SOCIETY *of*
UNITED PROFESSIONALS
IFPTE 160

16th December, 2019

Chris Graham
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VIA Canada Post, email and RSS Filing

Ms. Christine E. Long
Registrar and Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Re: EB-2019-0082 Hydro One Networks Inc. (HONI)
Application for Electricity Transmission Rates for 2020 to 2022
Society of United Professionals' Final Submissions

Dear Ms. Long,

Please find attached the Society of United Professionals' (SUP) Final Submissions in the Hydro One Networks Inc. (HONI) EB-2019-0082 Application for Electricity Transmission Rates for 2020 to 2022.

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

Sincerely,

[Original signed by]

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Copy by email: interested parties

SOCIETY *of*
UNITED PROFESSIONALS
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Society of United Professionals'
FINAL SUBMISSIONS

EB-2019-0082 Hydro One Networks Inc. (HONI)

Application for Electricity Transmission Rates for 2020 to 2022

16th December, 2019

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EB-2019-0082: Society of United Professionals' Final Submissions

Introduction:

This is the Final Argument of the Society of United Professionals ("the Society" or "SUP") in the Hydro One Networks Inc. (HONI) EB-2019-0082 Application for Electricity Transmission Rates for 2020 to 2022. This Argument is organized as per the Approved Issues List, in accordance with the OEB's decision on such, dated 20190923.

Rather than put forward positions on all issues, the Society has chosen to limit itself to those largely which it considers to be of primary concern to its interests and where it can provide a different perspective for the OEB's consideration in reaching its decision in this proceeding.

On the other issues, the Society supports the position put forward by the applicant.

D: TRANSMISSION SYSTEM PLAN

Issue 9. Are the proposed forecast capital expenditures and in-service additions arising from the transmission system plan appropriate, and is the rationale for planning and pacing choices (including consideration of customer preferences, planning criteria, system reliability, asset condition and benchmarking) appropriate and adequately explained?

In page 66 of its December 11, 2019 submission, OEB staff asked the OEB to disallow $4.5M, or 10%, of Hydro One's ISOC (Integrated System Operating Centre*)* Project cost. The stated rationale is that the Hydro One estimate is supposed to be of the highest quality category and that an incentive is needed for the company to avoid further "unanticipated costs increases." The Society is concerned that the seemingly arbitrary nature of the OEB staff rationale for this recommendation ignores the facts presented by Hydro One, which OEB staff quoted in its submission (ref. OEB staff submission p.65). Specifically, potentially uncontrollable "skilled trade labour rate escalations, new foreign tariff structures, and competition for local construction resources" are listed by Hydro One as the causes of the cost estimate increase. While the Society understands that prudency of capital projects needs to be assessed, regulatory disallowances should be based on sound rationale, on reasonably controllable events and on evidence of poor management practice, and not on unpredictable and uncontrollable factors like evolving market forces or newly arising political events like foreign trade actions. The Society is concerned that the rationale proposed by OEB staff for its recommended disallowance introduces a significantly flawed and dangerous precedent in respect of prudency evaluation of capital projects, and as such should be disregarded by the OEB.

Issue 10: Are the methodologies used to allocate Common Corporate capital expenditures to the transmission business and to determine the transmission Overhead Capitalization Rate appropriate?

10A) General

Two significant policy issues arise in the context of Hydro One's capitalization of corporate common costs:

- Firstly, should Hydro One be allowed to continue to capitalize indirect and overhead costs under the accounting guidance provided within United States Generally Accepted Accounting Principles (US GAAP)? Should Hydro One be regulated under US GAAP and if so, should its indirect and overhead costs capitalization policy be based on a different accounting construct?
- Secondly, following a recent change in US GAAP specific to employee benefits costs, should Hydro One be authorized by the OEB to continue to capitalize all its other post-employment benefits (OPEB) costs as it has historically done?

The first issue is a macro issue that focuses on whether Transmission, and by extension Hydro One's other rate regulated businesses, should continue to be regulated on a US GAAP basis as an exception to the default regulatory model used in Ontario, which is Modified International Financial Reporting Standards (MIFRS). In the event US GAAP continues to be deemed appropriate as a general basis for regulation, should the OEB consider overriding the overhead capitalization methods allowable under US GAAP to require a MIFRS-type capitalization policy?

A subsidiary but clearly related issue related to the treatment of OPEBs is, if the OEB accepts Hydro One's proposed capitalization policy for overheads subject to a wider and more detailed future review, as OEB staff recommends, does it make sense to block the capitalization of certain OPEB costs in response to a recent US GAAP change? There is a certain attractiveness to treating OPEBs separately from other overhead costs as, unlike other indirects and overheads, they are subject to a specific US GAAP accounting standard. However, it is important to recall that the US accounting standard setter and the US Federal Energy Regulatory Commission (FERC) specifically allowed for an exception to the new accounting standard for rate regulated enterprises the cessation of capitalization raises regulatory fairness and principles issues.

10 B) Hydro One Transmission – Appropriate Regulatory Accounting Framework in General and for Overhead Capitalization

The OEB authorized Hydro One and several other large Ontario regulated utilities to adopt US GAAP as the underlying accounting framework to be used as their approved basis for rate regulation. This was done when IFRS was initially adopted for use in Canada in place of legacy Canadian GAAP almost ten years ago. In Hydro One's case, the OEB approvals followed comprehensive proceedings to evaluate the rate impacts and the arguments for and against the adoption of US GAAP (EB-2011-0268 for Transmission and EB-2011-0399 for Distribution). In these prior proceedings, the argument for allowing Hydro One to be regulated under US GAAP focused primarily on the issue of overhead capitalization and on the related rate impacts of moving to MIFRS. This is not the place to repeat these arguments, but it is important to remind the OEB that it granted approval for Hydro One, which was not at that time even a US securities filer, to use US GAAP as the basis of regulation for all of its regulated businesses after an evaluation of the respective costs and benefits of the competing accounting models. Revisiting the 2011 proceedings will show that the issues of inter-utility comparability within Ontario and across North America were also considered, as was the materially adverse customer rate impact of moving to an IFRS-based overhead capitalization policy. In the Society's judgment, the rate impact of adopting an IFRS overhead capitalization policy was the single overriding issue driving the OEB's acceptance of US GAAP as the basis of regulation.

