from revenue requirement because of a possible contribution holiday. What the Board said is that Hydro One's compensation levels are too high, and it is no longer reasonable for customers to pay those high compensation levels in rates. Removing the pension contributions from revenue requirement was expressly because the plan was in surplus, and compensation levels were too high. Surplus and contribution holiday are not the same thing, as the Board expressly acknowledged.

4. Another important fact is that the Board recognized and cited the arguments of Hydro One and others (including SEC[3]), that the collective agreement with the PWU required Hydro One to make pension contributions at least as much as those contributed by employees. It was thus clear to the Board that Hydro One would be making at least some pension contributions every year. Despite that, the Decision reduces the pension amounts included in revenue requirement to zero.

5. ***Salient Facts.*** SEC submits that the facts in this case are not as stated by Hydro One in its submissions. The actual facts appear to be:

   5.1. Whether Hydro One would be entitled to a contribution holiday was uncertain at the time of the oral hearing[4], still uncertain at the time of the Decision[5], and is still uncertain today[6].

   5.2. The possibility of a contribution holiday is irrelevant to the current motion, because the Decision did not deny the recovery of pension costs on the basis that Hydro One was not going to make cash payments to the pension plan. The Board knew that Hydro One was going to make at least some payments to the plan[7], but determined that no payments would be recoverable in rates because compensation costs were too high.

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[1] Decision, p. 109.
[2] Decision, p. 94.
[3] See Decision, p. 108.
[4] Transcript 4, p. 76.
[5] Decision, p. 109.
[6] Applicant's Submissions, para. 18-19.
[7] At least $47.4 million, because that was the forecast amount to be contributed by employees: Ex. C/2/2//1, p. 11. Of that amount, at least $20 million would be allocable to Distribution.

6. ***The Issue Addressed in the Decision.*** Hydro One would like the Review Panel to focus on the state of flux in which the rules on contribution holidays have been over the last year and a half. In fact, Hydro One erroneously states the issue before the Board on this motion as:

> *"The decision at issue in this motion is whether Hydro One management should make pension contributions required by legislation."*[8]

7. With respect, this is not and never has been the issue in this proceeding, as the Board correctly recognized in the Decision. The issue was then, and still is, the amount of compensation-related costs that should be included in revenue requirement to ensure that rates are just and reasonable.

8. Hydro One has not, on this Motion, challenged the conclusion of the Board in the Decision that Hydro One's compensation costs are too high, and only a lesser amount should be included in just and reasonable rates.

Threshold Test

9. It is not clear to us whether the Applicant is only alleging that there was a material change in circumstances that makes the Decision incorrect, or that there was also an error in the decision unaffected by the change of circumstances. We will deal with both possibilities.

10. ***Change in Circumstances.*** It is not just any change in circumstances that grounds a motion for review. After any decision, a utility faces a myriad of changes to its situation, and very few of those changes would be grounds for a motion for review. It is only changes that a) go to a root fact on which the Board relied in its decision, and b) are sufficiently material that with the corrected fact the Board would have reached a different conclusion.

11. In this case, the purported change of circumstances – if there is a change at all - fails to meet both parts of the test.

12. On the first part, the Applicant has failed to show that the potential availability of a contribution holiday was a fact relied on by the Board in the Decision. As we have noted in the quote above, the Board in fact recognized that the contribution holiday was unlikely, and knew that in any case the Applicant would not actually be contributing zero to the plan. However, the Board still determined, in the context of a detailed discussion on Hydro One's unreasonably high compensation costs, that the customers should not bear any pension costs in their rates.

13. On the second part, it important to keep in mind that the "change" is a change in the nature of the uncertainty about whether contributions are required.

    - Initially, during the oral hearing, the uncertainty was "We don't know the grandfathering rules yet".

[8] Applicant's Submissions, para. 30.

- Then, at the time of the Decision, it was "Under the grandfathering rules now announced by FSCO, we may be too late to qualify for 2018, and the new rules appear to kick in for everyone at the beginning of 2019, but we're not sure".

- The current situation is "We are grandfathered as long as our current valuation report is effective, but we don't know whether our 2017 valuation will terminate in 2018, in 2020, or somewhere in between, because of the uncertain timing of the Inergi/Vertex transfers".

14. Thus, the evolution of the contribution holiday "fact" is a lurching from one uncertainty to another. Even if the availability of a contribution holiday was the underlying basis of the Board's Decision – which it clearly was not – the situation today is no different from the situation then. Indeed, under the new regulations if anything there is a higher probability that there is an available contribution holiday, not lower.

15. SEC therefore submits that, if the basis for this motion for review is change of circumstances, the Motion does not meet the threshold test. The change of circumstances, if any, did not relate to a key assumption in the Decision, and to the extent that external facts changed, they could not have had a material impact on the outcome.

16. ***Error In the Decision.*** SEC suspects that what Hydro One is really arguing on this Motion is that, if they have an obligation to make payments into the pension plan, they are entitled as a matter of law to recover those amounts from customers. These are, they say, "prudently incurred costs" because they are government mandated spending.

17. In their submissions, the Applicant cites[9] the Supreme Court of Canada in the OPG case[10], for the proposition that utility spending is to be assessed by a regulator on the basis of prudence. The Applicant then goes on to argue that failing to follow government pension funding rules would be imprudent[11], and by analogy following those rules is prudent.

