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VIA RESS, EMAIL & COURIER

July 10, 2019

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON M4P 1E4

Dear Ms. Walli,

Re: EB-2019-0122 Motion to Review and Vary – Hydro One Reply Submissions

We write on behalf of Hydro One Networks Inc. (“**Hydro One**”). Pursuant to Procedural Order No. 1 in this proceeding, please find enclosed Hydro One’s reply submissions.

Please contact the undersigned with any questions in regards to the foregoing.

Yours truly,

McCarthy Tétrault LLP

Signed in the original

Gordon M. Nettleton

cc: EB-2017-0049/EB-2019-0122 Intervenors

ONTARIO ENERGY BOARD

IN THE MATTER OF an application made by Hydro One Networks Inc. on March 31, 2017 under section 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B) for an order or orders approving just and reasonable rates and other charges for electricity distribution to be effective January 1, 2018 and for each following year effective January 1 through December 31, 2022;

AND IN THE MATTER OF the Decision and Order dated March 7, 2019 in EB-2017-0049; and

AND IN THE MATTER OF sections 40 and 42 of the Ontario Energy Board's *Rules of Practice and Procedure*.

**REPLY ARGUMENT OF HYDRO ONE NETWORKS INC.
(motion for review and variance)**

Date: July 10, 2019

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PART I - INTRODUCTION AND SUMMARY

1. Pursuant to Procedural Order No. 1 issued by the Ontario Energy Board (the “**OEB**” or the “**Board**”) in this proceeding, these are the reply submissions of Hydro One Networks Inc. (“**Hydro One**”) to the submissions of OEB staff (“**Staff**”), the Canadian Manufactures and Exporters (“**CME**”), the Power Workers’ Union (“**PWU**”), the School Energy Coalition (“**SEC**”), the Society of United Professionals (“**SUP**”) and the Vulnerable Energy Consumers Coalition (“**VECC**”) in regards to Hydro One’s motion to review and vary the Board’s decision and order dated March 7, 2019 in EB-2017-0049 (the “**Decision**”).
2. In the Decision, the Board disallowed Hydro One’s pension costs for 2018 and throughout the term of the IRM plan (2018-2022). The amount of the disallowance for 2018 base rates is \$37 million (\$17 million in OM&A and \$20 million in capital)¹ (the “**Pension Findings**”).
3. PWU and SUP support Hydro One’s motion. VECC supports the motion in part.² CME, SEC and Staff do not support the motion.
4. The key points of these reply submissions are set out below.
5. **Hydro One’s ability to take a pension contribution holiday pursuant to pension legislation has changed since the hearing:** The submissions of Staff and CME assert that circumstances have not changed since the hearing. Hydro One disputes these assertions and relies on the most recent information it has now been provided by the pension regulatory authority, FSRA (formerly FSCO), as it concerns the ability to take a contribution holiday and in the context of the Inergi Transfer (as defined below). The understanding provided to Hydro One by FSRA is that the Post-May 1, 2018 Rules (as defined below) apply to Hydro One effective March 1, 2018. Consequently and contrary to the submissions of Staff and CME, Hydro One will not be legally permitted to take a contribution holiday. Specifically:
 - For 2018-2020, as result of the Inergi Transfer the effective date of the Post-May 1, 2018 Rules is understood to be March 1, 2018 as therefore described herein, the

¹ Issue 38, page 96, “Pension Costs.”

² VECC agrees that the threshold test has been met. See VECC submissions para. 1.7.

Post-May 1, 2018 Rules will apply as of March 1, 2018 and Hydro One will not be legally permitted to take a contribution holiday.

- For 2021 and 2022, the Post-May 1, 2018 Rules are certain to apply. Under the Post-May 1, 2018 Rules, barring extraordinary circumstances such as the Hydro One Pension Plan (the “**Pension Plan**”) assets experiencing at minimum a 56% investment return over two years, Hydro One will not be legally permitted to take a contribution holiday.
6. The changes that have occurred since the EB-2017-0049 distribution rates application to pension legislation and the impact of the Inergi Transfer are depicted visually in the chart attached hereto at Schedule “A”. This chart demonstrates the changes in circumstances since the hearing.
 7. **Further evidence is needed for the Board to make a determination in this proceeding:** The changes introduced to pension legislation in the period during the EB-2017-0049 proceeding and after were obviously matters that could not be given full consideration at the time of the original hearing. Pension legislation is complex and changes to the legislation have evolved with at least some degree of inconsistency since the original proceeding and up until when new regulations were issued in May of this year. It is not surprising, therefore, that there is gap in understanding in terms of the impacts of these changes on Hydro One. Moreover, the impact of Hydro One must be understood taking into account the Inergi Transfer and the regulator’s position on when this transfer will be effective. Hydro One notes that fundamentally, there appears to be a misunderstanding in the Staff and CME submissions (as well as, to a lesser extent, the SEC submissions) in regards to the changes that have occurred and the impact of these changes on Hydro One’s eligibility to take a contribution holiday.
 8. As a result, Hydro One submits that the Board requires additional evidence from subject-matter experts in order for a fully reasoned determination to be made on this motion. With further evidence, the Board will have the benefit of specific pension investment, pension law and actuarial expert evidence in the resolution of this motion. The need for further evidence is discussed in detail in Part II below.

9. **Pension contributions should be a “pass through cost”:** Due to the complexity and dynamism of pension legislation, Hydro One supports the view that pension contributions are a “pass through” cost which Hydro One will continue to record in its existing Pension Cost Differential Account (1508) (the “**PCDA**”).
10. It is important to note that EB-2017-0049 parties, including Staff and SEC, agreed that pension costs are a “pass-through” cost.³
11. In this motion, Hydro One is therefore requesting to recover its legally mandated pension contributions in rates for the 2018-2022 period and record any differences in its PCDA so that any balances can be cleared annually. If Hydro One is not permitted to recover its legally mandated pension contributions in rates during the 2018-2022 period, it will incur large incremental borrowing costs and result in increased future period costs.
12. **The disallowance of legally-required pension costs was not addressed in EB-2017-0049:** Parties opposing this motion assert that the disallowance of pension costs required by law was considered in EB-2017-0049. As shown in paragraphs 44 to 51 below, this is not consistent with what was in fact discussed on the record. There was no discussion at the hearing on whether the OEB should disallow pension costs if Hydro One was not legally permitted to take a contribution holiday.
13. **The pension findings are based on the assumed presence of a “surplus”, not the level of Hydro One’s compensation costs:** SEC’s assertion that the Pension Findings are based on a finding relating to the reasonableness of Hydro One’s compensation costs is an attempt by SEC to re-write the Decision. As discussed in paragraphs 28 to 37 herein, no other reasons aside from the presence of a “surplus” are provided or implied in the Decision in support of the Pension Findings.
14. **The Board’s decisions should be accurately informed by the law:** Hydro One’s argument is not, as stated by SEC, that Hydro One is entitled as a matter of law to recover pension costs in rates. Rather, Hydro One submits that the Board must make decisions which are accurately

³ See Part VI, below.

informed by the law. In this case, the Board had regard to the law as it assumed that the disallowance of pension contributions could be based on the “surplus” in the Pension Plan. However, the assumption that the law permitted a contribution holiday was incorrect.

PART II - EVIDENTIARY MATTERS RAISED BY PARTIES’ SUBMISSIONS

15. The following evidentiary matters arise as a result of the Staff and CME submissions in particular. Hydro One respectfully submits that evidence needs to be provided to the OEB on all of these matters:

- **The Post May 1, 2018 Rules are understood to apply to Hydro One as of March 1, 2018:** The Staff submissions correctly note at page 5 that depending on the effective date of the transfer of pension assets and liabilities in relation to the in-sourcing of call centre functions from Inergi LP (“**Inergi**”) and Vertex Customer Management (Canada) Ltd. (“**Vertex**”) to Hydro One (the “**Inergi Transfer**”)⁴, the Post-May 1, 2018 Rules (as defined⁵ in the Argument) **could apply to Hydro One as early as March 1, 2018** (emphasis added). Inexplicably, the Staff submissions are silent on the implications of this outcome.

Subsequent to Hydro One’s filing of its June 5, 2019 Written Arguments in these proceedings, the Financial Services Regulatory Authority (“**FSRA**”, successor to the Financial Services Commission of Ontario (“**FSCO**”) as the Ontario pension regulatory authority), has advised Hydro One’s advisors that the May 1, 2018 Rules will apply to the Pension Plan on March 1, 2018 if the Inergi Transfer is approved.⁶ Hydro One’s pensions

⁴ As discussed during the EB 2017-0049 proceeding, Hydro One is repatriating its call centre function, having previously outsourced this function to Inergi, who then subcontracted the function to Vertex for a period of time. This transition includes the transfer of pension assets and liabilities from the pension plans of Inergi and Vertex to the Hydro One Pension Plan, which transfer must be approved by FSRA under section 80 of the PBA before taking effect.

⁵ As set out in Hydro One’s Argument: On March 28, 2018, the Ontario Budget was released and announced that work was continuing on new pension funding rules. On April 20, 2018, amendments to the O. Reg. 909 under the Pension Benefits Act were announced effective May 1, 2018 pursuant to section 55.1 of the PBA and pursuant to O. Reg 250/18 (the “Post-May 1, 2018 Rules”). The Post-May 1, 2018 Rules introduced a new test which provided that a private employer such as Hydro One can only take a contribution holiday in a year if an actuary certifies the plan has a funded ratio of at least 105% calculated on a wind-up basis.

