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British Columbia Utilities Commission

Order Number G-89-13

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IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473

and

an Application by Pacific Northern Gas Ltd.
and Pacific Northern Gas (N.E.) Ltd.
for 2012 Pension and Non-Pension Benefits

BEFORE: L.A. O'Hara, Panel Chair/Commissioner
C. van Wermeskerken, Commissioner June 6, 2013

O R D E R

WHEREAS:

A. On September 21, 2012, the British Columbia Utilities Commission (Commission) issued Order G-130-12 and its accompanying Reasons for Decision for Pacific Northern Gas Ltd.'s 2012 Revenue Requirements Application (RRA);

B. Order G-130-12 Reasons for Decision states: "If PNG wishes to reapply to the Commission for recovery in rates in 2013 for any of the Pension/NPPRB [Non-Pension Post Retirement Benefits] items already addressed in this Application[RRA], or any other Pension/NPPRB items, PNG is to file a separate comprehensive Pension Application, describing all of PNG's Pension/NPPRB components, in order for the Commission to review PNG's Pension accounting and rate recovery strategy in its entirety;"

C. On November 30, 2012, Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd. (PNG) applied pursuant to sections 58, 59, 60, 89 and 80 of the *Utilities Commission Act* for approval of certain Pension and Non-Pension Post Retirement Benefit (NPPRB) treatments (the Application);

D. On December 19, 2012, the Commission issued Order G-196-12 establishing a Regulatory Timetable for the review of the Application, which allowed for two rounds of information requests, and final/reply submissions. The dates established in the Regulatory Timetable were subsequently amended by Letters L-7-13 and L-24-12.

NOW THEREFORE for the reasons attached to this Order, pursuant to sections 58 to 61 of the *Utilities Commission Act*, the Commission orders as follows:

.../2

1. Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd. (PNG) is granted its request to recognize the After-tax Pension Asset in rate base as of December 31, 2012, to compensate PNG for the financing costs of its after-tax Cash Contributions in excess of the Pension Expense.

2. PNG is directed to calculate the applicable After-tax Pension Asset at December 31, 2012, in accordance with all findings in Section 3.4 of the attached Reasons for Decision and file it with the Commission within 30 calendar days after the date of this Order, and attach a schedule showing the details of the calculation.

3. PNG is directed to file additional After-tax Pension Asset reconciliation schedules as determined in Section 3.6 of the attached Reasons for Decisions in all future Revenue Requirement Applications and to file a draft of the schedules within 45 calendar days after the date of the Order, to be reviewed and approved by the Commission upon its satisfaction.

4. PNG is allowed to establish a Non-Pension Post Retirement Benefit (NPPRB) Regulatory Asset Deferral Account calculated at December 31, 2012, under US GAAP in the amount of $2.525 million. The NPPRB Regulatory Asset Deferral Account must be a non-rate base, non-interest bearing deferral account with no further additions allowed.

5. The NPPRB Regulatory Asset Deferral Account must be amortized over six years, commencing on January 1, 2013, with an equal and offsetting amortization of the deferred income tax balance. The NPPRB deferral account must be closed when fully amortized.

6. Any NPPRB expense recovered in rates, including the amortization of the NPPRB Regulatory Asset and the transitional obligation, in excess of the cash cost of providing retiree benefits must continue to be contributed to the RCA Trust Structure.

7. In the future, if the NPPRB retiree benefits payments become greater than the accrual accounting expense recovered in rates, PNG is not to request recovery of the difference.

8. PNG is to reflect the impacts of this Order in the compliance filing regarding the PNG 2013 Revenue Requirements Application final Gas Tariff Rate schedules.

DATED at the City of Vancouver, in the Province of British Columbia, this 6th day of June 2013.

BY ORDER

Original signed by

L.A. O'Hara
Panel Chair/Commissioner

Attachment

IN THE MATTER OF

PACIFIC NORTHERN GAS LTD. AND PACIFIC NORTHERN GAS (N.E.) LTD.
2012 PENSION AND NON-PENSION BENEFITS APPLICATION

REASONS FOR DECISION

June 6, 2013

BEFORE:

L.A. O'Hara, Panel Chair/Commissioner
C. van Wermeskerken, Commissioner

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EXECUTIVE SUMMARY

On November 30, 2012, Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd. (PNG) filed its Pension and Non-Pension Benefits Application (Application). The Application was in response to an earlier 2012 Revenue Requirements Commission Decision, which recommended PNG to file a comprehensive document, describing all of the pension expense and non-pension post retirement benefit components in order to allow the Commission to review PNG's pension accounting and rate recovery strategy in its entirety.

PNG seeks "fair, reasonable and non-discriminatory treatment" of the funding of its defined benefit pension plan costs and its non-pension post retirement benefit costs. In particular, PNG applies for:

- approval for the cumulative after-tax difference between PNG's defined benefit pension plan's cash contributions and pension expense to be added to rate base to recover the carrying costs related to the capital required to fund the difference; and
- approval to establish and amortize a deferral account to recover the historically unrecovered non-pension post retirement benefits (NPPRB) expense.

Recent changes in financial reporting standards, low interest rates resulting in declining discount rates and lower investment returns on pension plan assets, as well as PNG's efforts in the past to mitigate rate increases during some challenging years contributed to the situation where PNG found itself in 2012.