The Society submits very little has changed in terms of business facts or GAAP for indirect and overhead costs from when the EB-2011-0268 and EB-2011-0399 proceedings occurred. OEB staff claim that "accounting standards from 2006 have evolved" (ref. OEB staff submission p. 71) with respect to US GAAP treatment of overheads. This is debateable and, with the exception of the specific OPEB change under discussion in this proceeding, the staff assertion that US GAAP has changed needs further exploration and should not be accepted by the OEB without confirming evidence being submitted and evaluated.

Over the last few Transmission and Distribution proceedings, this issue has become something of a pet issue for OEB staff and several arguments have been advanced. In its submission arguing against the capitalization of other post employment benefits (OPEB) costs in this proceeding, OEB staff have stated that capitalization increases long-term costs for customers. "Over the long-term, it is more expensive for ratepayers to fund these costs in rate base as opposed to OM&A due to the return on rate base that is applied to these costs when they are capitalized" (ref. OEB staff submission p.78). Although this argument was raised in the specific context of OPEB capitalization, the Society believes that it is one of the key concerns underlying staff's aversion to Hydro One's general capitalization approach. Whether one accepts this general argument or not, the Society does not believe that regulatory accounting policy should be set based solely on which alternative is cheaper in which year. Other factors such as customer equity, rate impacts and consistency, both between utilities and across rate years, should be addressed and weighed too.

The Society agrees with Hydro One that the question of whether US GAAP should be used as a general basis for regulation and, specifically, as the basis for indirect cost and overhead capitalization, should be considered as out of scope for this proceeding as very little evidence has been tabled, and what has been submitted has not been sufficiently explored. In its response to OEB staff's questions on this matter (ref. Exhibit I Tab 1 Schedule 140), Hydro One Transmission reminded OEB staff that in the last Transmission decision the OEB noted it would decide whether to initiate a separate policy review of all of the utilities it regulates on a US GAAP basis to determine its appropriateness as a basis for the capitalization of overhead. This was reinforced by the OEB in its last Distribution decision (EB-2017-0049) when the OEB requested that Hydro One prepare a report comparing its overhead capitalization policy to other North American utilities (US GAAP and IFRS). The Society is of the view that a multiple utility process is not necessary or useful given differences in organization and management accounting practices in use within Hydro One versus other Ontario US GAAP regulated utilities.

Despite evident concern over the nature and amount of indirect costs that Hydro One capitalizes, OEB staff have made the sensible recommendation that Hydro One's proposals on overhead allocation and capitalization (with the exception of OPEB costs) be accepted at this time and that this issue be examined in detail at the time of the next combined Transmission and Distribution hearing for 2023 rates (ref. OEB staff submission p. 71). The Society concurs that a combined assessment of all Hydro One Networks Inc's. shared corporate and other costs represents the best opportunity to examine common policy issues, common services costs and common asset depreciation/allocation.

The Society would add that Hydro One Inc.'s regulated Remote Communities business is also regulated on a US GAAP basis and it will likely also be impacted by regulatory policy decisions made in respect of Hydro One Networks Inc. Given this, Hydro One Remote Communities' capitalization policy should follow whatever the outcome of this process is.

The Society also agrees with OEB staff that Hydro One's proposed allocation of shared functions and services costs, including corporate common assets and related costs, are reasonable and should be accepted as proposed by its external third-party expert's reports. Black and Veatch is a recognized expert in cost allocation and its proposed allocation methodologies have been accepted by the OEB in various prior Transmission and Distribution proceedings. That is not to say that the OEB should fall into blindly relying on prior decisions to grandfather acceptance of these methodologies. However, the Black and Veatch methodologies are based on tested cost causality and benefit principles and they contribute to ensuring appropriate intergenerational equity. The Society notes that the proposed allocation methodologies were not seriously challenged in this proceeding. As such, the Society submits that the proposed allocation and capitalization approaches remain appropriate under US GAAP, which allows for the capitalization of overheads based on causality and benefit relationships.

10 C) Regulatory Treatment of OPEB Costs Potentially Excluded From Capitalization by Recent US GAAP Changes

Effective January 1, 2018, a new US GAAP accounting standard (i.e. ASU-2017-07) was effective for Hydro One. This new standard effectively banned the capitalization of all but current service pension and OPEB costs for companies following US GAAP.

However, the Financial Accounting Standards Board (FASB), acting in its role as accounting standard setter, recognized that this might not be appropriate for rate regulated utilities and that it could result in an accounting treatment that would poorly align with assigning costs to appropriate customer generations. Following from this, the FERC issued guidance allowing companies under its jurisdiction and subject to rate regulated accounting, to continue to capitalize these costs in the interests of retaining appropriate cost causality relationships and intergenerational equity.

Given Hydro One is using the cash basis of accounting for pensions and will presumably continue to do so subject to recommended OEB approval in this proceeding, this issue is only impactive for Hydro One's OPEB costs. Hydro One points out that the OEB, in previous Distribution and Transmission decisions, authorized a creation of a deferral account to accommodate the OM&A portion of its OPEB costs that would be ineligible for capitalization under the new accounting standard until a wider regulatory decision on capitalization occurred.

Hydro One Transmission has put forward two potential alternative rate regulated accounting solutions for OEB consideration. Under its preferred alternative, Hydro One is requesting that the OEB provide a policy exception consistent with the FERC guidance and allow the continued capitalization of otherwise ineligible OPEB costs on a continuing basis (ref. HONI Tx Argument-in-Chief, p. 75). As an alternative, Hydro One requests that the ineligible OPEB costs continue be included in a deferral account and be recovered on a vintaged twenty-year rolling basis (ref. HONI Tx Argument-in-Chief, p. 76). This second alternative would avoid the inclusion of deferred OPEB costs in rate base, while also avoiding rate shock and preserving some of the intergenerational benefits of spreading to the costs to customers who cause them or benefit from them. The Society submits that the exclusion from rate base would seem to deal with staff's concerns about affordability to customers.