⁶ Paragraphs 18 and 19 of Hydro One’s June 5, 2019 Written Arguments noted that the Post-May 1, 2018 Rules will take effect on the earlier of (i) the date on which the Inergi/Vertex Asset Transfer Report becomes operative and (ii) the effective date of the next actuarial valuation of the Pension Plan (which will be no later than December 31, 2020). FSRA has since informed Hydro One’s

counsel has written to FSRA confirming FSRA's position, a copy of this letter is attached at Schedule "B" hereto.

A March 1, 2018 effective date for the Inergi Transfer means that Hydro One's December 31, 2017 valuation report – which the Staff submissions rely on exclusively as the basis for Staff's allegation that Hydro One can take a contribution holiday in 2018, 2019 and 2020 – will cease to be operative as of March 1, 2018. While FSRA's approval of the Inergi Transfer is currently outstanding, it is highly unlikely that it would not be approved. Hydro One has every reason to believe that the Inergi Transfer meets the requirements set out in s. 80 of the PBA and O. Reg 310/13 (the "**PBA Asset Transfer Rules**").

- **The Staff submissions that Hydro One could have taken a contribution holiday in 2019 are not legally correct:** The Staff submissions state at pages 8 and 12 that Hydro One could have taken a contribution holiday in 2019. This is not legally correct and disregards the fact that the guidance published on FSCO's website on August 29, 2018 (the "**FSCO August 2018 Policy**") prohibited Hydro One from taking a contribution holiday in 2019 until the May 21, 2019 changes to the Regulations were filed. However, this point will be moot in light of the fact that, as described above, the May 1, 2018 Rules are understood to apply to the Pension Plan on March 1, 2018.
- **Barring extraordinary circumstances (such as investment returns of 56% on the plan assets over two years), it will be impossible for Hydro One to take a contribution holiday in 2021 and 2022:** The Staff submissions make the surprising suggestion that "For years 2021 and 2022, it is uncertain whether Hydro One will be eligible to take a contribution holiday as the current valuation report does not cover this period."⁷ CME makes a similar assertion.⁸ These suggestions demonstrate a misunderstanding of the impact of the Post-May 1, 2018 Rules. The Post-May 1, 2018 Rules introduce a new test

advisors that the Inergi/Vertex Asset Transfer Report will become operative on March 1, 2018, the effective date of the Inergi/Vertex Asset Transfer Report, assuming the Inergi Transfer is approved.

⁷ Staff submissions p 11.

⁸ CME submissions para 40.

which provides that a private employer such as Hydro One can only take a contribution holiday in a year if an actuary certifies the plan has a funded ratio of at least 105% calculated on a wind-up basis (the “**Wind-up Test**”). Under Hydro One’s December 31, 2017 valuation report filed on April 30, 2018, this ratio is 73%⁹. Based on calculations performed as of December 31, 2018, the ratio remains at 73%¹⁰ – i.e., nowhere close to the required 105%.

More specifically, and based on the calculations of Hydro One’s actuary, in order for the transfer ratio to increase to 105% by December 31, 2020 and assuming no changes to bond yields, the Pension Plan assets would have to earn approximately a 56% return over the 2019-2020 period, equivalent to a return of 25% in each of 2019 and 2020. Given that the Pension Plan assets are invested in a mix of equities and bonds, the long-term rate of return is expected to be about 6% per annum. Achieving a 25% return in two consecutive years would be extremely unlikely. Alternatively, assuming normal levels of investment return over the two year period, discount rates would need to increase by roughly 250 bps in order for the transfer ratio to reach 105%. To put this in context, long bond yields have been fairly flat over the last number of years. The impact of the Wind up Test is therefore that it is almost certainly impossible for Hydro One to take a contribution holiday under the new test.

- **Staff’s allegations regarding a 2018 cost certificate disregard normal practice accepted by FSCO:** the Staff submissions also contain allegations that Hydro One should have filed a cost certificate in March 2018 instead of planning to rely on the December 31, 2017 full valuation report which Hydro One filed in April 2018 as the actuarial basis for taking a contribution holiday in 2018.¹¹ Given these allegations, which were not raised in the EB-2017-0049 proceeding, Hydro One could file evidence which demonstrates that in

⁹ December 31, 2017 valuation report filed as part of Hydro One’s transmission rates application (EB-2019-0082) p 12. Under the December 31, 2017 valuation report, the Pension Plan was more than 100% funded on a going concern and solvency basis but was only approximately 73% funded on a wind-up basis (see p 12).

¹⁰ See Actuarial Cost Certificate as at January 1, 2018, attached at Schedule “C” hereto.

¹¹ In contrast to the Staff submissions, the VECC submissions observe that in VECC’s opinion, further evidence is needed before drawing conclusions on this point, see VECC submissions para 2.4.

the opinion of a qualified actuary, it was reasonable for Hydro One to assume that the December 31, 2017 valuation report filed in April 2018 would allow a contribution holiday to be taken in 2018. For the moment, Hydro One provides at Schedule “D” hereto a FSCO question and answer document which supports the understanding of Hydro One’s actuaries that a cost certificate was not required in a year when a full valuation was prepared in order to establish the right to a contribution holiday once the full valuation is filed.¹² However, this point will be moot in light of the fact that, as described above, the Inergi Transfer will result in Hydro One becoming subject to the Post-May 1, 2018 Rules on and after March 1, 2018. As a result, evidence may not be required on this point.

16. Section 21(1) of the *Ontario Energy Board Act* (the “**OEB Act**”) provides as follows:

21 (1) The Board may at any time on its own motion and without a hearing give directions or require the preparation of evidence incidental to the exercise of the powers conferred upon the Board by this or any other Act.

17. Moreover, Rule 8.04 of the Board’s *Rules of Practice and Procedure* states the following:

8.04 The Board, in hearing a motion, may permit oral or other evidence in addition to the supporting documents accompanying the notice, response or reply.

18. Pursuant to section 21(1) of the OEB Act and Rule 8.04, the Board may therefore allow the items attached to these reply submissions to be included on the record of this proceeding. The Board may also provide for further procedural steps in regards to further evidence in this proceeding which, as noted above, will allow the Board to make its decision based on complete and accurate actuarial, pension law and pension investment evidence. In this regard, Hydro One is respectfully requesting the further procedural steps needed for Hydro One to file this additional evidence, either

¹² See “Questions on Contribution Holidays” attached hereto at Schedule “D”. Question 4 on page 3 deals with the situation where a full valuation report is filed with the same effective date as a cost certificate. FSCO’s position stated in the document is that the regulatory intent was to have a full valuation report take precedence over a cost certificate if they have the same effective date. FSCO then takes the position that for the first fiscal year covered by a filed valuation report, contributions must be made in accordance with the funding requirements set out in that report, **regardless of whether an actuarial cost certificate was previously filed**. Only for subsequent fiscal years covered by the filed valuation report is an actuarial cost certificate required to be filed in the first 90 days. Based on this information and based on discussions with FSCO (both when this document was issued and during the ensuing years), Hydro One’s actuaries understood that a cost certificate was not required in a year when a full valuation was prepared in order to establish the right to a contribution holiday once the full valuation is filed.

The understanding of Hydro One’s actuaries was that FSCO was administering the contribution holiday rules in accordance with the position described above, until FSCO issued the FSCO August 2018 Policy.

as part of the current motion process (i.e., by amending Procedural Order No. 1 to allow for the filing of additional evidence), or as part of a hearing of the merit of this motion (i.e., a review hearing).

19. Hydro One notes that the need for further evidence on certain points is raised in the SEC¹³ and VECC¹⁴ submissions and therefore these submissions also demonstrate that further evidence is needed.

PART III - THE THRESHOLD TEST ON A MOTION TO REVIEW AND VARY

20. Hydro One has reviewed the submissions made by parties and notes that there is general agreement that the threshold test on this motion to review is whether there is a change in circumstance and/or error that is material such that a reviewing panel would change the Decision.¹⁵

PART IV - THERE IS A MATERIAL CHANGE IN CIRCUMSTANCE

21. SUP, PWU and VECC¹⁶ agree that the threshold test is met while Staff, SEC and CME do not.
22. SUP submits that significant new circumstances have arisen since the Decision, given the issuance of new pension regulations and the new circumstance of the transfer of the Inergi/Vertex pension assets to Hydro One.¹⁷ Similarly, PWU agrees that there has been a change in circumstances¹⁸, and VECC submits that while many things may change subsequent to a Board decision, what

¹³ SEC indicates a need for further evidence regarding the legal requirement to make contributions to the pension plan, see SEC submissions para 28.

¹⁴ VECC observes that further discovery would be needed to determine the reasonableness and prudence of Hydro One's decision to file a full valuation report as opposed to a cost certificate in 2018, see VECC submissions para 2.4.

¹⁵ See CME submissions p 3-4.

¹⁶ VECC agrees that the threshold test is met and submits that pension cost differentials should be recorded. VECC does not think that 2018 pension variances should be eligible for recovery due to its submission that without further discovery is it not possible to ascertain whether Hydro One acted reasonably in regards to not filing a 2018 cost certificate, which matter is addressed in paragraph 15 above. See VECC submissions page 5.

¹⁷ SUP submissions p 1-3.