The Application was reviewed by way of a written hearing process. The only registered Intervener was the British Columbia Pensioners' and Seniors' Organization *et al.* The scope of the review was restricted to the Application before the Commission. The Panel excluded from the scope broader revenue requirements related issues, such as whether PNG should be allowed to continue to recover the cost of a defined benefit pension plan in rates or whether the non-pension post retirement benefits are excessive from a rate setting perspective.

The major findings of the Commission Panel are summarized as follows:

- The importance of meeting the Fair Return Standard is reaffirmed.
- PNG is granted its request to recognize the After-tax Pension Asset in rate base as of December 31, 2012, to compensate PNG for the financing costs of its after-tax Cash Contributions in excess of the Pension Expense.
- PNG is allowed to establish a NPPRB Benefit Regulatory Asset Deferral Account calculated at December 31, 2012, under US GAAP in the amount of $2.525 million and this deferral account must be amortized over six years, commencing January 1, 2013, with an equal and offsetting amortization of the deferred income tax balance.
- Any NPPRB expense recovered in rates in excess of the cash cost of providing retiree benefits must continue to be contributed to the RCA Trust Structure.

1.0 INTRODUCTION

The 2012 Pension and Non-Pension Benefits Application (Application) is a joint application by Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd. (PNG, the Company, PNG Consolidated) and applies to all divisions – PNG-West, Fort St. John/Dawson Creek and Tumbler Ridge. The Application was filed with the British Columbia Utilities Commission (Commission, BCUC) on November 30, 2012.

PNG seeks "fair, reasonable and non-discriminatory treatment" of the funding of its defined benefit pension plan costs and its non-pension post retirement benefit costs. (Exhibit B-1, p. 1)

In particular, PNG applies for:

- approval for the cumulative after-tax difference between PNG's defined benefit pension plan's cash contributions and pension expense to be added to rate base to recover the carrying costs related to the capital required to fund the difference; and
- approval to establish and amortize a deferral account to recover the historically unrecovered non-pension post retirement benefits (NPPRB) expense.

Recent changes in the financial reporting standards, as specified in generally accepted accounting standards, regarding the reporting of pension benefit costs and other post retirement benefit costs were a contributing cause for this Application. A lower interest rate environment, resulting in declining discount rates and lower investment returns on pension plan assets, has specifically contributed to the funding challenge. In addition, PNG's efforts to mitigate rate increases during some challenging years also contributed to the issues to be addressed in this Decision.

The Application was reviewed by way of a written proceeding, which included two rounds of Information Requests (IRs). The only registered Intervener was the British Columbia Pensioners' and Seniors' Organization *et al* (BCPSO).

2.0 SCOPE OF THE COMMISSION'S REVIEW

The scope of the Commission's review of this Application includes consideration of rate base treatment for the pension asset related to PNG's defined benefit (DB) pension plan, recognition of a Regulatory Asset equaling the historical unrecovered NPPRB benefit expense as well as a potential wind-up of the RCA Trust Structure. It should be noted that PNG did not apply for the wind-up but this optional solution surfaced during the written process, and consequently PNG selected it as the preferred solution in its Final Submission.

The scope of the review excludes the following matters:

- whether PNG should be allowed to continue to recover the cost of a defined pension plan in rates or if the Company should consider freezing the DB plan and moving to a defined contribution (DC) plan;
- whether non-pension post retirement benefits are excessive from the rate setting perspective;
- consideration of anything related to the forecast 2013 pension expense and NPPRB expense because these matters are being examined as part of the PNG-West and PNG(N.E.) 2013 Revenue Requirements Applications (RRA); and

- consideration of anything related to the existing core DC plan, as the Panel understands that the DC expense and contributions have no impact on the carrying value of the DB pension plans.

3.0 DEFINED BENEFIT PENSION PLAN – AFTER-TAX PENSION ASSET

3.1 Request

PNG is requesting a rate base treatment for a balance of $2.75 million as of December 31, 2012. This amount represents the cumulative after-tax difference between PNG's DB pension plan's cash funding contributions and its DB pension plan's actuarially determined expense. Once recorded in rate base, the $2.75 million would earn a rate base return and, as a result, PNG would be compensated for the carrying costs related to the capital required to fund this difference. (Exhibit B-1, pp. 2, 6) PNG's pension expense has been recovered in rates annually. However, the plan cash contributions in excess of the pension expense have been funded by PNG without any related cost recovery in rates. As a result, PNG currently receives no compensation for the carrying costs of the additional contributions. PNG calculates the after-tax pension asset by starting with the Pension Asset from the financial statements (which is reported before-tax) and adjusting it to reflect any tax saving.

If approved, this treatment represents 0.7 percent (or half) of the 1.4 percent rate increase requested for PNG-West in the 2013 RRA, 0.4 percent of the 1.6 percent rate increase requested for PNG(N.E.) Fort St. John/Dawson Creek, and a 2 percent off-set to the requested rate decrease of 2.7 percent for PNG(N.E.) Tumbler Ridge. (Exhibit B-4, BCUC 1.12.2.1)

In this Decision, the Commission Panel will refer to the after-tax difference as 'After-tax Pension Asset'. The before-tax difference between legislated funding cash contributions (Cash Contributions) and the pension expense in financial statements (Pension Expense) is referred to as 'Net Pension Asset' when cumulative cash funding contributions are in excess of the cumulative recorded pension expense. The difference is referred to as 'Net Pension Liability', when cumulative Cash Contributions are below the cumulative recorded Pension Expense.