In its submission, OEB staff asked the OEB to reject both of Hydro One's proposals, arguing that continued capitalization is more expensive to customers due to the inclusion of costs in rate base and the earning of a return on them. OEB staff does not support the secondary alternative arguing immateriality of the costs and increased regulatory burden (ref. OEB staff submission p79).

In its argument against a policy exception allowing for continued capitalization, OEB staff notes: "In OEB staff's view, providing special accommodation to Hydro One that will allow it to continue to capitalize the OPEB costs that are not permitted by US GAAP will only exacerbate this issue further. From a regulatory perspective, OEB staff submits that the requirements of ASU-2017-07 that limit the capitalization of pension and OPEB costs is positive step toward addressing the OEB's concerns over the large capitalization amounts that USGAAP allows compared to MIFRS." (ref. OEB staff submission p.79)

The Society supports the continued capitalization of these costs as the methodology previously allowed by US GAAP and approved by the OEB ensured that the appropriate customers were paying for the costs they cause or benefit from. This is the same logic that allowed the FASB and the FERC to provide for an exception to be available for rate regulated entities.

The OEB staff argument seems to continue to reflect a preconception that capitalization of overhead costs is inherently bad. While capitalized costs do land in rate base and are subject to a return, the Society objects to the view that appropriate cost capitalization policy should be predicated on avoiding a return where possible. Instead, capitalization should be based on GAAP, and where GAAP allows alternatives, based on appropriate regulatory principles and objectives. In this case, continued capitalization allows for an alignment of OPEB costs with the assets that result from the related labour efforts. This results in the costs finding their way to the customer generations that caused the costs to be incurred.

The Society is also concerned that a decision taken now to deny continued capitalization of these costs would pre-judge the outcome of the wider review of overhead capitalization that OEB staff has asked for as a part of the 2023 combined filing. Why the hurry to deal with this issue when it is clearly and closely related to the wider issue of indirect cost capitalization policy? If the US GAAP change did not provide for a specific regulatory exemption, the Society would agree that the change in regulatory accounting policy should be made now. However, that is not the case. An exemption exists and is available to regulators to allow them to retain the appropriate matching of costs by entities following US GAAP.

It is the Society's position that the wider issue of cost capitalization of indirect and overhead costs should be studied from a policy perspective before a decision is taken to block this one sub-category of costs from being included in rate base or otherwise deferred. To do so would result in an inherent inconsistency in the treatment of indirect costs for Hydro One and an inconsistency between past and future rate periods.

The Society notes that OEB staff repeated the OEB's previously expressed views on the importance of consistency across rate periods in its discussion of pension costs: "The OEB Report also states that the intended practice of maintaining a consistent method used to determine recovery over time may be one reason for not adopting the accrual method for rate setting. Stability and predictability in regulation are desirable unless unintended and undesirable effects occur. Hydro One has historically recovered its pension costs on a cash basis and its ratepayers have historically been better-off under the cash method. Therefore, OEB staff submits that the continued use at this time of the cash method by Hydro One to recover its pension costs is justified. (ref. OEB staff submission p. 117)" If inter-period consistency is a sound argument for the use of cash pension costs, how is it not also one for the continued capitalization of OPEB costs, especially when no convincing counter argument has been tabled?

Finally, the Society rejects OEB staff's views that Hydro One's second option should be rejected due to increased regulatory burden and immateriality as unsupported and unsupportable. The burden is not different than any other deferral account time and the materiality is clear in comparison to other issues and deferral and variance items deemed material by the OEB in prior hearings. It should be noted that this option avoids staff's concerns with continued capitalization as the costs are not included in rate base and no return on equity is earned.

E: OPERATIONS MAINTENANCE & ADMINISTRATION COSTS

13. Are the proposed 2020 OM&A expenditures appropriate and is the rationale for planning choices appropriate and adequately explained?

The Society submits that OEB staff's proposed reduction of 2020 OM&A to $363.6M[1] is an unreasonably low expenditure level which is insufficient to complete required work.

In particular, SUP submits that OEB staff's assertion that Hydro One's requested 2020 transmission compensation of $680.0M, of which 26% is allocated to 2020 transmission OM&A, appears to be too high is incorrect [ref. OEB staff submission p83]. SUP's submission on compensation costs is found further below under issue 17.

SUP further submits that OEB staff's assertion that requested 2020 Sustainment OM&A of $214.2M may be overstated is incorrect [ref. OEB staff submission p83]. OEB staff provide several suggestions which follow as to why they believe that the requested 2020 OM&A is too high in their opinion [ref. OEB staff submission pp88-89], which SUP submit should all be disregarded

(i) OEB staff offer that Hydro One's deferment of maintenance cycles that occurred in 2019 could be repeated again in 2020 to some extent, which would decrease the proposed 2020 OM&A. OEB staff provide no concrete rationale for their opinion on maintenance cycles and the inference of their suggestion is that in each year of the test period, Hydro One should to some extent defer maintenance cycles. If OEB staff take issue with Hydro One's maintenance cycle strategy, there is nothing specific provided in their submission to support this opinion. On this basis, SUP submits that OEB staff's suggestion of further deferment of maintenance cycles through the test period should be disregarded due to the resulting increased risk of negative impacts

[1] As per OEB staff submission pp82-83, $363.6M is the 2019 forecast of $356.5M uplifted by the approximate rate of inflation of 2.0%. A revised 2020 OM&A of $363.6 M would represent a reduction of $10.5M, or 2.8% from the requested 2020 OM&A.

upon system reliability, customer expectations, employee safety and public safety as well as increased demand costs.

(ii) OEB staff also submit that it is unclear to them why Hydro One's one-time extension of its planned asset maintenance cycles in 2019 is concerned, why there was no impact on capital amounts. OEB staff also submits that if Hydro One's asset management practices have been improved, there should be a better integration of capital and OM&A trade-offs, but the 2019 deferment only affected OM&A and not capital. OEB staff in their submission disregard the Hydro One position that the reason it looked at OM&A only is that they have more of an "impact on the revenue requirements that were allocated to us" [Undertaking – JT 1.3]. SUP submits that Hydro One's position is reasonable.