¹⁸ PWU submissions p 4-5.

differentiates this motion is the materiality of the current changes and Hydro One's anticipation of changes as expressed at the time of the later portions of the original proceeding.¹⁹

The impact of the Inergi Transfer is a significant change in circumstances

23. The Staff submissions assert that there has been no change in circumstances because the EB-2017-0049 panel was advised that new funding rules were coming into effect during the term of Hydro One's custom IR application and there was uncertainty as to when these new rules would apply to Hydro One.²⁰ In a similar vein, CME argues that the changes to the pension regulations and additional guidance given by FSCO does not result in a material change for the Pension Plan.²¹ SEC submits that there was uncertainty at the time of the proceeding as well as at the time of the Decision, and that there is uncertainty now.²²
24. At the outset, Hydro One notes that the May 1, 2018 changes to the PBA and the Regulations were a fundamental change to the way in which Ontario registered pension plans have been required to be funded for over 20 years. Substantive policy guidance from FSCO and FSRA including changes to long-standing practices were released after August 2018 and even in the last number of weeks. Further changes to the Regulations themselves were made as recently as May 21, 2019. Hydro One respectfully submits that the substantive guidance from the regulator released after August 2018 was beyond what any of the parties could have contemplated at the hearing and clarity in regard to the impact of the Post May 1, 2018 Rules on all Ontario-registered pension plans has understandably taken time.
25. The submissions of Staff, SEC and CME disregard the implications of the Inergi Transfer which, as explained above, will result in the contribution holiday restrictions in the Post-May 1, 2018 Rules applying to the Pension Plan effective on and after March 1, 2018, assuming that the Inergi Transfer is approved.²³

¹⁹ VECC submissions para 1.6.

²⁰ Staff submissions p 5.

²¹ CME submissions p 7.

²² SEC submissions para 5.1.

²³ As noted above, the decision to approve the Inergi Transfer is not a discretionary decision on the part of FSRA – as long as the Inergi Transfer meets the requirements of the PBA Asset Transfer Rules, which Hydro One believes it does, the transfer must be approved.

26. The impact of the Inergi Transfer became apparent as a new material consideration after the close of the hearing. The agreement to transfer pension assets and liabilities from Inergi and Vertex to Hydro One was entered into in late August 2018²⁴ and the required pension asset transfer report submitted to FSCO in November 2018²⁵. It has only been in recent weeks, after Hydro One's Argument was submitted, that FSRA staff provided guidance that the result of the Inergi Transfer is that the Post-May 1, 2018 Rules will apply to the Pension Plan effective March 1, 2018.

The FSCO August 2018 Policy

27. The submissions of Staff, SEC and CME also disregard the FSCO August 2018 Policy which provided that the contribution holiday restrictions in the Post-May 1, 2018 Rules would apply starting January 1, 2019. As a result and as noted in paragraph 15 above, the Staff submissions state that Hydro One could have taken a contribution holiday in 2019 in complete disregard of the fact that Hydro One was prohibited from taking a contribution holiday in 2019, until subsequent changes to the regulations under the PBA (the "**Regulations**") were filed on May 21, 2019. The Staff submissions also state that Hydro One should have been aware of what Staff refers to as the cost certificate filing requirement.²⁶ This disregards the fact that a complete valuation report (under the old test, confirming that the plan has a surplus on both the solvency and going concern bases) had historically been accepted by FSCO to establish the right to a contribution holiday in that year and therefore the FSCO August 2018 Policy represents a change to this standard practice.²⁷

The changes in circumstances are relevant: contrary to SEC allegations, there is no basis in the Decision for the Pension Findings other than a "surplus"

28. SEC submits that changes in regards to whether or not Hydro One can take a contribution holiday are irrelevant to this motion because the Board disallowed Hydro One's pension costs on the basis that Hydro One's compensation costs were too high.²⁸ In support of this SEC does not cite the

²⁴ See letter to FSRA attached hereto at Schedule "B".

²⁵ See letter to FSRA attached hereto at Schedule "B".

²⁶ Staff submissions p 7.

²⁷ See paragraph 15 above and footnote 12 above.

²⁸ SEC submission para 3,5.1, 5.2.

Direction directly.²⁹ Hydro One submits that SEC's assertion, which is not supported by the submissions of any other party, is not a tenable position based on the Decision itself.

29. Reproduced below, with emphasis added, are the sections of the Decision³⁰ which contain the Board's findings in relation to pensions cost contributions (pages 108-109 of the Decision contain a summary of parties' submissions).
30. At page 94 of the Decision, the Board lists out revenue requirement reductions that it finds should be made in four categories: one, a reduction based on past cost performance; two, a reduction related to above market median compensation; three, a reduction related to pension costs and four; a reduction associated with the Hydro One Accountability Act:

Findings

The OEB finds that Hydro One's proposed 2018 OM&A budget of \$576.7 million has not been fully justified and shall be reduced by \$32.3 million (to \$544.4 million). This reduction (representing 5.6%) includes \$10 million based on Hydro One's past cost performance, \$4.8 million related to above market median compensation, \$17 million related to pension, and \$0.5 million associated with the Hydro One Accountability Act (section 78(5.0.2) of the OEB Act).³¹

31. The Board then provides reasons for each of these four reductions including, in regards to pension, that "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" (emphasis added).³²
32. At page 96, the Board sets out its findings in relation to pension costs:

Pension Costs

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). Further details are provided under Issue 40. [as noted, Issue 40 includes a summary of the position taken by parties]

²⁹ See SEC submissions footnotes 1-2, 5.

³⁰ Pages 94 and 96 of the Decision.

³¹ Decision p 94.

³² Decision p 94.

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.

33. As can be seen from the text of the Decision above and contrary to SEC's submission, the Decision does not suggest that the pension costs reduction is made due to compensation costs being too high – the Decision does not state this anywhere nor is this implied. It is clear from the wording of the Decision that the pension reduction is made “based on the magnitude of the current surplus.”³³ There is no relevance to a “surplus” other than the fact that when a surplus meets the test set out in the PBA, a contribution holiday is legally permitted under the PBA. As noted by SUP, the OEB decision is based on a presumption (as a result of a “surplus”) that Hydro One had options available to it which were not in fact available.³⁴

34. Furthermore, as submitted by PWU:

[I]t is apparent that the Board's conclusion that there is “no justification” for continued pension contributions could only be correct if Hydro One was under *no obligation to continue to make such contributions*. If Hydro One was under *some obligation*, the OEB might retain some authority to disallow such costs nonetheless³⁵, however, it could not say that there was “no justification” for those costs. It would then be necessary for the Board to consider that justification and make a determination whether it was sufficient to warrant inclusion of those costs in the revenue requirement so as to generate “just and reasonable” rates.

As a consequence, it is apparent that the Board's decision was premised upon its understanding that, by virtue of the valuation report, Hydro One did not have an obligation to make the pension contributions in question. As Hydro One has demonstrated, that understanding was not correct.

35. Hydro One agrees with the above PWU submissions. The only reasons that the Board provided in support of the pension cost disallowance was the presence of a “surplus” in the Pension Plan. SEC's importing of other factors is effectively an attempt to re-write the Board's decision.

³³ Decision p 96.

³⁴ SUP submissions p 4.

³⁵ As noted by PWU, it is not necessary to determine this issue given that as set out herein, Hydro One is all-but-certain to not be allowed by law to take a contribution holiday in the rate period.

36. Moreover, SEC's assertions imply is that the Decision was purely results oriented, i.e., that the Board wanted to disallow a certain amount and based on this, determined what costs should be cut to add up to that amount. But this is clearly not the case based on the actual text of the Decision as cited above: the Board acted in a principled manner by considering each item related to compensation costs on its merits and found that in relation to pension contributions, these should be disallowed on the basis of "the significant surplus in [the Hydro One] pension plan"³⁶.
37. Hydro One does agree with SEC and Staff that the Board's decision took into account the submissions made by parties – as noted by SEC and Staff, these submissions are set out at pages 108 to 109 of the Decision. All the submissions were based on the assumption that Hydro One could take a contribution holiday;³⁷ this is the context in which the Board made its decision.

**PART V - THERE IS A MATERIAL ERROR AND THE DECISION SHOULD BE
CORRECTED**

The surplus position relied upon by the Board is insufficient to permit Hydro One to legally take a contribution holiday under the PBA and the Regulations

38. As to the correctness of the Decision, Staff and CME³⁸ disagree with Hydro One that there is an error in the Decision. Specifically, Staff disagrees with the following points in Hydro One's Argument³⁹:
- the going concern and solvency surplus status of the Hydro One Pension Plan cannot be relied upon as a basis for Hydro One to take a contribution holiday under the Hydro One Pension Plan for the 2018-2022 rate period given the PBA requirements for contribution holidays under the Post-May 1, 2018 Rules; and
 - Hydro One is not legally permitted to take a contribution holiday under the PBA and the Regulations in 2018 and for much of the period covered by the Decision; as a result, the Decision erroneously denied Hydro One costs that are and will be prudently incurred.

³⁶ Decision p 94.

³⁷ For example, SEC submitted that "The evidence is that Hydro One is not actually required to make any further contributions to its pension plan at this time as it is in a significant surplus position (\$443.7M)."

³⁸ See CME submissions para 14-18.

³⁹ As cited by Staff at pp 7-8 of the Staff submissions.