3.2 Background – Legislative, Accounting and Regulatory

Legislative Requirements

Registered pension plans are subject to legislative requirements, including the amount of funding that a pension plan sponsor (the employer) must contribute to the pension plan trust on behalf of the plan members to ensure its ongoing financial viability. The funded status of the defined benefit pension plans is reflective of an actuary's best estimate of the discounted present value of the future pension obligations to past and current employees of the company arising from their service to the employer; in this case, PNG. In respect of DB plans, the legislated funding contributions requirement will not be the same as the annual pension expense that a plan sponsor is required to recognize in its financial statements in accordance with accounting standards.

The different evaluation assumptions that are required to be used by pension legislation, such as mortality rates, can cause the funding contribution and the annual Pension Expense required under relevant accounting standards to be different. Accounting places greater emphasis on allocating costs to when benefits are earned, rather than when contributions are made. Both methodologies ultimately recognize the same costs, but the allocation to each year differs. (Exhibit B-2-1, p. 5) However, differences also arise when the plan funding requirements are re-determined alongside the triennial plan valuations that may reflect an underlying change in actuarial assumptions, such as changes in discount rates or investment returns, which can alter the funded status of the plan even though prior annual Pension Expense amounts were determined in accordance with applicable accounting standards and best estimates available at the time.

Generally Accepted Accounting Principles (GAAP) and Financial Reporting

Background to the Changes in Financial Reporting Standards

Up until January 1, 2012, PNG's financial and regulatory reporting was prepared under Canadian GAAP, after which time it converted to United States Generally Accepted Accounting Principles (US GAAP).

In 2008, the Canadian Accounting Standards Board announced that International Financial Reporting Standards (IFRS) were to replace Canadian GAAP for publically accountable enterprises. Under the changes PNG was required to adopt IFRS on January 1, 2012. However, IFRS does not allow for the recognition of Rate Regulated Assets and PNG's financial statements would be materially impacted by such a change. As a result PNG decided to convert to US GAAP for financial reporting purposes starting on January 1, 2012, because US GAAP is the only set of accounting standards that currently exist that would allow for regulatory assets and liabilities to continue to be recognized.

In late 2011, PNG applied to the Commission to adopt US GAAP, effective January 1, 2012, for the calculation of cost of service, revenue requirements, rate base and the preparation of regulatory schedules and filings. In order for regulatory accounting to remain consistent with financial reporting, PNG's request was approved by the Commission.

Implications of Adoption of the US GAPP Financial Reporting Standard

Under Canadian GAAP, the Net Pension Asset (before-tax) is reported in the notes to the financial statements and is the sum of, among other items, the Funded Status of the Pension Plan (Asset – Liability) and the Unamortized Actuarial Net Gains/Losses for the pension plan.

Under US GAAP, the components are reported separately under the Funded Status and the Unamortized Actuarial Net Gains/Losses.

Regulatory Treatment

As stated above, PNG is requesting to be compensated for the carrying cost related to the after-tax variance between the required Cash Contributions, which are determined from the latest available funding status, and the annual Pension Expense amounts. PNG is using the Pension Asset from the financial statements to determine the balance and then making a tax adjustment. If accounted for properly the Cash Contributions in excess of the Pension Expense should exactly equal the Net Pension Asset (before-tax) as reported in the financial statements.

Prior to 2008, PNG's cumulative Cash Contributions in respect of its pension plan were very similar to the cumulative recorded Pension Expense per financial reporting in accordance with Canadian GAAP. As a result, PNG's Net Pension Asset or Net Pension Liability was immaterial up to this point in time. Commencing in 2008, and in each subsequent year, PNG's Cash Contributions have exceeded its recorded Pension Expense, resulting in a growing Net Pension Asset. The growth in PNG's Net Pension Asset was largely due to declining discount rates; however, returns on plan assets were also less than expected.

PNG has been recovering from ratepayers an amount equal to the recorded Pension Expense in its annual revenue requirements rather than the larger Cash Contributions. Therefore, PNG has had to source capital to allow it to make the Cash Contributions that are in excess of its recovered Pension Expense. To date, PNG has not been permitted by the Commission to recover any carrying charges (i.e. financing costs) on this capital outlay. PNG applied for approval to do so in conjunction with both its 2011 and 2012 RRAs. The Commission denied the request in 2011 because the status of PNG's GAAP for financial reporting was uncertain at the time. In 2012, the request was denied mainly due to lack of sufficient evidence on the record.

As of December 31, 2012, the Net Pension Asset on PNG's balance sheet was \$3.915 million (\$2.750 million after-tax) and is expected to increase to \$5.4 million (\$3.9 after-tax) by the end of 2013. It should be noted that PNG updated the Net Pension Asset balance of \$3.834 million shown in the Application to \$3.915 million to reflect the actual December 31, 2012 data filed in conjunction with the 2013 RRA. (Exhibit B-4, BCUC 1.5.1)

3.3 PNG's Rationale for the Request

PNG's request is based on a combined argument of fair rate of return standard and equivalent regulatory treatment of utilities. PNG states that it would not only be discriminatory to disallow the requested treatment that has been allowed to other utilities but it would also deny PNG the opportunity to earn its awarded rate of return on equity. Therefore, PNG states its rates will be set below a level that is fair and reasonable. (Exhibit B-1, pp. 4-5) PNG's responses in the IR process identified differences and varying circumstances in the case of other utilities. The Commission Panel will address these two issues separately, as PNG did in its Final Submission.