In order to include capex in its 2019 deferment, HONI would have to choose capex to defer which otherwise would have been placed into service in 2019. Further in its submission [p107], OEB staff note that Hydro One stated that the typical rule of thumb that is used for a rate base change to revenue requirement is approximately 8% to 9% [ref. Tr V4 p155]. Hydro One's 2019 OM&A Sustainment is $13.6M lower than its 2020 proposed level. If half of this $13.6M reduction in 2019 spend were to be effected by deferring 2019 in-service additions, then taking the ISA half year rule of thumb into account, Hydro One would have had to have found $160M of in-service additions to defer into future years from 2019 [=$6.8M/(.085 x 0.5)]. For a line of business with primarily multi-year capex projects, finding $160M of capex in 2019 which would also go into service that year to defer into future years would be very difficult if not impossible. It would even be difficult to find $80M of in-service additions to defer into future years from 2019 to reduce Revenue Requirement by $3.4M in 2019.

On this basis, SUP supports Hydro One's position on this matter, and submits that OEB staff's submission should be disregarded.

(iii) OEB staff also submits that the proposed 2020 Sustainment OM&A of $214.2M may also be overstated as it is $13.6 M or 6.8% higher than the 2019 forecasted amount. The average annual Sustainment spend for 2015 until 2019 is $219.4M. In this context, SUP submits that a proposed spend of $214.2M in 2019 is reasonable.

F: COMPENSATION COSTS

17. Are the compensation related costs appropriate?

The following three sections address: a) overall compensation costs, as well as b) the Mercer Compensation Cost Benchmarking Study as provided in F-4-1 Attachment 2 and how its findings are applied as well as considerations to be taken into account; and c) regulatory accounting policy for pensions.

17 A) Overall Compensation Costs
The Society submits that the compensation related costs put forward and justified by Hydro One are appropriate and justified.

As outlined in evidence (e.g. F-04-01), and summarized in exhibits I-07-55 (OM&A) and JT-2.09 (capex), between 2017 and 2020 assorted changes have reduced compensation costs between those two points in time to the advantage of ratepayers.

Specifically, as a result of updated actuarial valuations of pension expenses (as of December 31, 2017 as provided in Exhibit F, Tab 5, Schedule 1 Attachment 1, which in turn was superceded by an updated pension valuation as of December 31, 2018 which was submitted in the updated response to JT 2.31) Hydro One's pension contribution costs were significantly reduced. As noted by Hydro One's Mr. Chhelavde, the new valuations are not just the result of improved market conditions over that period [ref. Tr V6 p62 lns13-16]. Rather the new valuations also reflect the positive impacts (which reduce Hydro One's pension costs) of:
- Hydro One's successful management of the pension fund. For instance, the new pension valuation notes that:

> *Effective May 14, 2018, a new policy asset mix was adopted by Hydro One. This policy will be implemented over the next several years, when the appropriate investment opportunities are available. Notably this includes a shift towards real-estate and infrastructure and the removal of specific regional equity and fixed income mandates. This report reflects the new policy asset mix. [*ref. *JT 2.31 Attachment 1 p4}*

- Increased employee pension contributions between 2017 and 2020. And as summarized by Hydro One's Ms. Lila, "over the six-year period from 2013 to present, employee contributions have increased from 20 percent to now over 40 percent as a whole". [ref. Tr. V4 p117 lns13-15]

It should be noted that the increased employee pension contributions are the result of negotiated lump sum payments followed by share grants with SUP and PWU. Hydro One confirmed that the increase in employee pension contributions more than offset the costs of the share grants to both SUP and PWU [ref. Tr V4 p113 ln20-24].

Further reductions in pension benefits in 2025 and beyond are also tied in with this as confirmed by Ms. Lila [ref. Tr V4 p115 lns5-9].

This along with lower than market base wage increases were all further elaborated upon by Ms. Lila in the next hearing day [ref. Tr V5 p52 lns 4-23]:

The point I think Mr. Morris is trying to outline in the summary is that the shared grant and lump sum payments were in-year payments for lump sums, and then forward looking for each year for share grants in lieu of future pension cost sharing and pension contribution increases.

So as a result of these, you know, one time payments in the case of lump sum or, you know, fixed periods of time of compensation, we see an ongoing impact to reduced Hydro One pension contributions because employee contributions are increasing significantly. In fact, over the you know, six-year period that we started to increase contributions, employee's contributions have doubled, so quite significant in that regard.

And that continues to have, you know, lasting impacts because there were also lower than market base wage increases that occurred as part of the same compensation package, which also impact all of labour burden elements such as pension, benefits, overtime, so all of these things that we have been talking about.

OPEB costs have also been reduced as a result of the latest valuation, as provided in Exhibit I-1-OEB-205.

Executive costs have been reduced, as outlined in F-4-1 pp35-36, to be in compliance with Bill 2. Hydro One in fact went beyond what Bill 2 specified, which was to remove the compensation costs of three executives which were previously recovered in rates, and instead removed all executive compensation costs for seven or eight individuals from revenue requirement [ref. Tr V6 p67 ln7-15].

In order to be compliant with the Ontario Government direction issued on February 21, 2019 (“the Directive”), Hydro One also reduced the compensation of executives as well as non-Executive Vice Presidents, the Board of Directors and the Chair of the Board [ref. F-4-1 p36]. The latter three reductions further benefitted ratepayers.

In addition, over the past several years, negotiated contract increases for both the PWU and SUP have been significantly less than inflation, thus further decreasing real base labour costs as well as associated costs such as overtime and pension contributions [ref. F-4-1 pp28-29], all to the benefit of ratepayers in 2020 and beyond. As concluded by Energy Probe’s Dr. Higgins in cross-examination of Mercer’s Mr. Morris with regards to I-02-21 table 9, Hydro One is improving versus market median compensation in the rate year due to base labour rate increases less than inflation Mr. Morris agreed with Dr. Higgins’ conclusion on this matter. [ref. Tr Vol4 p152 ln22-25]

Consequently, due to the above factors, SUP submits that HONI has materially reduced its compensation costs to the benefit of ratepayers in 2020 and beyond.