39. Staff's disagreement with the above is simple: the Staff submissions note that according to Hydro One's December 31, 2017 valuation report, Hydro One is eligible to take a contribution holiday in 2018, 2019 and 2020. Hydro One agrees with Staff that this is what the December 31, 2017 valuation states – but this is expressly made subject to the application of the Post May 1, 2018 Rules.⁴⁰ However, as noted above due to the Inergi Transfer the December 31, 2017 valuation report will cease to be operative effective March 1, 2018 assuming the Inergi Transfer is approved by FSRA.⁴¹ As a result, effective on and after March 1, 2018 Hydro One will only be permitted to take a contribution holiday if the Wind-Up Test threshold is met. Staff appears to understand that the December 31, 2017 valuation could cease to be operative⁴² but does not account for this possibility in the Staff submissions.
40. Staff's disagreement with Hydro One also lies in Staff's assertion that Hydro One made a "decision" not to file a cost certificate in 2018 and withheld this information from the Board in the EB-2017-0049 proceeding.⁴³ This assertion is completely incorrect and Hydro One did not withhold information: as outlined in paragraph 15 above⁴⁴, it was expected that the December 31, 2017 valuation report filed before May 1, 2018 would be sufficient to meet the requirement relating to the basis for taking a contribution holiday in 2018. It was only in connection with the FSCO August 2018 Policy when Hydro One's advisors made inquiries with FSCO that it became apparent that this standard practice would not hold true for 2018.⁴⁵
41. Hydro One did not, as alleged by Staff⁴⁶, choose to make payments that could have been avoided: Hydro One filed a valuation in April 2018, and has filed a cost certificate for 2019 (despite the fact that as indicated, FSRA has advised that the Inergi Transfer effective date is to be March 1, 2018

⁴⁰ Footnote 2 on page 11 of the December 31, 2017 report reads as follows:

Amounts shown reflect the funding rules in force at the time this current valuation was filed and are subject to the preparation of a cost certificate at the beginning of year confirming the level of available surplus that may be applied in 2019 and 2020. At the time this report was filed, any potential impact resulting from the funding regulations taking effect on May 1, 2018 on the application of surplus for the period covered by this report was not clear.

⁴¹ As noted above, the decision to approve the Inergi Transfer is not a discretionary decision on the part of FSRA – as long as the Inergi Transfer meets the requirements of the PBA Asset Transfer Rules, which Hydro One believes it does, the transfer must be approved.

⁴² See Staff submissions p 12: "Unless something changes with respect to its current valuation (i.e., it ceases to be operative)..."

⁴³ Staff submissions p 9.

⁴⁴ See forth bullet point, and see also footnote 12.

⁴⁵ That this standard practice would not hold true for 2018 was indicated in an email to Hydro One's counsel.

⁴⁶ Staff submissions p 9.

which precludes the possibility of Hydro One taking a pension contribution holiday during the rate period).

The pension contributions are and will be prudently incurred

2018, 2019 and 2020:

42. The Staff submissions assert that the pension contributions were not prudently incurred in 2018 because Hydro One did not file a cost certificate in 2018, and are/will not be prudently incurred in 2019 because Hydro One is eligible to take a contribution holiday in 2019 and 2020.⁴⁷ It is not imprudent for Hydro One to make pension contributions which, as set out above, are almost certain to be required by law for 2018, 2019 and 2020.

2021 and 2022:

43. In regards to 2021 and 2022, Hydro One's inability to take a contribution holiday in these years is essentially certain: based on the figures set out in paragraph 15 above, it is essentially impossible that the Pension Plan meet the required threshold under the new Wind-up Test for a contribution holiday which is certain to apply in 2021 and 2022.

The denial of costs required by law was not considered in EB-2017-0049

44. Staff asserts that Hydro One's description of the details of rule changes and uncertainties⁴⁸ with regards to pension legislation "does not present anything that was not already considered as part of the EB-2017-0049 proceeding."⁴⁹ This assertion is difficult to understand given the impact of the Post May 1, 2018 Rules including changes made to them on May 21, 2019 coupled with the Inergi Transfer, which was not at all considered as part of the proceeding.
45. Staff, SEC and CME⁵⁰ assert that the disallowance of pension costs required by law was considered in EB-2017-0049. Yet as noted above, the discussion at the time of the hearing was in regards to

⁴⁷ Staff submissions p 7.

⁴⁸ Staff submissions p 6.

⁴⁹ Staff submissions p 7.

⁵⁰ See CME submissions p 19.

whether Hydro One would take a holiday if it was able. There was no discussion at the hearing on whether the OEB should disallow pension costs if Hydro One was not legally permitted to take a contribution holiday: all discussions at the hearing and in the submissions of all parties, including Staff, SEC and CME, assumed that Hydro One could take a contribution holiday under the PBA and Regulations. For example, Staff stated as follows in their final submissions:

Given that the actuary has determined that Hydro One does not have to make any employer contributions to the pension plan in the test period, combined with the fact that the surplus in the pension plan appears to be large enough to offset the Hydro One's contribution requirements over the 5-year application term (holding all else equal), OEB staff submits that the pension costs included in the test period revenue requirement should be reduced from \$37 million to zero.⁵¹

46. Staff submissions assumed a contribution holiday was possible. CME adopted the Board Staff submissions on pensions adding:

In particular, since the actuarial valuation provided by HONI indicates that no employer contributions are presently required as the fund is in a significant surplus position of \$434 million, CME agrees that there should be an additional \$17 million reduction from OM&A and \$20 million in capital as described in Board Staff's submissions.⁵²

47. SEC submissions also assumed a contribution holiday was possible, stating:

The evidence is that Hydro One is not actually required to make any further contributions to its pension plan at this time as it is in a significant surplus position (\$433.7M).⁵³

48. As a result, it is clear that parties assumed a contribution holiday could be taken, and nowhere is there any indication that any party considered or discussed the disallowance of pension contributions if a contribution holiday could not be taken. The Staff submissions state that there is "ample material on the record with respect to pension contributions"⁵⁴ but they cannot provide a reference to where this particular issue – i.e., disallowance of pension contributions required by legislation – was discussed. The reason for this is simple: this issue was not raised and addressed by parties.

⁵¹ Staff submissions in EB-2017-0049, p 125.

⁵² CME submissions in EB-2017-0049 para 280.

⁵³ SEC submissions in EB-2017-0049 para 4.4.4.

⁵⁴ See Staff submissions p 13.

49. Finally, the Staff submissions state that “Hydro One argued during EB-2017-0049 that it intended, at its own discretion, to continue to make pension contributions to its pension plan notwithstanding that it was legally eligible to take a contribution holiday in order to insulate itself against any potential adverse future events” [emphasis added]. This statement, although it truly mischaracterizes the exchange between Board Staff and Hydro One’s witness⁵⁵, demonstrates how Staff, like all other parties, incorrectly assumed at the hearing that Hydro One could take a contribution holiday and therefore focused on its argument that Hydro One should take a contribution holiday.
50. In regards to the above-noted mischaracterization in the Staff submissions, Hydro One has reviewed the exchange relied upon by the Staff submissions in support of this allegation. In it, Staff and Hydro One’s witness discuss Hydro One’s ability to take a contribution holiday based on the Pre-May 1, 2018 rules for contribution holidays⁵⁶ and the valuation report on the record.⁵⁷ Hydro One’s witness notes that new pension rules have come out in May 2018.⁵⁸ Staff and Hydro One’s witness then discuss extensively why Hydro One might not take a contribution holiday even if Hydro One is eligible to take a contribution holiday under the PBA.⁵⁹ It is clear in reading the exchange that Hydro One’s witness is concerned with future special payments that may need to be made and recovered from ratepayers⁶⁰ (indeed, Hydro One had to make such special payments when the Pension Plan was recently in deficit, as set out in the original EB-2017-0049 application⁶¹).
51. A review of the March 1, 2018 technical conference transcript⁶² also reveals that discussion is based on the assumption that, in Staff’s words, “legally the company for 2018-2019 would not be required to make contributions to the plan... Because the plan is in a surplus position and therefore could be funded through the surplus amounts.”⁶³ Nowhere is there any discussion on whether the

⁵⁵ See Staff submissions p 9, para 2. Transcript volume 4, p 72-85 is cited by Staff.

⁵⁶ Transcript volume 4, p 73-77.

⁵⁷ The December 31, 2016 valuation.

⁵⁸ Transcript vol 4 p 76.

⁵⁹ Transcript volume 4, p 77-84.

⁶⁰ Transcript volume 4, p 78-84.

⁶¹ See Hydro One’s original (i.e., prior to the June 2017 update) EB-2017-0049 application at C1-2-2.

⁶² See pages 128-130 of Transcript Day 1 dated March 1, 2018, which are the pages cited in the Staff submissions.

⁶³ See page 128 of Transcript Day 1 dated March 1, 2018.

OEB should disallow pension costs if Hydro One was not legally permitted to take a contribution holiday. The Staff submissions therefore truly mischaracterize what is on the record of the EB-2017-0049 proceeding.