3.3.1 Fair Return Standard

PNG bases its Application on a foundation of the fair return standard and emphasizes certain key issues to outline its rationale.

PNG submits that the fair return standard of section 59(5)(b) of the *Utilities Commission Act* (Act) cannot be achieved if PNG is not permitted to earn an appropriate rate of return on its After-tax Pension Asset. PNG's conclusion in this regard is based on the following:

a) The cash funding contributions made by PNG on behalf of its employees represent a valid cash outflow required by legislation to maintain the financial viability of the employee pension fund, itself a representation of a genuine, accepted and prudent liability incurred in the delivery of service to PNG's customer base.
b) Denial of a return on PNG's After-tax Pension Asset in accordance with its request is equivalent to reducing PNG's approved rate of return on common equity by 30 basis points (Exhibit B-4, BCUC1. 3.1) in 2013.
c) The Commission has allowed other utilities under its jurisdiction to earn a rate of return on their After-tax Pension Assets, including the FortisBC utilities and, "to the best of PNG's understanding, BC Hydro."
d) PNG's common equity risk premium does not reflect an adjustment relative to the FortisBC Energy

Inc. (FEI) benchmark rate of return on common equity to account for the additional regulatory risk of PNG being denied any return on its After-tax Pension Asset while FEI has been allowed to earn its rate of return on rate base on its After-tax Pension Asset.

e) If the Commission has recognized the need to allow FEI to include its After-tax Pension Asset in rate base in order for FEI's rates to be fair and reasonable, then denying PNG equivalent treatment for its material After-tax Pension Asset must result in PNG's rates not meeting the fair return standard under the *Act.*

(PNG Final Submission, pp. 4-5)

BCPSO submits it accepts that PNG has effectively been supplying capital that attracts no carrying charges since 2008 when the Pension Asset became material. (BCPSO Final Submission, p. 3)

3.3.2 Regulatory Treatment of Other Utilities

PNG elaborates on the rationale outlined above by further addressing the regulatory treatment of other utilities. PNG states that to continue to deny it a treatment of the Pension Asset equivalent to the treatment given to other utilities would be discriminatory and contrary to the Act. (Exhibit B-1, p. 2)

PNG states that "[t]he [2012] decision did not address the fairness or legal basis for denying the same treatment for PNG's Pension Asset that is afforded BC Hydro and the Fortis utilities operating in B.C." (Exhibit B-1, p. 4)

PNG submits that FEI is the most appropriate utility for the purposes of comparison to PNG because it is under the same jurisdiction and faces many of the same business risks as PNG, it is the benchmark utility in BC and it is the utility used for the purposes of examining relative risks and determining relative returns for PNG. PNG also lists a number of utilities in other jurisdictions, which in most cases are allowed recovery of full accrual pension plan expense. However, the recovery of carrying costs relating to Cash Contributions in excess of funds collected in rates varies. (PNG Final Submission, pp. 5-6)

BCPSO submits that notwithstanding the somewhat ambiguous regulatory treatment in other jurisdictions – with some regulators approving effectively no carrying costs on Pension Assets – BCPSO accepts that a return on capital required by the utility to carry out its operations is warranted. (BCPSO Final Submission, p. 3)

Commission Determination

Regarding the regulatory treatment of other utilities, the Panel has considered the submissions on the past rulings in BC and other jurisdictions, and notes that different circumstances may have influenced those decisions. First, the Panel notes it is not bound by precedents and will therefore give little weight to other regulatory decisions. Second, PNG brought forward arguments but did not provide sufficient evidence elaborating on why circumstances of a particular utility would be similar to those of PNG.

The Panel will therefore evaluate this Application on its own merits, considering the case before it as it relates to legislation, accounting standards, regulatory practice, materiality and risks.

However, the Commission Panel will give significant weight to fair return considerations and reaffirms the importance of meeting the Fair Return Standard. In other words, the Commission has a duty to approve rates that will provide PNG a reasonable opportunity to earn a fair return on its invested capital, which is consistent with the regulatory compact.

The Commission Panel concurs with PNG and BCPSO and finds that PNG is entitled to earn a return on capital it reasonably requires to carry out its operations. Accordingly, PNG is to be compensated for the carrying charges related to the After-tax Pension Asset. The amount of the After-tax Pension Asset and the appropriate level of return will be further addressed below.

3.4 Determination of the Appropriate After-tax Pension Asset Amount

The Commission Panel has determined that PNG should be compensated for the carrying charges related to the After-tax Pension Asset. Nevertheless, the Panel needs to ensure that the Net Pension Asset as reported on the financial statements has been calculated appropriately for regulatory purposes to ensure that PNG is only recovering the carrying cost related to the actual amount of capital that PNG is required to source. Therefore, in addition to reconciling these amounts, the Panel will address potential differences between the calculation of the Pension Expense for financial reporting and its recovery in rates. Ultimately, the Panel prefers keeping the financial and regulatory reporting of these items the same.