17 B) Mercer Compensation Cost Benchmarking Study

The following three subsections address the Compensation Cost Benchmarking Study as prepared by Mercer Canada Limited (the "Mercer study") as provided in F-4-1 Attachment 2.

(i) Adjustments to 2020 OM&A and Capex to reflect Mercer Market Median

SUP submits that the estimate of the dollar difference between the weighted average total compensation for Hydro One's employees allocated to its transmission business and the P50 median used in the Mercer study as provided in exhibits I-07-55 (OM&A) and JT-2.09 (capex) are appropriate with one adjustment.

As noted earlier in section 17 A) above, for the benefit of receiving increased SUP and PWU employee pension contributions as well as reduced future pension benefits, Hydro One has provided employee share grants.

Hydro One's payout of employee share grants to PWU and SUP employees decline significantly between 2017 and 2020. As confirmed, by Hydro One's Ms. Lila [ref. Tr. V4 p125 lns 6-19], this is indeed the case and the significant decline is due to:
- Eligibility, in that only those who were employees in 2015 are eligible for share grants, and
- Forfeitures, as employees must still be employed at the time of the annual grant which is April in order to receive a share grant.

It was confirmed by Mercer's Mr. Morris, who prepared the Mercer study, that these lower share grant costs were not reflected in exhibits I-07-55 (OM&A) and JT-2.09 (capex). [ref. Tr. V4 p125 lns20-22]

The table which follows[2] estimates that the lower share grant costs would materially reduce the adjusted Mercer market median impacts in 2020, as reflected in exhibits I-07-55 (OM&A) and JT-2.09 (capex), by $0.3M for Transmission OM&A and $1.0M for Transmission capex. This is a 26% reduction in SUP represented employee share grants costs per FTE between 2017 and 2020, and a 19% decline in such for the PWU represented employees.

[2] This is a more detailed version of the table provided on page 16 of exhibit K4.5, SUP compendium for panel 2.

Decline in SUP & PWU Share Grant Costs Between 2017 & 2020 ($)					
	Maercer Study Year			Rate Year	
Transmission Society Represented	**2017**	**2018**	**2019**	**2020**	
Lump Sums	1,312,146	-	-	-	
Share Grants	-	1,243,401	1,142,108	1,127,076	
Distribution Society Represented	**2017**	**2018**	**2019**	**2020**	
Lump Sums	1,385,814	-	-	-	
Share Grants	-	1,436,756	1,319,711	1,302,342	
Total SUP Lump Sums + Share Grants	2,697,960	2,680,157	2,461,819	2,429,417	
Total SUP Lump Sums + Share Grants per FTE	**2,093**	**2,005**	**1,561**	**1,552**	
Total SUP Decline in 2020 from 2017 per FTE				**(541)**	-25.83%
Total SUP Decline in 2020 from 2017 per FTE X 2020 FTE's				**(846,229)**	
TOTAL SUP Represented FTE	1289	1337	1577	1565	
Transmission PWU Represented	**2017**	**2018**	**2019**	**2020**	
Share Grants	3,778,937	3,382,051	3,283,939	3,254,468	
Distribution PWU Represented	**2017**	**2018**	**2019**	**2020**	
Share Grants	3,991,098	3,907,977	3,794,608	3,760,554	
Total PWU Share Grants	**7,770,035**	**7,290,028**	**7,078,547**	**7,015,023**	
Total PWU Share Grants per FTE	**2,297**	**2,067**	**1,893**	**1,851**	
Total PWU Decline in 2020 from 2017 per FTE				**(447)**	-19.44%
Total PWU Decline in 2020 from 2017 per FTE X 2020 FTE's				**(1,692,379)**	
TOTAL PWU Represented FTE	3382	3527	3739	3790	
Total SUP+PWU Decline in 2020 from 2017 per FTE X 2020 FTE's				***(2,538,608)***	
- Transmission Portion of Total Decline				***(1,283,702)***	
- Transmission OM&A Portion of Total Decline				***(335,496)***	
- Transmission Capital Portion of Total Decline				***(948,206)***	
					2020 % of
	2017	**2018**	**2019**	**2020**	**Tx+Dx Total**
Total Capital Transmission Comp	394,177,597	424,531,224	453,763,524	502,291,507	37.35%
Total OM&A Transmission Comp	223,675,880	185,069,058	174,699,777	177,721,606	13.22%
Total Transmission Compensation	**617,853,477**	**609,600,282**	**628,463,301**	**680,013,112**	50.57%
	2017	**2018**	**2019**	**2020**	
Total Capital Distribution Comp	285,834,231	303,991,403	397,133,581	375,212,846	27.90%
Total OM&A Distribution Comp	293,726,326	315,330,439	294,404,650	289,545,734	21.53%
Total Distribution Compensation	**579,560,557**	**619,321,842**	**691,538,231**	**664,758,580**	49.43%
Source of data: J-4.09-01					

SUP submits that these lower share grants costs adjustments should be made to exhibits I-07-55 (OM&A) and JT-2.09 (capex) as they reflect the material decline in share grant costs between 2017 and 2020.

Further, as provided in J4.11, the difference between a 1:1 service cost ratio and the current service cost ratio (as per the updated valuation as of December 31, 2018) for employee pension contributions for the period of 2020 – 2022 totals $6.55M/ $6.80M/$6.75M in 2020-2022 respectively. As confirmed by Mr. Morris of Mercer in cross examination, this difference is at least partially captured in the Mercer market median adjustment outlined in SEC55 [ref. Tr Vol 4 p141 lns 6-15].

(ii) Decline in the Mercer Median Gap By 2020

As outlined above in sections 17A) and 17 B) (i), Hydro One compensation costs are approaching the Mercer study market median costs in 2020 for a variety of reasons. These reasons include increased employee pension contributions, lower employee share grants, base wage increases lower than inflation and lower pension costs as well as reduced non-executive Vice President compensation costs. Layer on to this the ongoing attrition of tier 1 pension plan SUP employees as well as management new hires on defined contribution pension plans (new hires are on a lower cost defined contribution pension plan as per F-4-1, p41 ln6-7), and total Hydro One pension contribution costs decline further.