SEC's submissions regarding the OPG Supreme Court Decision

52. SEC notes that in *Ontario Energy Board v. Ontario Power Generation Inc.* (“OPG”),⁶⁴ the Supreme Court of Canada (the “**Supreme Court**”) says “not that the prudence test is required, but that it is one of the tools that the Board has available for use”.⁶⁵ Contrary to SEC’s allegation that Hydro One has mis-cited OPG, Hydro One’s Argument in fact states as follows (emphasis added):

The OEB and other regulatory tribunals regularly use the prudent investment test to assess whether or not payments to a utility are just and reasonable. As recently stated by [the Supreme Court of Canada] in [OPG]:

The prudent investment test, or prudence review, is a valid and widely accepted tool that regulators may use when assessing whether payments to a utility would be just and reasonable.⁶⁶

53. As evident in the excerpt above, Hydro One stated that the prudence test was a tool regularly used by regulators. There is therefore no contradiction between Hydro One’s Argument⁶⁷ and SEC’s position that in OPG, the Supreme Court rejects the notion that the prudence test is mandatory. SEC does not indicate what test it believes should apply instead of prudence, but presumably this alternative test would apply the language of the *Ontario Energy Board Act’s* section 78 which requires that rates be “just and reasonable”. Hydro One submits that the inclusion of the pension contributions in rates is reasonable as the pension contributions are a cost incurred by Hydro One for the provision of rate regulated service based on the requirements of the PBA and the Regulations. In OPG, the Supreme Court described the just-and-reasonable approach to recovery of the cost of services provided by a utility as follows:

⁶⁴ *Ontario Energy Board v. Ontario Power Generation Inc.*, 2015 SCC 44.

⁶⁵ SEC submissions p 5.

⁶⁶ OPG para 102.

⁶⁷ As indicated in footnote 29 of Hydro One’s Argument in this motion, in the OPG Decision, the Supreme Court accepted the component of the prudence test which states that to be prudent, a decision must be have reasonable under the circumstances that were known or ought to have been known to the utility at the time the decision was made (which component was articulated in *Enbridge Gas Distribution v. Ontario Energy Board*). In OPG, the Supreme Court did not endorse the presumption of prudence, which is not in issue in this case.

The just-and-reasonable approach to recovery of the cost of services provided by a utility captures the essential balance at the heart of utilities regulation: to encourage investment in a robust utility infrastructure and to protect consumer interests, utilities must be allowed, over the long run, to earn their cost of capital, no more, no less.⁶⁸

54. Indeed, Hydro One's argument is not that Hydro One is entitled as a matter of law to recover pension costs in rates, as stated by SEC.⁶⁹ Hydro One's argument is that a just-and-reasonable approach to recovery of cost of services provided by a utility requires the Board to make decisions which are accurately informed by the law. In this case, the Board had regard to the law as it assumed that the disallowance of pension cost contributions could be based solely on the "surplus" in the Pension Plan. But its assumption that the law permitted a contribution holiday was incorrect.
55. SEC also argues that Hydro One "failed" to note that in OPG, the reasonableness of compensation costs was at issue and the Board determined that OPG's compensation costs were too high and disallowed some costs despite knowing that OPG would likely incur some of these costs. Hydro One disagrees that this aspect of the OPG case is relevant to this motion because as discussed in paragraphs 28 to 37 above, this motion is not about the Board's reduction of Hydro One's compensation costs made as a result of the Board's finding that Hydro One's compensation costs are above market median or too high based on past cost performance⁷⁰ (the "**General Compensation Reductions**"). Unlike in OPG, where the subject of the appeal was a general reduction to OPG's compensation costs, Hydro One is not appealing the General Compensation Reductions. SEC is the only party that has misleadingly alleged that the Board's disallowance of pension costs is related to a finding that Hydro One's compensation costs are too high.⁷¹ As set out above in paragraphs 28 to 37, the Board explicitly stated in the Decision that the pension cost disallowance was made on the basis of a "surplus" in the Pension Plan. The Decision does not state that the pension cost disallowance was made due to Hydro One's compensation costs being too high and therefore the reasonableness of compensation costs is not at issue in this motion.

⁶⁸ OPG para 76.

⁶⁹ See SEC submissions para 16.

⁷⁰ The Board made specific findings in this regard which are separate and apart from the pension disallowance, see page 94 of the Decision.

⁷¹ CME's submissions contain one sentence regarding compensation costs being above market median as a "fact" which is relevant to the reasonableness of the decision; again, Hydro One submits that the misleading conflates the Board's General Compensation Reduction with the Board's Pension Findings, the latter which was explicitly on the basis of a "surplus" as set out herein.

PART VI - PENSION COST DIFFERENTIAL ACCOUNT

56. Hydro One will continue to record the difference between the cost of contributions it makes to the Pension Plan and the amounts collected in rates in its PCDA. In light of the changes to and evolution of pension legislation, Hydro One believes it is important that pension contributions be a “pass through” cost.

57. Parties in EB-2017-0049 agreed that pension costs should be a pass through. At page 126 of the Staff submissions in EB-2017-0049, Staff state:

OEB staff further submits 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.

58. CME adopts the submissions of Staff in regards to pension in EB-2017-0049 and therefore supports the above as well.⁷²

59. Also in support of pension contributions as a “pass-through” cost, the SEC submissions state:

Hydro One has a variance account to capture the variance between forecast pension costs built into rates and actuals, so it is entirely protected from changes in external factors.⁷³

60. To be clear, “pass through” treatment of pension costs protects ratepayers as well: Hydro One is requesting in this motion to recover its legally mandated pension contributions in rates for the 2018-2022 period, but it will record any differences between what it collects in rates and what it is legally required to contribute in its PCDA so that any balances may be disposed of annually. Hydro One notes that the use of the PCDA to record pension contribution differentials was also supported in other EB-2017-0049 parties’ August 2018 submissions.⁷⁴

⁷² See CME submissions in EB-2017-0049, para 279.

⁷³ SEC submissions in EB-2017-0049, para 4.4.6.

⁷⁴ See, for example, CCC submissions in EB-2017-0049 which state at p 19 “Under the new rules, if HON is restricted from taking a contribution holiday, the difference can be recorded in the existing pension variance account.”

61. If Hydro One is not permitted to recover its legally mandated pension contributions in rates during the 2018-2022 period, it will incur large incremental borrowing costs and result in increased future period costs.

PART VII - CONCLUSION

62. As explained herein, there has been a material change in circumstance since the time of the EB-2017-0049 hearing: during the hearing, parties assumed that Hydro One could take a pension contribution holiday.
63. That assumption no longer holds true for any year of Hydro One's custom IR application. Specifically:
- In regards to 2018, 2019 and 2020, the Inergi Transfer is understood to place Hydro One in the Post-May 1, 2018 Rules under which Hydro One cannot take a holiday as the Pension Plan does not meet the required funding threshold.
 - In regards to 2021 and 2022, the Post-May 1, 2018 Rules will apply and absent truly extraordinary circumstances, the Pension Plan will not meet the required funding threshold to take a contribution holiday under these new rules.
64. The Decision was based on the assumption that Hydro One could take a contribution holiday. That assumption was incorrect and as a result, the Decision should be corrected by allowing Hydro One to recover the pension contributions that it is required to make pursuant to the PBA and Regulations during the years covered by the Application. Legally required pension contributions have historically been determined by the Board to be prudently incurred costs for the provision of rate regulated services that Hydro One provides to its customers. These costs will continue to be prudently incurred under the legislative scheme governing pension contribution obligations.
65. Prior to a determination being made in this proceeding and for the reasons detailed herein, Hydro One submits that the Board requires further evidence. With further evidence, the Board will have the benefit of specific pension investment, pension law and actuarial expert evidence prior to making a decision to resolve this motion.