PNG's calculation of the After-tax Pension Asset is determined by taking the December 31, 2012 before-tax Pension Asset (sum of the 'Funded/Unfunded Status' and the 'Unamortized Net Actuarial Gains/Losses' for the DB pension plan) from the year-end US GAAP financial statements and then adjusting for the tax savings. PNG makes an adjustment for income tax because it is only required to finance the after-tax portion of the Pension Asset as the cash contribution is tax deductible while the Pension Expense is not. When Cash Contributions are in excess of the Pension Expense, PNG experiences a tax benefit; therefore the amount PNG is required to finance is the after-tax balance. (Exhibit B-1, p. 6)

In the following sections, the Commission Panel will assess:

(i) whether PNG has provided sufficient evidence to support the assertion that the December 31, 2012 before-tax Net Pension Asset of $3.915 million from the financial statements equals the cumulative Cash Contributions in excess of the cumulative Pension Expense;

(ii) whether the amount of capital that PNG has been required to source is driven by the Pension Expense for financial reporting, which PNG has used to determine the $3.915 million Net Pension Asset, or if it is driven by the forecast pension expense recovered in rates;

(iii) whether the Pension Expense should include any pension expenses disallowed for rate making purposes; and

(iv) the appropriateness and accuracy of the tax adjustment as proposed by PNG in the Application.

3.4.1 <u>(i) Calculation of the Net Pension Asset</u>

The before-tax difference on December 31, 2012, between the cumulative Cash Contributions and the cumulative Pension Expense for financial reporting, should equal the Net Pension Asset of $3.915 million as reported in the US GAAP Financial Statements. PNG provided the cumulative life-to-date totals for the Cash Contributions to the plan and the Pension Expense for financial reporting and compared them against the GAAP carrying values (Net Pension Asset). (Exhibit B-4, BCUC 1.5.1)

The reconciliation shows that based on PNG's accounting records the difference between the cumulative Cash Contributions to the plan and the cumulative Pension Expense for financial reporting at December 31, 2012, is $3.658 million, a variance of $257,000 or seven percent in PNG's favor (when using the US GAAP balance in

2011). PNG states that the variance is mostly attributable to the lack of information available on the pre 2004 pension data from Westcoast Energy Inc. (Westcoast). Prior to 2004, PNG's employees were part of the Westcoast master consolidated trust. PNG further states it does not have the information available to follow up on the differences. (Exhibit B-4, BCUC 1.5.1.3) Finally, PNG states it also lacks the resources to follow up and suggests that its go-forward rate base pension asset, if approved, be calculated from 2008 forward. (Exhibit B-4-1)

In addition, the reconciliation shows that in 2011 there was an $86,000 adjustment in PNG's favour that was made to reflect the difference between the 2011 Pension Expense under Canadian GAAP and US GAAP accounting standards, which represents a non-cash adjustment. (Exhibit B-4, BCUC 1.5.1)

PNG's records show that the total difference between the cumulative Cash Contributions and the cumulative Pension Expense for financial reporting at December 31, 2012, after correcting for the non-cash US GAAP adjustment, is $3.572 million, a $343,000 variance in PNG's favour.

3.4.2 (ii) & (iii) Forecast Pension Expense and Executive Bonuses

As described above, the Net Pension Asset of $3.915 million should be equal to the difference between the cumulative Cash Contributions and the cumulative Pension Expense for financial reporting. The expense that drives the financial reporting Net Pension Asset is the Pension Expense used for financial reporting, which for PNG has historically been different than the forecast pension expense recovered in rates.

PNG recovers in rates the forecast pension expense from ratepayers. The amount recovered in rates goes to offset the Cash Contributions to the plan and the difference is the amount that PNG is required to finance.

The two differences that arise between the Pension Expense for financial reporting and the forecast pension expense recovered rates are:

- the forecast variance that exists because rates are set based on a forecast pension expense and the Pension Expense in the financial statement is based on the actual pension expense at year-end (Exhibit B-4, BCUC 1.7.2, 1.10.2.2); and
- the Commission's disallowance of the 2/3 pension expense on executive bonuses. (Exhibit B-4, BCUC 1.7.3)

Forecast Pension Expense vs. Actual Pension Expense

PNG states that, historically, the actual Pension Expense as reported in the financial statements has varied from the test year forecast pension expense by small amounts. PNG also confirms that, commencing in 2012, it has made a policy choice to expense in the financial statements its forecast pension expense such that the test year forecast expense (prior to deducting the disallowed pension expense) and the actual expense will be the same. (Exhibit B-4, BCUC 1.7.4.)

PNG was asked in the IR process to confirm that the actual amount that PNG is required to finance is the difference between the actual Cash Contributions made and the forecast pension expense recovered in rates. PNG replied that this issue could be argued either way. First, the amount financed could be as articulated in the question. Second, the amount financed could also be the difference between the actual Pension Expense and the actual Cash Contributions because the difference between the forecast expense included for recovery in rates and the actual Pension Expense is a shareholder risk that is reflected in retained earnings. (Exhibit B-6, BCUC 2.3.1)

PNG states that if the $2.75 million After-tax Pension Asset was calculated based on forecast pension expense recovered in rates it would increase to $2.9 million, with resultant immaterial difference in carrying costs. (Exhibit B-6, BCUC 2.3.2.1)

Executive Bonuses Disallowed for Rate Making

For rate setting, the Commission has consistently disallowed recovery of 2/3 of the pension expense on executive bonuses in the past RRA decisions.