As Dr. Dodds noted, a Mercer study based on 2020 compensation costs would have higher market median costs "and you [HONI] might be closer to achieving your goal of, you know, closing that 12 percent [Mercer study P50 median] differential". [ref. Tr V6 p125 lns 19-25]

Using exhibits I-07-55 (OM&A) and JT-2.09 (capex) with the adjustment for lower share grants costs of represented employees as outlined earlier in section 17 B) (i), a range for the Hydro One gap from the Mercer P50 median in 2020 can be approximated.

As per I-07-55 (OM&A) and JT-2.09 (capex), the HONI 12% gap from the P50 median in 2020 is about $10.1M and $28.3M respectively for Transmission OM&A and capex, or about $38.6M in total. So a $1M gap from the P50 median represents a 0.31% gap from the P50 median [=12%/$38.6M]. The adjustments of the market median in those two exhibits total $(19.7)M plus $(1.3)M for the share grants adjustment, resulting in total adjustments of $(21.0)M. The estimated resulting adjusted dollar gap from the P50 median in 2020 is $17.6M [=$38.6M-$21.0M]. This represents roughly a 5% gap from the P50 median in 2020 [=$17.6M X 0.31%].

Though only a directional estimate, the 5% ballpark P50 median gap in 2020 would strongly infer that HONI will be making a material move towards market median by that year. A benchmarked P50 median gap in the range of 5-10% based on 2020 HONI compensation would represent a material decline from the initial 2008 Mercer study results of 17% above market median as well as the most recent 2017 Mercer study results of 12% above market median, as summarized in F-4-1 p38, Table 8.

Table 8: Mercer Compensation Benchmarking Study Results vs. Market Median

Total Compensation Above/Below Market Median

Employee Group	2008 Survey Results	2011 Survey Results	2013 Survey Results	2016 Survey Results	2017 Survey Results	Total Change from 2008 to 2017
Management	-1%	-17%	-1%	2%	1%	2%
Society	5%	5%	9%	11%	12%	7%
PWU	21%	18%	12%	16%	12%	-9%
Overall	17%	13%	10%	14%	12%	-5%

**Management employee group positioning of -17% to market median likely impacted by legislative freeze for non-represented compensation.*

SUP submits that this should be taken into consideration by the OEB when determining adjustments for 2020 compensation costs.

(iii) Considerations For Future Compensation Cost Benchmarking Studies

StatCan produces an annual "Inter-city indexes of price differentials of consumer goods and services". This index includes most if not all of the cities which are home to the non-Ontario companies which are included in the Mercer Compensation study. The following table from page 17 of exhibit K4.5, the SUP compendium for panel 2[3], shows that for the 2017 values (the year that the Mercer study is based on), the cost of living index for Toronto is the highest of all cities. Its about 20% higher than that for Montreal or Saint John and 10% higher than for Calgary.

[3] Source: StatCan https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810000301

Inter-city indexes of price differentials of consumer goods and services, annual 1 2 3 4 5 6 7 8

Frequency: Annual

Help

Table: 18-10-0003-01 (formerly CANSIM 326-0015)

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Geography	Products and product groups	2016	2017	2018
		Index, combined city average=100		
St. John's, Newfoundland and Labrador (map)	All-items	98	96	95
Halifax, Nova Scotia (map)	All-items	100	98	98
Saint John, New Brunswick (map)	All-items	93	92	91
Montréal, Quebec (map)	All-items	92	92	93
Toronto, Ontario (map)	All-items	108	110	109
Winnipeg, Manitoba (map)	All-items	95	94	93
Regina, Saskatchewan (map)	All-items	100	96	97
Calgary, Alberta (map)	All-items	103	100	101
Edmonton, Alberta (map)	All-items	100	97	99
Vancouver, British Columbia (map)	All-items	102	103	104

How to cite: Statistics Canada. Table 18-10-0003-01 Inter-city indexes of price differentials of consumer goods and services, annual

When cross examined, Mr. Morris of Mercer confirmed that "cost of living was not reflected in the [compensation benchmarking] study that Mercer did" [ref. Tr V4 P129 lns3-4]. Mr. Morris also offered "Given the source [StatCan], I would assume it [the StatCan cost of living index] is correct within the methodology that's used [ref. Tr V4 P127 lns 22-23].

Mr. Morris elaborated that "we [Mercer] recommend that they [client companies] look at labour market values, which are, generally speaking -- do factor in, you know, the labour market and the cost of living in the marketplace". [ref. Tr V4 P128 lns6-9]

The direct inference of Mr. Morris' elaboration is that provincial labour markets do factor in the cost of living into local compensation levels. Consequently, it would be inappropriate not to make cost of living adjustments for a study peer group comprised of companies from across Canada, as cost of living costs do have an impact upon local compensation market costs as per Mr. Morris.

In a similar vein, when asked, Mr. Morris confirmed that the Mercer study does not take different provincial tax regimes into account [ref. Tr V4 P129 lns11-17]. As stated by Mr. Morris, something like different provincial income tax regimes would be very difficult and complex to take into account in a compensation benchmarking study [ref. Tr V4 P129 lns18-24]. However the different provincial sales tax regimes are straightforward and could be taken into account in a compensation benchmarking study. For example, quite a number of the companies in the Mercer study peer group are located in Alberta which has a 0% PST, whereas in Ontario it is

8% PST. So for every dollar earned by an individual in Alberta, an individual employed in Ontario would have to earn the equivalent of the 8% PST paid annually on purchases, in order to earn the same income, before even taking into account cost of living differences amongst the peer group companies (that is if the cost of living differences applied do not take into account the different PST rates across Canada).