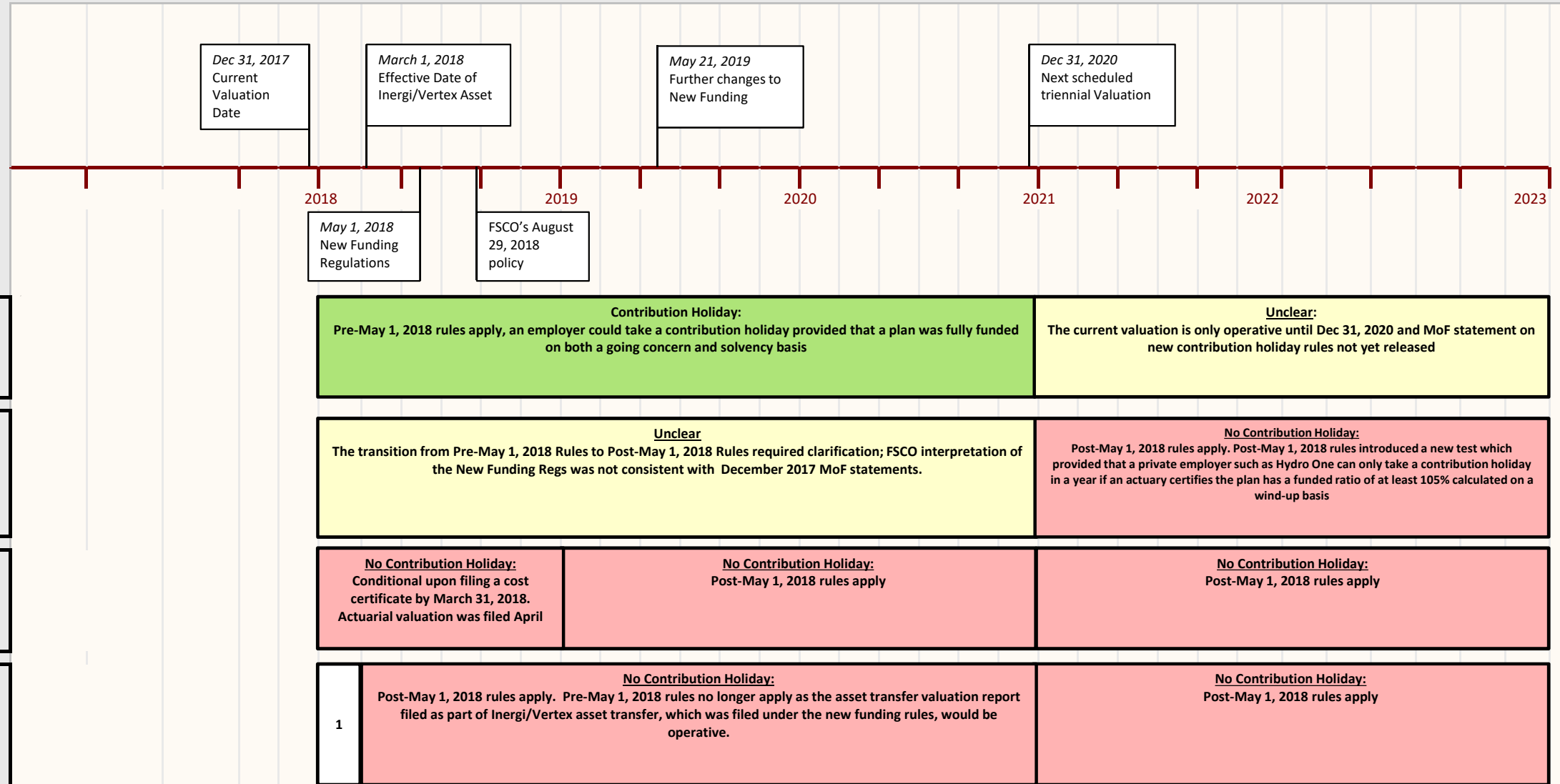
ALL OF WHICH IS RESPECTFULLY SUBMITTED this 10th day of July, 2019.

Signed in the original _____
Gordon Nettleton
McCarthy Tétrault LLP
Counsel for Hydro One Networks Inc.

Signed in the original _____
George Vegh
McCarthy Tétrault LLP
Counsel for Hydro One Networks Inc.

SCHEDULE A

Evolution of Pension Funding Scenarios



EB-2017-0049 distribution rate application (March 31, 2017 as updated June 7, 2017)

May 1, 2018 Rules prior to the publication of August 2018 FSCO Policy

Following the publication of FSCO's August 2018 Policy & prior to the new May 21, 2019 Regs

New May 21, 2019 Rules, Inergi/Vertex transfer approved & the May 1, 2018 funding rules are effective March 1, 2018 (the effective date of the Inergi/Vertex transfer based on FSCO guidance)

1 No Contribution Holiday Taken
January and February 2018 is outside of rate period. Hydro One may be eligible to create a credit against future contributions for this period.

SCHEDULE B



Brown Mills Klinck
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Pension, Benefits & Executive Compensation Law

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July 10, 2019

BMKP Matter #5-6

DELIVERED BY REGULAR MAIL & E-MAIL
caroline.blouin@fsrao.ca

Ms. Caroline Blouin
Executive Vice President, Pensions
Financial Services Regulatory Authority of Ontario (FSRA)
5160 Yonge Street, 16th Floor
Toronto, Ontario
M2N 6L9

Dear Ms. Blouin:

Re: Hydro One Pension Plan, Registration No. 1059104 (the “Plan”)

We are writing to confirm FSRA’s interpretation of the new Ontario funding rules under Regulation 909 (the “PBA Regulations”) as they apply to the Plan for the purposes of proceedings before the Ontario Energy Board (“OEB”).

Background

The Plan is currently being funded by Hydro One Inc. and its affiliates (“Hydro One”) pursuant to the actuarial valuation of the Plan as at December 31, 2017 which was filed with the Superintendent of Financial Services (the “Superintendent”) on April 30, 2018. As this Plan valuation was filed before May 1, 2018, the Plan is currently being funded pursuant to the pre-May 1, 2018 funding regime, as amended by Regulation 105/19 (the “PBA Regulations”). Based on the December 31, 2017 report, the Plan is in a going concern and solvency surplus position and the transfer ratio is 0.73.

Hydro One entered into an agreement with Vertex Customer Management (Canada) Limited (“Vertex”) and Inergi LP (“Inergi”) on August 22, 2018 which, among other things, provides for the transfer of assets and liabilities from the Vertex Customer Management (Canada) Limited Pension Plan, Registration no. 1099993 (the “Vertex Plan”) and the Inergi LP Customer Service Operations Pension Plan, Registration no. 1285733 (the “Inergi Plan”), respectively, to the Plan effective March 1, 2018 in relation to certain transferred employees and former employees. An Application to the Superintendent for consent to the proposed asset and liability transfers pursuant to s. 80 of the Ontario *Pension Benefits Act* (the “PBA”) was made by Hydro One on

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Partners practicing through professional corporations.



November 28, 2018. An actuarial valuation report, the “Hydro One Pension Plan Asset Transfer Actuarial Valuation as at March 1, 2018” (the “Hydro One Asset Transfer Report”) was filed with the Superintendent as part of this Application. The Application is currently under review by FSRA.

BMKP Law and Hydro One’s actuarial advisors at Willis Towers Watson have had discussions and email correspondence with FSRA staff seeking guidance on Hydro One’s funding obligations under the Plan as a result of the proposed asset and liability transfers from the Vertex Plan and Inergi Plan to the Plan, assuming that the Application is approved by the Chief Executive Officer of FSRA at some point in the future.

This letter is to confirm FSRA’s position based on the guidance provided by FSRA staff. FSRA’s interpretation of the PBA Regulations will have implications for Hydro One’s ongoing regulatory proceedings before the OEB as explained below.

The OEB Proceedings

Hydro One’s pension funding obligations under the Plan were considered under OEB Decision and Order EB-2017-0049, pursuant to which the OEB set Hydro One’s electricity distribution rates for the period from May 1, 2018 to December 31, 2022. Hydro One has applied for a review and variance of this OEB Decision and Order (proceeding EB-2019-0122), as it relates to the OEB’s assessment of Hydro One’s pension funding obligations under the PBA Regulations. Hydro One intends to submit this letter and any response received as evidence in the EB-2019-0122 review and variance proceedings.

Hydro One’s pension funding obligations under the Plan will also be considered by the OEB in ongoing proceeding EB-2019-0082 which will set Hydro One’s electricity transmission rates for the period from January 1, 2020 to December 31, 2022. Hydro One also intends to submit this letter and any response received as evidence in the transmission rate EB-2019-0122 proceedings.

Interpretative Issues

The following sets out our understanding of FSRA’s interpretation of the PBA Regulations as they apply to the Plan assuming that the Application is approved:

1. The Hydro One Asset Transfer Report will be considered the “first report with a valuation date on or after December 31, 2017” for purposes of s.4(2)(a.1) of the PBA Regulations assuming the Application is approved prior to the filing of the next full actuarial valuation report for the Plan.



2. Hydro One will be required to commence funding the Plan in accordance with the post-May 1, 2018 PBA funding rules, including the funding of the provision for adverse deviations (PfAD), retroactive to March 1, 2018.
3. The Hydro One Asset Transfer Report will be considered “the last filed valuation” for purposes of section 6.3 of the PBA Regulations such that section 55.1 of the PBA will effectively apply to the Plan retroactive to March 1, 2018.
4. Hydro One will only be permitted to take a contribution holiday on and after March 1, 2018 if the transfer ratio of the Plan is greater than 1.05.
5. If Hydro One were to take a contribution holiday under the PBA Regulations prior to the approval of the Hydro One Asset Transfer Report, a true-up would be required once the Hydro One Asset Transfer Report is approved to reflect the requirement that contribution holidays on and after March 1, 2018 require the Plan to have a transfer ratio greater than 1.05.

If the above statements are not reflective of FSRA’s position, please advise as soon as possible. Also, if there is any update that you may be able to provide on the timing or status of the Application approval, this would also be most appreciated.

Yours very truly,

A handwritten signature in blue ink, appearing to read 'LJM'.

LJM/

c: Mark Eagles
Ann Chow
David Pahn
Robert Cultraro
Cassidy McFarlane
Suzanne Jacques
Gordon M. Nettleton

SCHEDULE C

Hydro One Inc.
Hydro One Pension Plan
Actuarial Cost Certificate as at January 1, 2019
Registration Number: 1059104

This actuarial cost certificate has been prepared for Hydro One Inc. with respect to the Hydro One Pension Plan (the “Plan”), and is intended to satisfy the requirements of section 7 of the Regulation to the *Pension Benefits Act (Ontario)*.

The most recent actuarial valuation of the Plan was prepared as at December 31, 2017. The corresponding report, dated April 30, 2018, disclosed a surplus on both a going concern and solvency basis, and that the amount of the going concern surplus is sufficient to meet the expected normal actuarial cost for the period covered by the report. The remainder of this certificate will refer to this report as the “Funding Report”. In addition to the Funding Report, an asset transfer report was prepared as at March 1, 2018 and was filed in November 2018. As of the date of this actuarial cost certificate, regulatory approval of asset transfer report is still pending.