PNG states that "PNG Consolidated can give full assurance to the Commission that any disallowed amounts due to executive pensions are being deducted in the calculation of the [Net] Pension Asset and therefore PNG is not suggesting that ratepayers should pay any form of a carrying cost on amounts disallowed for recovery by the BCUC." (Exhibit B-1, p. 5)

PNG subsequently states that the amount used to calculate the pre-tax Pension Asset of $3.915 ($2.750 after-tax) includes disallowed pension expense. As a result, the amount requiring financing when using the pension expense recovered in rates would be higher than when using the actual expense used for financial reporting, which would result in an after-tax Pension Asset greater than $2.750 million. (Exhibit B-6, BCUC 2.3.1)

3.4.3 (iv) After-tax Calculation

As stated previously, PNG calculates the After-tax Pension Asset from the year-end financial statements Net Pension Asset and then makes an adjustment for income tax. An adjustment is appropriate because the Cash Contributions are tax deductible while the Pension Expense is not. When cumulative Cash Contributions is greater than cumulative Pension Expense, PNG experiences a tax benefit, which reduces the actual amount of cash that is required to be financed. (Exhibit B-1, p. 6)

In response to BCUC IR 1.7.1 PNG reconciled the Net Pension Asset of $3.915 million and the After-tax Pension Asset of $2.750 million. PNG notes that the After-tax Pension Asset of $2.750 million is slightly lower than the $2.828 million shown on the reconciliation in response to BCUC IR 1.7.1 (a difference of $78,000 in the ratepayer's favour). PNG claims the difference is attributable to the additional years included in the build-up of the (2004 through 2012) reconciliation shown in BCUC IR 1.7.1 versus the years included in the build-up of the After-tax Pension Asset of $2.750 million. (Exhibit B-4-1, BCUC 1.7.1)

Commission Determination

The Commission Panel finds that PNG should be compensated for the carrying costs related to the actual amount of capital that has to be sourced, which excludes the 2/3 disallowed pension expense. This is the verifiable difference between the cumulative Cash Contributions and the cumulative Pension Expense of $3.572 million to be adjusted to reflect actual tax savings.

Calculation of the Net Pension Asset

If everything reconciled properly (other than the US GAAP adjustment) then the actual funding amount should equal the Net Pension Asset of $3.915. This is not the case, however, with PNG. The Panel notes PNG's assertion that PNG does not have the historic data from the period before it took over the company to determine the reasons for difference. The Panel further notes that the balance seems to reconcile for all periods post 2004 but the information provided is not clear to support this assertion.

The Panel considers that the actual balance PNG is required to fund is the verifiable difference between the Cash Contributions and the Pension Expense as of December 31, 2012, of $3.658 million, not the Net Pension Asset as reported in the financial statements. Further, the $86,000 representing the 2011 accounting change to US GAAP is a difference relating to a non-cash change in accounting standards, and does not represent an increase in carrying costs to PNG. After disallowance of that non-cash item, the Panel arrives at the $3.572 million, which is the Net Pension Asset that the Commission determines PNG is allowed to earn an appropriate return on.

Finally, because PNG is requesting recovery of the difference between the cumulative Cash Contribution and the cumulative Pension Expense for financial reporting since the inception of the plan, PNG's go-forward rate base pension asset should not be based on 2008 forward but on the balance per the inception of the plan, as determined above.

<u>Forecast Pension Expense and Executive Bonuses</u>

The Commission Panel finds that the After-tax Pension Asset should be calculated, as a matter of principle, as the difference between the actual cumulative Cash Contributions and the actual cumulative forecast pension expense recovered in rates. The rationale for this view is that PNG should only be compensated for the financing of the actual amount of cash related to rate regulated pension activities. The other choice, using the Pension Expense for financial reporting, is not consistent with this principle.

In addition, PNG is compensated in its capital structure and allowed return on equity for the short terms risks related to annual variances between forecast and actual cost of service. This further supports the choice of the forecast pension expense recovered in rates for determining the appropriate Pension Asset.

The Panel finds that PNG should not be compensated for the carrying cost on the 2/3 disallowed pension expense for rate making purposes, but is persuaded that PNG's calculation of the After-tax Pension Asset is virtually reflective of this. The Panel recognizes that for the actuarial valuation the disallowed amounts have also been included for the purpose of determining the funding requirements. Since the amounts are recognized consistently both on the Cash Contributions and Pension Expense sides, this practice is acceptable because the difference related to the disallowed amounts is expected to be immaterial.

There are also other considerations that influence the determination on whether the December 31, 2012 Pension Asset calculation should be based on Pension Expense per financial reporting or the forecast Pension Expense recovered in rates. Those considerations include the following:

- the practical goal of keeping the financial reporting and regulatory reporting the same;
- regulatory efficiency with emphasis of minimized reconciliations at each year-end;
- PNG has commenced using the forecast balance used for rate making also for financial statement purposes, which means that there will not be any variances in the future; and
- the difference in the after-tax balance is relatively small, approximately $150,000 as shown in response to BCUC IR 3.21. PNG states that if the $2.75 million After-tax Pension Asset was calculated based on the forecast pension expense recovered in rates, it would increase to $2.9 million, with resultant immaterial difference in carrying costs.