18. This argument also fails on two bases.

19. First, the Applicant fails to quote the most salient aspect of the Supreme Court's decision in the OPG case, as follows[12]:

> *"[102]…I see no reason in principle why a regulatory board should be barred from applying the prudence test to operating costs.*
>
> *[103] However, I do not find support in the statutory scheme or the relevant jurisprudence for the notion that the Board should be required as a matter of law, under the Ontario Energy Board Act, 1998, to apply the prudence test as outlined in Enbridge*

[9] Applicant's Submissions, para. 28.
[10] *Ontario Energy Board v. Ontario Power Generation Inc.* 2015 SCC 44, para. 102.
[11] Applicant's Submissions, para. 31.
[12] *OEB v. OPG*, op. cit., para. 102-103.

> *such that the mere decision not to apply it when considering committed costs would render its decision on payment amounts unreasonable. Nor is the creation of such an obligation by this Court justified. As discussed above, where a statute requires only that the regulator set "just and reasonable" payments, as the Ontario Energy Board Act, 1998 does in Ontario, the regulator may make use of a variety of analytical tools in assessing the justness and reasonableness of a utility's proposed payment amounts. This is particularly so where, as here, the regulator has been given express discretion over the methodology to be used in setting payment amounts: O. Reg. 53/05, s. 6(1)." [emphasis added]*

20. SEC therefore submits that, when the SCC decision is looked at fully, it says the exact opposite to what the Applicant proposes. It says, not that the prudence test is required, but that it is one of the tools that the Board has available for use. It expressly rejects the notion that the prudence test is mandatory.

21. Second, the Applicant fails to note that the Decision focused, not on what the Applicant was going to pay, but on the reasonableness of those compensation costs. The Decision accepted that the Applicant was going to spend money on compensation at levels the Board considered unreasonable (for example, on direct compensation above the median, and on pension contributions required by the collective agreement), but determined that the total amount of compensation costs was too high. Whether you spend it or not, said the Board, it is not reasonable for you to recover all of it from the customers.

22. Hydro One's alleged "error", SEC submits, is the Board's refusal to allow them to recover amounts from customers, just because they were going to pay them out. That is not an error.

23. We note in this context that most utilities regulated by the Board do not collect pension costs from customers on a cash basis at all[13]. The point of this is not that the accrual method should be used for Hydro One, but rather that there is no expected connection between cash contributions to a pension plan, and recovery in rates.

24. If compensation levels are too high, the Board can deny recovery in rates. Whether the utility has to make the contributions in any case is not within the jurisdiction of the Board. FSCO is the agency responsibility for regulating those payment requirements. The Board regulates what is collected from customers. The two are different responsibilities, with very different goals and principles at play.

25. SEC therefore submits that, if even in the absence of the alleged change in circumstances, the Applicant is alleging an error in the Decision, no such error in fact occurred. Consistent with the clear legal framework, the Board found that Hydro One's compensation costs are too high, and reduced the amount recoverable in rates to a more reasonable amount.

[13] For Hydro One, the accrual amount is quite different, but still substantial. However, it would be well within the discretion of the Board to deny recovery of accrual amounts where a plan is in surplus, on the basis that past amounts recovered from customers have already been sufficient to fund the plan.

26. It is notable that the Board's freedom to disallow compensation costs, even when it could reasonably be expected that the utility would have to pay some or all of those disallowed costs anyway (which the shareholders would bear), was the central *ratio* of the OPG case[14]. In that case, the Supreme Court expressly notes that at least some of the $145 million of compensation costs of OPG disallowed by the Board would probably be paid out, but it is within the Board's mandate and discretion to do exactly that in its effort to keep costs recoverable from customers just and reasonable.

Merits of the Motion

27. In the event that the Board determines that the threshold test has been met in this case, then SEC submits that the Motion must fail on the merits, for at least three reasons.

28. First, the Applicant has not provided evidence sufficient for the Board to conclude that it is required by law to make contributions to the pension plan. It has only provided evidence that its contribution obligations are still uncertain. Thus, if the Board concludes that there should be a connection in this case between contribution obligation and recovery in rates (which we believe the Board should not conclude), there is no FSCO contribution obligation in the evidence that would support that recovery.

29. SEC notes that, if this situation were to change in the future, and if the Board were to determine that contributions and rate recovery should be linked in some way, the Applicant would presumably make a Z-factor application, which would then be determined by the Board on its merits.

30. Second, the Board in the Decision determined that OM&A compensation levels should be reduced by $32.3 million because they were too high. If the $17 million in OM&A pension costs were to be reinstated, then this Review Panel would, in our submission, be required to embark on a review of the reasonableness of the new compensation level, starting from the premise that the $17 million would have to be found somewhere else to get down to reasonable levels.

31. Since Hydro One has not argued that the Board's determination that compensation levels are too high is an error, this Review Panel should not, in our view, order total compensation levels to be recovered in rates at a higher level than those determined in the Decision.

32. Third, the well-accepted test in motions for review is whether the decision under review is within the range of reasonable outcomes based on the facts of the case. In this case, the Board decided that, despite the requirement in the collective agreement to make payments to the pension plan of $47.4 million in 2018, and despite the uncertainty of the contribution holiday under FSCO rules, it was not reasonable to recover pension contributions in rates when the Applicant's pension plan had a substantial surplus that had continued for some years.

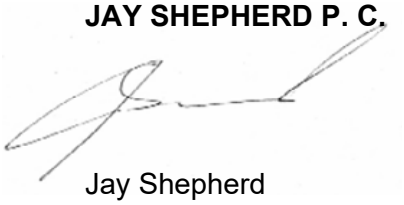
[14] *OEB v. OPG*, op. cit., para. 112-114.

33. In order to overturn the Decision, this Review Panel would have to determine that that conclusion was not within the range of reasonable outcomes based on the facts in evidence in this proceeding. SEC submits that it is not possible to argue that is not within that range of reasonable outcomes.

34. SEC therefore submits that, for each of these three reasons, even if the threshold test is met the motion fails on the merits.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.



Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested Parties