The purpose of this actuarial cost certificate as at January 1, 2019 is to determine the maximum amount of actuarial surplus identified in the Funding Report that can be applied to reduce contributions for the employer normal actuarial cost in respect of the Plan year beginning on January 1, 2019. This determination is necessary under section 7(3.1) of the Regulation to the *Pension Benefits Act (Ontario)*.

Plan Provisions

This actuarial cost certificate is based on the provisions of the Plan in effect at January 1, 2019. A summary of these provisions can be found in Appendix F of the Funding Report.

Membership Data

This actuarial cost certificate is based on the membership data supplied by Hydro One Inc.’s third-party administrator, Morneau Shepell, as at January 1, 2019. A summary of the data can be found in Appendix A. Elements of the data review are similar to those described in Appendix E of the Funding Report.

Assets

The data relating to the invested assets are based on the draft financial statements issued by KPMG. Appendix B contains further details related to the invested assets and development of the actuarial value of assets.

Actuarial Assumptions and Methods

The going concern, solvency, and hypothetical windup actuarial assumptions and methods used for the purpose of this actuarial cost certificate are the same as those summarized in Appendix C and Appendix D of the Funding report, with the following exceptions:

- For going concern liabilities and normal actuarial cost, the discount rate is 5.60% p.a. The assumption is an estimate of the expected long-term return on plan assets as at January 1, 2019 adjusted as follows:

▪ Expected long-term return on plan assets before adjustments	6.07%
▪ Investment management fees	(0.04)%
▪ Adjustment for non-investment expenses paid by the plan	(0.07)%
▪ Margin for adverse deviations	(0.40)%
▪ Rounding effect (discount rate is rounded to 10 basis points)	0.04%
▪ Expected long-term return on plan assets after adjustments and margin	5.60%

- For going concern liabilities and normal cost, the salary scale for members of the Powers Workers Union was adjusted to reflect an increase of 1.5% p.a. (plus merit and promotion) for 2019 and 2020 as per the terms of current collective bargaining agreement.
- For solvency and windup liabilities assumed to be settled via annuity purchase, the discount rates are:
 - Non indexed: 3.20% p.a.
 - Fully-indexed: 0.08% p.a.
 - Partially-indexed: 0.85% p.a.

These assumptions correspond to an approximation of the annuity purchase rates as at January 1, 2019 following consideration of the annuity purchase proxy guidance from the Canadian Institute of Actuaries for valuations with effective dates on and after December 31, 2018.

- For solvency and windup liabilities assumed to be settled via commuted value transfer, the discount rates are:
 - Non indexed: 2.80% p.a. for 10 years and 3.20% p.a. thereafter
 - Fully-indexed: 1.60% p.a. for 10 years and 1.70% p.a. thereafter
 - Partially-indexed: 1.90% p.a. for 10 years and 2.10% p.a. thereafter

These assumptions have been determined in accordance with the *Standards of Practice for Pension Commuted Values* in effect at January 1, 2019.

- 2019 YMPE and Income Tax Act (ITA) limits have been reflected. For the solvency and windup liabilities, the ITA limit has been escalated at 1.09% p.a. for 10 years and 1.89% p.a. thereafter.

The Funding Report includes certain other disclosures relevant to this cost certificate, as required by actuarial standards of practice.

Calculation Results

The going concern and solvency results at January 1, 2019 and the estimated employer normal actuarial cost and member contributions for the ensuing year are provided below. Comparable figures as at December 31, 2017 from the Funding Report are also provided.

	January 1, 2019	December 31, 2017
<i>Going Concern Financial Position</i>		
Actuarial value of assets	\$ 7,202,478,000	\$ 6,932,459,000
Total going concern liability	<u>6,095,036,898</u>	<u>6,120,630,269</u>
Going concern surplus	\$ 1,107,441,102	\$ 811,828,731
Prior year credit balance	<u>48,000,000</u>	<u>48,000,000</u>
Going concern surplus after prior year credit balance	\$ 1,059,441,102	\$ 763,828,731
<i>Solvency Financial Position</i>		
Solvency value of assets ¹	\$ 7,201,634,000	\$ 7,298,522,000
Total solvency liability	<u>6,564,444,397</u>	<u>6,547,705,910</u>
Solvency surplus	\$ 637,189,603	\$ 750,816,090
Prior year credit balance	<u>48,000,000</u>	<u>48,000,000</u>
Solvency surplus after prior year credit balance	\$ 589,189,603	\$ 702,816,090
<i>Estimated Normal Cost for Ensuing Year²</i>		
Employer normal actuarial cost	\$ 68,934,975	\$ 70,892,448
Member contributions	\$ 53,554,752	\$ 49,552,747

Note:

¹ Reflects \$7,000,000 of assumed windup expenses.

² Provided for the purpose of satisfying the requirements of section 7 of the Regulation to the Pension Benefits Act (Ontario). The employer normal actuarial cost and actuarial cost rule described in the Funding Report will be used to determine employer normal cost requirements.

The going concern surplus increased from \$811,828,731 to \$1,107,441,102 as a result of the following:

- \$43,838,751 due to expected interest on the surplus;
- \$132,768,855 due to investment experience;
- \$(48,628,867) due to liability experience; and
- \$167,633,632 due to changes in the going concern discount rate and salary scale.

The effect of decreasing the discount rate by 1% would result in the following as at January 1, 2019:

- an increase of \$871,986,663 in the going concern liability;
- an increase of \$958,236,557 in the solvency liability; and
- an increase of \$37,451,248 in the total normal actuarial cost.

If the plan were to be wound up on January 1, 2019, the hypothetical windup value of assets would be equal to the solvency value of assets. As permitted by the Regulation to the *Pension Benefits Act (Ontario)*, the employer has elected to exclude certain benefits from the solvency liability. The full hypothetical windup liability, taking into account all of the benefits excluded under the Regulation, is \$9,823,719,689 as at January 1, 2019. The transfer ratio, as defined in the Regulation to the *Pension Benefits Act (Ontario)*, is 73%.

In accordance with section 7 of the Regulation to the *Pension Benefits Act (Ontario)*, the maximum amount of the surplus revealed in the December 31, 2017 valuation that may be applied to reduce contributions for the normal cost for the plan year commencing January 1, 2019 is \$589,189,603. This amount has been determined as the lesser of the estimated going concern surplus and estimated solvency surplus at January 1, 2019, net of the prior year credit balance.

Actuarial Opinion

In our opinion, for the purpose of this actuarial cost certificate:

- the membership data on which the calculations are based are sufficient and reliable,
- the assumptions are appropriate, and
- the methods employed are appropriate.

This certificate has been prepared, and our opinion has been given, in accordance with accepted actuarial practice in Canada.

The calculations have been performed in accordance with our understanding of the funding and solvency standards prescribed by the *Pension Benefits Act (Ontario)* and Regulation thereto, and in conformity with the requirements of the *Income Tax Act (Canada)* and Regulation thereto.

To the best of our knowledge and on the basis of our discussions with Hydro One Inc., no events which would have a material impact on the results occurred between January 1, 2019 and the date this certificate was completed.

The results presented in this certificate have been developed using a particular set of actuarial assumptions and methods. Other results could have been developed by selecting different actuarial assumptions and methods. The results presented in this certificate are reasonable actuarial results based on actuarial assumptions reflecting our expectation of future events.

The information contained in this certificate was prepared for Hydro One Inc., for filing with the Financial Services Commission of Ontario.

Towers Watson Canada Inc.



Davis Gonsalves
Fellow of the Canadian Institute of Actuaries



Suzanne Jacques
Fellow of the Canadian Institute of Actuaries

June 7, 2019

Appendix A – Membership

Summary of Membership Data

January 1, 2019

Active and disabled members

▪ Number	5,599
▪ Average age	44.1
▪ Average credited service	12.1
▪ Average pensionable earnings	\$ 105,362

Retired members and beneficiaries

▪ Number	7,492
▪ Average age	74.0
▪ Average annual lifetime pension (excluding temporary pension amounts)	\$ 41,125

Terminated vested members

▪ Number	302
▪ Average age	53.7
▪ Average annual lifetime pension	\$ 10,060

Appendix A – Membership

Membership Reconciliation

	Actives & Disabled Members	Terminated Vested Members	Retired Members & Beneficiaries	Total
As at December 31, 2017	5,308	305	7,449	13,062
<ul style="list-style-type: none"> ■ New entrants (including re-employed) ■ Transfers from Inergi LP ■ Terminated (with lump sum payment) ■ Termination (vested pension entitlement) ■ Retirement ■ Deceased (with lump sum payment) ■ Deceased (without beneficiary) ■ Deceased (with beneficiary) ■ New beneficiaries (including ex-spouses) ■ Data corrections ■ Net change 	<p>299</p> <p>272</p> <p>(43)</p> <p>(32)</p> <p>(200)</p> <p>(3)</p> <p>0</p> <p>(2)</p> <p>0</p> <p>0</p> <hr/> <p>291</p>	<p>0</p> <p>0</p> <p>(10)</p> <p>32</p> <p>(23)</p> <p>0</p> <p>0</p> <p>(1)</p> <p>0</p> <p>(1)</p> <hr/> <p>(3)</p>	<p>0</p> <p>0</p> <p>0</p> <p>0</p> <p>223</p> <p>0</p> <p>(89)</p> <p>(189)</p> <p>95</p> <p>3</p> <hr/> <p>43</p>	<p>299</p> <p>272</p> <p>(53)</p> <p>0</p> <p>0</p> <p>(3)</p> <p>(89)</p> <p>(192)</p> <p>95</p> <p>2</p> <hr/> <p>331</p>
As at January 1, 2019	5,599	302	7,492	13,393

Appendix B – Assets

Reconciliation of Invested Assets

Assets as at December 31, 2017 \$ 7,305,522,000

Receipts:

■ Contributions:			
– Employer normal actuarial cost	\$ 75,042,000		
– Employer amortization payments	0		
– Member required contributions	52,525,000		
– Past service contributions	451,000		
– Provision for non-investment expenses	0	\$ 128,018,000	
■ Investment return, net of investment expenses		161,011,000	
■ Total receipts		\$ 289,029,000	

Disbursements:

■ Benefit payments:			
– Pension payments	\$ (324,564,000)		
– Lump sum settlements	(34,403,000)		
– Other benefit payments	0	\$ (358,967,000)	
■ Non-investment expenses		(26,950,000)	
■ Total disbursements		\$ (385,917,000)	

Assets as at January 1, 2019 \$ 7,208,634,000

Comments:

- This reconciliation is based on the draft financial statements issued by KPMG and certain cash flow information provided by Hydro One.
- The rate of return earned on the market value of assets, net of all expenses, from December 31, 2017 to January 1, 2019 is approximately 1.9%.