The Commission Panel considers that the benefits of using the Pension Expense for financial reporting outweighs the incremental cost to ratepayers of using the forecast pension expense recovered in rates, based on the evidence on record, and determines that the Pension Expense per financial statements will be used as a practical solution.

Determination of the After-tax Pension Asset Amount

The Commission Panel finds that because PNG is requesting recovery of the difference between the cumulative Cash Contribution and the Pension Expense since the inception of the plan, the tax adjacent should be calculated from the inception of the plan. **Accordingly, the Panel directs PNG to recalculate the balance based on the after-tax amount since the inception of the plan, including an estimate for the pre 2004 balances.**

3.5 Appropriate Carrying Costs

In Section 3.4, the Commission Panel accepted that PNG is entitled to be compensated for the after-tax financing costs of its Cash Contributions in excess of the Pension Expense (After-tax Pension Asset) and will now determine the appropriate carrying costs on this amount. The alternatives considered for this Decision are:

(i) non-rate base treatment at weighted average cost of debt;

(ii) non-rate base treatment at weighted average cost of capital (WACC), which includes a debt and equity return component; and

(iii) rate base treatment at the WACC.

A full "rate base treatment" implicitly means that an asset is added to rate base thereby earning a WACC return, which a utility recovers annually in its rates.

Regulatory assets that are treated as deferred costs can attract WACC, the weighted average cost of debt as carrying costs or no carrying costs. Once the level of carrying costs is decided in these cases, the Panel can determine whether the carrying costs are charged to rates annually or accumulated in a deferral account and then amortized over a fixed time period.

PNG states that the After-tax Pension Asset should be accorded rate base treatment as is allowed to other major utilities regulated by the BCUC, including BC Hydro and all of the FortisBC utilities. (Exhibit B-1, p.2) Furthermore, PNG explained that it would be unable to obtain 100 percent debt financing for this long-term Pension Asset, because no lender would be prepared to finance the entire value of the asset. Therefore, PNG stated it is appropriate for the account to be included in rate base. PNG also pointed out that this treatment would be consistent with the rate base treatment afforded to its deferred income tax credit. (Exhibit B-4, BCUC 1.12.1)

By way of further explanation, PNG submits that FortisBC Inc. (electric) and, as best PNG has been able to determine, BC Hydro appear to receive a weighted average debt cost as a return on their pension asset, while the other FortisBC utilities (gas) include their after-tax pension assets in rate base for a full return. PNG submits that inclusion in rate base is the appropriate treatment for its After-tax Pension Asset, given the long-term nature of the asset, which has been material for over 4 years. Given the unavailability of 100 percent debt financing and that the characteristics of its After-tax Pension Asset are very similar to other long-term working capital assets such as line pack, PNG submits that rate base treatment is warranted. (PNG Final Submission, pp. 6-7)

PNG further submits that providing a return on its After-tax Pension Asset that is below PNG's allowed rate of return on rate base implicitly reduces PNG's approved return on common equity (ROE). "That is, given that shareholders have to fund the After-tax Pension Asset with a portion of common equity, if that common equity is denied the opportunity to achieve a return equal to PNG's approved ROE, then the opportunity for PNG to achieve its awarded ROE is diminished" (PNG Final Submission, p. 7). PNG submits that if the Commission intends to reduce PNG's approved ROE, it should do it explicitly and not through an implicit method such as providing reduced or zero returns on long-term assets such as the After-tax Pension Asset. (PNG Final Submission, p. 7)

If PNG was allowed to earn a weighted average cost of debt rather than the rate base treatment it is seeking, the forecast rate impact in 2013 would be a minor reduction of 0.15 percent. (Exhibit B-7, BCPSO 2.2.1)

BCPSO submits it does not take a strong position on what the appropriate rate of return should be on the Regulatory Asset. However, it notes that the characterization of the Pension Asset as a long lived asset is not entirely correct. BCPSO points out PNG's admission that "the long lived asset" could turn out to be short lived – even becoming a liability – should asset plan returns and discount rates increase. BCPSO further submits that any increase in asset plan returns is likely to be correlated with an increase in discount rates. Regardless, BCPSO concludes that the appropriate return is either the weighted average cost of debt or weighted average cost of capital. (BCPSO Final Submission, pp. 3-4)

In Reply, PNG submits that its characterization of the After-tax Pension Asset as long-term in nature is based on two points:

a) given the underlying long-term nature of DB pension plans, virtually all elements of pension-related accounts are long-term in nature; and

b) even though the balance may switch between a Pension Benefit Asset and Pension Benefit Liability over time, the transition is likely to take place over lengthy cycles. This occurs in part due to the fact that one of the primary drivers of the difference between Cash Contributions and the annual Pension Expense amounts are the triennial plan valuations that determine future cash contribution requirements. As such, there is likely to be a prolonged period where there exists a difference between Cash Contributions and annual Pension Expense amounts, thus giving rise to an asset (or liability) that will continue for the remainder of that valuation cycle. As valuation assumptions change with the business cycle (and timing thereof) it can easily occur that assets (or liabilities) will be recognized over two or more valuation cycles, thus spanning six years at a minimum. PNG submits that this is sufficient for characterization of the pension asset (or liability) as a long-term asset (or liability) and therefore rate base treatment is warranted.