Further, in the "Mercer's 25th annual Cost of Living Survey"[4], Gordon Frost, Partner and Career Business Leader for Mercer Canada states:
"From a global perspective, Canada remains a relatively affordable place to live and an attractive destination for expatriates placed by organizations outside the country ... Cost of living and quality of living are key components of a competitive total rewards program and compelling employee value proposition – both of which are essential for companies to attract and retain the best talent as they prepare for the workforce for the future."
So as per Mercer's Mr. Gordon Frost, cost of living is a key component of a competitive total rewards (ie compensation) program.

Consequently, the Society submits that in order to provide a reasonable market median of compensation for comparative purposes, the Mercer study results must be adjusted to take into account cost of living differences between the peer group companies, including the different provincial sales tax levels. SUP submits that HONI should include on a trial basis in its next compensation benchmarking study a provincial cost of living factor to normalize compensation levels across the peer group. If the cost of living normalization factor proves to be immaterial in this next compensation benchmarking study which Hydro One provides in evidence in its next revenue requirement proceeding, SUP submits that going forward, it should be dropped from such future compensation benchmarking studies.

17 C) Regulatory Accounting Policy for Pensions

Consistent with the last Distribution hearing, OEB staff have again raised the question of the appropriateness of Hydro One continuing to use the cash method of accounting as the approved regulatory basis for including its pension costs in rates. (ref. Exhibit I Tab 01 Schedule 202). In its EB-2015-0040 decision on generic pension and OPEB accounting for all Ontario regulated entities, the OEB determined that the accrual method should be used for employee benefits costs unless specific criteria were met, and an exemption was explicitly approved. The Society is pleased that OEB staff has resurfaced this issue again as this issue can and should be settled for the long term in the interests of regulatory and planning certainty. In the EB-2017-0049 proceeding, OEB staff determined that Hydro One had met the appropriate criteria for an exception and OEB staff therefore recommended that the OEB approve the use of the cash method. The OEB implicitly agreed by basing

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[4] "Mercer's 25th annual Cost of Living Survey", dated 20190626: https://www.mercer.ca/en/newsroom/mercers-25th-annual-cost-of-living-survey.html

approved rates on a rate base and revenue requirement that resulted from the use of the cash method. However, no specific approval was noted in the OEB's Decision. The Society considers that this was an oversight.

In its submission for this proceeding, after evaluation of Hydro One's specific arguments, OEB staff again concurs that the cash method should be used (ref. OEB staff submission p. 117). The Society agrees and hopes that the OEB will explicitly note its concurrence with this policy choice in its decision. The use of the cash method rather than the generic accrual method requires explicit approval given the criteria in the EB-2015-0040 generic report. Inclusion of a specific approval in the decision will clarify the OEB's position on this key policy matter and clearly authorize the use of this non-GAAP accounting treatment for the purposes of Hydro One's external financial reporting and for future regulatory purposes.

Given the commonality of much of Hydro One's labour costs, it is the Society's view that the same regulatory accounting policy should be applied in both of Hydro One Networks Inc.'s regulated Distribution and Transmission businesses. As the matter has been effectively settled in the last Distribution proceeding, the Society encourages the OEB to reinforce and reflect that decision with explicit wording in its Transmission decision for this proceeding.

(i) Recovery of Legally Required Pension Contribution Costs in Rates

Hydro One Transmission has made compelling arguments that it has made significant progress in managing its pension costs in the context of all its employee groups. Pensions are an integrated component of the Hydro One compensation framework. The Society considers that ample evidence has been tabled as to the prudency of the pension costs on a subject matter basis and asserts that compensation prudency is best benchmarked and assessed on a comprehensive basis and not by looking at separate components of a company's compensation framework that may significantly vary between companies and industries.

(ii) Availability of a Pension Contribution Holiday and Recoverability of Pension Costs

The Society also recognizes that the OEB has historically accepted Hydro One's contractually and legally obligated pension contributions as prudent and has included them in rates as either OM&A or capital expenditures. A significant exception was the most recent Distribution decision (EB-2017-0049) where Hydro One's pension contributions/costs were excluded from distribution rates based on the existence of a large pension surplus and a presumption that Hydro One could cease making contributions by initiating a pension contribution holiday. This represented what the Society considers to be a serious error in the interpretation of existing pension regulations, which were admittedly in a state of flux at the time of the hearing. The Society concluded that the OEB's decision to exclude pension contributions was apparently made solely based on the existence of a pension surplus and the presumed availability of a contribution holiday to the applicant. The Society did not see any significant evidence that the OEB decision was also based on the prudency of the actual pension benefits being offered to employees. As such, the Society concludes that absent the pension surplus and contribution holiday confusion, no blanket disallowance would have been imposed. This is important for Transmission as, in this proceeding, Hydro One has convincingly dealt with the surplus and contribution holiday issue under finalized pension rules as they apply now and as they are expected to apply through the rate setting period. The question at issue is whether pension contributions are prudent.

The Society notes that, unlike the recent EB-2017-0049 Hydro One Distribution proceeding, very little attention has been paid to the pension contribution holiday issue by intervenors in the interrogatory and oral segments of the proceeding. This is understandable as the OEB's EB-2017-0049 decision is currently under appeal and is being litigated.

The Society strongly agrees with Hydro One's position, expressed in its response to the CCC's interrogatory (ref. Exhibit I Tab 11 Schedule 19) that asked about the potential impact of Hydro One's Divisional Court Appeal on the OEB's EB-2017-0049 decision on pension costs: "The OEB has not indicated that its decision to limit Hydro One's ability to recover the distribution portion of its pension costs in EB-2017-0049 will have any impact on this proceeding, nor has it indicated that Hydro One's motion to review and vary findings (EB-2019-0122) (and the subsequent appeal which is being held in abeyance)…will have any impact on the proceeding."

The Society submits that Hydro One has put forward near unassailable evidence that its Transmission contributions for the test years are legally required under now finalized rules and not reasonably avoidable through a pension contribution holiday. This conclusion is based on two key pieces of evidence submitted by Hydro One. Specifically: the written response to Hydro One's questions provided by the FSRA (ref. Exhibit I Tab 1 Schedule 203 Attachment 2), and; the Eckler Expert Report in Respect of Pension Issues Related to Hydro One Networks Inc. (ref. Exhibit I Tab 1 Schedule 203 Attachment 3). The Society notes that these two documents were not significantly challenged in the oral stage of the hearing.