Appendix B – Assets

Development of Actuarial Value of Assets

	Adjusted Market Value Beginning from:				
	December 31, 2014	December 31, 2015	December 31, 2016	December 31, 2017	January 1, 2019
Adjusted market value as at December 31, 2014	\$ 6,311,204,000				
Net cash flow for 2015	(117,373,000)				
Assumed investment return	362,695,000				
Adjusted market value as at December 31, 2015	6,556,526,000	\$ 6,745,869,000			
Net cash flow for 2016	(182,014,000)	(182,014,000)			
Assumed investment return	349,203,000	359,427,000			
Adjusted market value as at December 31, 2016	6,723,715,000	6,923,282,000	\$ 6,909,437,000		
Net cash flow for 2017	(235,047,000)	(235,047,000)	(235,047,000)		
Assumed investment return	350,209,000	360,786,000	360,052,000		
Adjusted market value as at December 31, 2017	6,838,877,000	7,049,021,000	7,034,442,000	\$ 7,305,522,000	
Net cash flow for 2018	(230,949,000)	(230,949,000)	(230,949,000)	(230,949,000)	
Assumed investment return	363,146,000	374,493,000	373,706,000	388,345,000	
Adjusted market value as at January 1, 2019	\$ 6,971,074,000	\$ 7,192,565,000	\$ 7,177,199,000	\$ 7,462,918,000	\$ 7,208,634,000
Actuarial Value of Assets					
Average of the five adjusted market values as at January 1, 2019					\$ 7,202,478,000
Net outstanding amounts					0
Going concern value of assets as at January 1, 2019					\$ 7,202,478,000

SCHEDULE D

Questions on Contribution Holidays

Application of Subsections 7(3.1) and (3.2) of Regulation 909, As Amended

<i>Questions</i>	<i>FSCO's Responses</i>
<p>Based on the new regulations released in June of 2009, contribution holidays for plan fiscal years ending between June 30, 2010 and December 31, 2012 are not permitted unless an actuarial cost certificate is filed with the Superintendent within 90 days of the beginning of the fiscal year and that cost certificate demonstrates that the plan has sufficient funding excess to pay all or a portion of the normal cost for the year.</p> <p>1. Timing</p> <p>Q1: Will there be any ability for plan sponsors to request an extension in this deadline if it proves impossible to complete the work by that date? Our concern is that a plan with a significant surplus (potentially excess surplus from ITA perspective) may be forced to make contributions throughout a fiscal year because of a late filing of the cost certificate (despite the fact that there are sufficient assets in the plan to support a contribution holiday).</p> <p>Q2: In a situation where the new cost certificate cannot support ongoing contribution holidays, my assumption is that the requirement to remit current service cost contributions would be retroactive to the beginning of the fiscal year. When would this retroactive contribution have to be made by?</p>	<p>A1: FSCO would not consider a filing extension request for such an actuarial cost certificate as it is uncertain whether it will indeed be filed. We reserve the right to reject the actuarial cost certificate if it is filed after 90 days from the beginning of the fiscal year. There are provisions in the PBA and regulations relating to over-contributions and the process for requesting a refund of such over-contributions.</p> <p>A2: It is correct that current service contributions would be required retroactively if an actuarial cost certificate is not filed pursuant to subsections 7(3.1) and (3.2) of Regulation 909, as amended. Under subsection 4(4) of the Regulation, normal cost contributions are payable within 30 days after the month for which the contributions are payable. For purposes of such contributions that are required due to expiry of the contribution holiday period, FSCO would accept that normal cost contributions be payable by the later of the time limit specified in subsection 4(4) of the Regulation and 120 days after the beginning of the fiscal year.</p>

<i>Questions</i>	<i>FSCO's Responses</i>
<p>2. Market value vs. market-related value</p> <p>Based on our understanding of the new regulations, the determination under section 7(3.1) and 7(3.2) of the Regulation as to whether the plan has sufficient funding excess to pay for all or a portion of the normal cost for the year would be done on a market-value basis and would not reflect the impact of any smoothing that may be used in the actuarial valuations (on either the going concern or the solvency basis).</p> <p>Q3: Can you please confirm that this is the case?</p>	<p>A3: For the purposes of clause (a) of subsection 7(3.2), the going concern assets and estimated going concern liabilities should be determined on the same basis as that used in the last filed valuation report. For the purposes of clause (b) of subsection 7(3.2), both solvency assets and estimated solvency liabilities must be determined on a market-value basis.</p>
<p>3. Preparation of the cost certificate</p> <p>Q4: The cost certificate is required to include an estimate of the going-concern and solvency liabilities as well as the going concern service cost. In calculating these amounts, would FSCO accept an approach where the amounts are rolled forward from the results of the most recently filed valuation (with adjustments for any changes in actuarial assumptions and known significant changes in pension plan demographics over the intervening period)?</p> <p>Q5: FSCO policy A400-100 (which applies to actuarial filings at the time of plan amendments) contains a requirement for a 5% loading to going concern and solvency liabilities to allow for estimation errors. Would a similar requirement be imposed for the cost certificates that are required to be filed under the new regulations?</p>	<p>A4: In preparing the cost certificate, the actuary should perform the calculations in accordance with accepted actuarial practice, any applicable professional standards and FSCO's published policies. We are not in a position to provide you with specific guidance on how to prepare such estimates.</p> <p>A5: While FSCO Policy A400-100 applies to actuarial filings at the time of plan amendments, we believe that the guidance contained in the policy with respect to cost certificates is equally applicable to other situations where an estimate of the liabilities is required. Therefore, our view is that the 5% loading to the going concern and solvency liabilities to allow for estimation errors should be applied. A smaller percentage of loading may be used if the actuary can certify that the difference between the estimated amount and the actual result would be within that percentage.</p>

<i>Questions</i>	<i>FSCO's Responses</i>
<p>4. Filing of a full valuation report at the same date as the effective date of the cost certificate</p> <p>Q6: How would the new rules be applied in a situation where a full valuation is filed with the same effective date as the cost certificate and where the full valuation used smoothing (on either the going concern or the solvency basis)?</p> <p>For example, consider a situation where a triennial valuation needs to be filed as at December 31, 2009 for a plan with a December 31st year-end. In this situation, the cost certificate would be due by April 1, 2010 and the full valuation report would be due by September 30, 2010. Let say that on the market value basis, the plan now has a slight deficit and that on a smoothed basis the plan has sufficient surplus to cover the current service cost for the next couple of years. We are not entirely clear on what happens under the new regulations. Specifically, the new requirements to file a cost certificate (on a market basis) within 90 days from the beginning of each fiscal year in order to continue current service contribution holidays would suggest that contributions towards current service cost have to be resumed effective January 1, 2010 irrespective of what results are shown in the actuarial valuation report.</p>	<p>A6: We are aware of the situation you described where a full valuation is filed with the same effective date as the actuarial cost certificate previously filed. It has been our understanding that the regulatory intent was to have a full valuation report take precedence over a cost certificate if they have the same effective date. However, the regulations as drafted might lead one to conclude that both the cost certificate and full valuation would need to be considered in determining whether a contribution holiday could be taken. We have advised the Ministry of Finance of this drafting issue.</p> <p>Prior to the clarification of the wording of the regulations, we are prepared to take a position as follows:</p> <ol style="list-style-type: none"> 1. For the first fiscal year covered by a filed valuation report, contributions must be made in accordance with the funding requirements set out in that report, regardless of whether an actuarial cost certificate was previously filed. 2. For the subsequent fiscal years covered by the filed report, contribution holidays must be supported by an actuarial cost certificate prepared and filed in accordance with subsections 7(3.1) and (3.2) of the Regulation. 3. For the fiscal year periods not covered by a filed valuation report, no contribution holidays should be taken. The employer should make contributions in accordance with the report most recently filed (see subsection 4(5) of the Regulation), but without applying any of the surplus revealed in that report to reduce contributions for normal costs. <p>Under exceptional circumstances, FSCO would be willing to consider individual submissions to vary this approach on a case-by case basis.</p>