Hydro One has shown that the opportunity to avoid pension contributions due to an increase in the funded ratio to the required 105% on a wind-up basis approaches 0% probability (ref. Argument in Chief p.109 Footnote 324). As such, this scenario should effectively be disregarded. In the extremely unlikely event the required return was earned to achieve the 105% ratio, the Society expects that Hydro One would trigger a contribution holiday and the forecast pension contributions in rates would be captured in the existing pension variance account for future refund to customers.

The Society recognizes that the OEB is in an unenviable position in having to rule on this matter in this proceeding. If it allows pension contributions to be included in rates, it will be clearly and publicly contradicting the position taken by another OEB panel in the EB-2017-0049 decision and will be potentially jeopardizing the OEB's case currently being litigated. If, on the other hand, the panel excludes pension costs from recovery in the current proceeding, it will be ruling against extremely strong expert and regulatory evidence filed by Hydro One. This evidence has not been seriously or effectively challenged in this proceeding. A third option of parking the pension costs in a deferral account pending resolution of the EB-2017-0049 decision's legal appeal would be inappropriate in the Society's opinion as it would effectively mean this OEB panel is abdicating its responsibility to render a decision on the facts of this case alone.

The OEB staff submission argues that Hydro One should be able to recover its pension contributions related to the Transmission Business (ref. OEB staff submission pp. 119-120). This is contrary to OEB staff's recommendation to the panel in EB-2017-0049. The Society agrees with staff's position.

In conclusion, the Society expects that the OEB will include Hydro One's pension contributions in rates on the strength of the submitted evidence, however difficult that may be from the perspective of consistency of OEB decisions in different but related proceedings.

I: DEFERRAL AND VARIANCE ACCOUNTS

22. Are the proposed amounts, disposition and continuance of Hydro One's existing deferral and variance accounts appropriate?

(i) OPEB Cost Deferral Account

OEB staff note that "Hydro One has not proposed to dispose of the balance within the OPEB Cost Deferral account as it is tied to the outcome of Issue 11 in the current proceeding." (ref. OEB staff submission p.128) Consistent with its view that the OEB should not allow either Hydro One's request for continued capitalization or deferral and amortization of otherwise ineligible OPEB costs, OEB staff have recommended that the balance in this account be recovered in this proceeding and that the account be closed. The Society, consistent with its view that the OEB should defer a decision until the combined 2023 proceeding can comprehensively assess all indirect cost capitalization for both Transmission and Distribution, is of the opinion that it is premature to dispose of the balance and close this account. The OPEB deferral account should be left in place until the OEB renders its policy decision on the capitalization of all indirect costs, including otherwise ineligible OPEBs, preferably for 2023 rates. Unless the OEB decides to allow a capitalization or deferral exception in its decision on this proceeding, amounts that are otherwise ineligible for capitalization under US GAAP should continue to be captured in this account.

(ii) OPEB Asymmetrical Carrying Charges Account

The Society takes issue with OEB staff's position on the OPEB Asymmetrical Carrying Charges Account. While OEB staff agree that use of the alternative treatment described in the OEB's report on the Regulatory Treatment of Pension and OPEB Costs released on September 14, 2017 is warranted given Hydro One capitalizes a material portion of its benefits costs, it argues for an unworkable theoretical approach that requires inclusion of historical undepreciated employee benefits costs resident in rate base. Given that all parties agree that these cannot reasonably be estimated or identified to an auditable standard, OEB staff then argue that the generic approach must be used due to this information limitation. The Society notes that the alternative was put in place by the OEB to ensure greater precision and fairness where a utility's capitalization policy made a straight cash vs. accrual variance inappropriate. Any company applying it would almost certainly have the same information availability constraints that Hydro One is facing if it tried to adopt staff's version of calculating the balance. OEB staff's position essentially makes the alternative unworkable and unusable by any company in any circumstance.

This was obviously not the OEB's intent in offering the alternative to the generic treatment discussed in its benefits report. The Society's view is that Hydro One's proposed treatment is reasonable, balanced and that it meets the intent of the exception in the OEB's Pension Report. It allows a fairer assessment of the variance amount compared to the default method and is auditable. In addition, it does not carry the hint of retroactive rate making that OEB staff's proposal does. Hydro One's proposal should be approved.

(iii) Regulatory Income Tax Revenue Requirement Variance Account
Hydro One has also applied for a variance account to record the difference, effective January 1, 2017, between Hydro One's regulatory income tax revenue requirement in approved transmission rates and what the amount would have been if its appeal on the sharing of tax benefits before the Divisional Court is successful. On page 96 of its submission, OEB staff have argued against approval based on the view that "the proceeding is still on-going and the outcome unknown." OEB staff also claim that the account will result in increased regulatory burden associated with a hypothetical amount that may never materialize. OEB staff also take the position that a variance account for this purpose should only be established once the need for it is confirmed, which in the OEB staff's view, only occurs at the time the outcome of the Divisional Court proceeding is known.

To take each argument in turn, the Society submits that this type of legal contingency is exactly the sort of situation that is ideally suited to be tracked in an auditable tracking account in case the information is required for regulatory purposes at a later date. If Hydro One is successful, it will likely seek to recover the variance that would be recorded in the account. As such, having this amount subject to the discipline of a formal tracking account must be useful to all stakeholders. Hydro One is proposing a tracking account only and this does not presuppose recovery of any balance without future OEB review. The Society would expect the administrative cost of maintaining the account to be insignificant to Hydro One as they have established processes to deal with such matters. Nor should there be a significant incremental regulatory burden to OEB staff as it is a single account and staff considers the information to be stored in the account to be valueless. Finally, opening an account at the date a decision is rendered implies that only impacts after this date can be considered by the OEB. If Hydro One is successful, the Society would agree that the information to be tracked could be of material interest to all parties as it may form the basis of amounts that should be included in future rates. The OEB should approve this information only tracking account.

ALL OF WHICH IS RESPECTFULLY SUBMITTED ON THIS 16th DAY OF DECEMBER, 2019