(PNG Reply Submission, pp. 1-2)

Commission Determination

As stated previously, the Panel gives little weight to regulatory treatment of other utilities as each case may have its unique circumstances. **In this case, because of the long-term nature of the After-tax Pension Asset and the comparable rate base treatment of the deferred tax credit balance, the Commission Panel grants PNG's request to recognize the After-tax Pension Asset in rate base as of December 31, 2012.** The rate base treatment with full weighted average cost of capital return compensates PNG for the financing costs of its after-tax Cash Contributions in excess of the Pension Expense. The Commission Panel was persuaded by arguments put forward by PNG and also notes BCPSO did not take a strong position regarding the nature of the carrying costs allowed.

If the After-tax Pension Asset becomes an After-tax Pension Liability at some point in the future, due to such events as higher discount rates or healthy returns on plan assets, PNG must provide a credit to rate base in the same manner approved for the After-tax Pension Asset. This is to ensure that PNG's rates remain fair and reasonable to ratepayers.

3.6 Future Tracking and Reporting and Compliance Filings for the After-Tax Pension Asset

PNG is directed to calculate the applicable After-tax Pension Asset at December 31, 2012, in accordance with all findings in Section 3.4 and file it with the Commission within 30 calendar days after the date of the Order, and attach a schedule showing the details of the calculation.

In all future RRAs, the Commission directs PNG to file the following After-tax Pension Asset reconciliation schedules:

1. **A reconciliation, similar to the table provided in response to BCUC IR 1.5.1, showing the cumulative Pension Expense and Cash Contributions on a year by year basis reflective of the adjustment directed in this decision.**
2. **A schedule showing any variance between the forecast cash contribution to the pension plan and the actual cash contribution for the previous year. PNG is to reflect the actual cash contributions in the following RRA when the actual contribution is known**. This will ensure that carrying costs on the Net Pension Asset recovered in rates reflects the true amount of cash financing required by PNG.
3. **A reconciliation between the cumulative Net Pension Asset and the After-Tax Pension Asset on a year by year basis**.

PNG is directed to file, within 45 days of the date of this Decision, drafts of these schedules, which will be reviewed and approved by the Commission upon its satisfaction.

4.0 NON-PENSION POST RETIREMENT BENEFITS (NPPRB)

4.1 Request

PNG is requesting approval for the recognition of a Regulatory Asset equal to the historical unrecovered non-pension post retirement benefit (NPPRB) expense of $2.525 million at December 31, 2012, calculated under US GAAP, and approval to amortize the Regulatory Asset in rates commencing January 1, 2013, over a period of 13 years. (Exhibit B-1, p. 14 and Exhibit B-6, BCUC 2.8.1)

Table 1 below shows how this amount was derived.

Table 1 – Regulatory Asset Equalling the Unrecovered NPPRB Expense as of December 31, 2012

				USGAAP adjustments			
($000's)	CGAAP	CGAAP	OBS	2011	2011	USGAAP	USGAAP
	2010	2011		expense	reclass	2011	2012
Funded status	(5,409)	(5,513)	112	6	290	(5,105)	(7,013)
Unamortized net actuarial gains and losses	1,889	1,791	(157)	11	(1,645)	-	-
Unamortized transitional obligation	986	863		(2)	(861)	-	-
	(2,534)	(2,859)	(45)	15	(2,216)	(5,105)	(7,013)
	37	357			(357)	-	-
Carrying value	(2,497)	(2,502)	(45)	15	(2,573)	(5,105)	(7,013)
Regulated asset - unamortized net actuarial gains & losses					1,706	1,706	3,750
						(3,399)	(3,263)
Regulated asset - historic costs	2,497	2,497	45	(15)	(2)	2,525	2,525
Regulated asset - forgone transitional obligation					861	861	738

Source: Exhibit B-4, BCUC 1.13.2

PNG states that ultimately, with both the recovery of the historical amount and the future expense being calculated under US GAAP, there will be no over or under recovery of the NPPRB expense in rates relative to PNG's benefit payments. (Exhibit B-4, BCUC 1.13.2)

4.2 Background

4.2.1 PNG's Non-Pension Post Retirement Plan

PNG explained that pre 2004 retirees (31 members) receive extended medical coverage, dental benefits, MSP premiums and life insurance.

Post 2004 retirees (123 members of which 17 are retired) receive extended medical coverage, MSP premiums, Health Spending Account and life insurance. PNG stated that extended health benefits and life insurance coverage were significantly reduced relative to the plan pre 2004.

Cash cost of retiree benefits was $186,000 in 2012. (Exhibit B-2, p. 6)

4.2.2 The Historical Regulatory Treatment of PNG's NPPRB Plan

PNG states that unlike defined benefit pension plans there is no legislation governing the funding of NPPRB plans and these plans are normally unfunded. (Exhibit B-1, p. 8) The historical regulatory treatment of PNG's NPPRB plan costs has varied, generally, due to a set of circumstance relatively unique to PNG. The chronology of the events is outlined below.

Pre 2004

Up to 2004, PNG Consolidated recovered its NPPRB plan costs on the pay-as-you-go method (cash cost of retiree benefits paid). PNG did not recover the full accrual method out of concern for the significant impact on customer rates. (Exhibit B-1, pp. 7-8)

2004

In 2004, PNG applied for a change to a partial accrual methodology for recovery of the NPPRB expense because the plan deficit had grown to $4.7 million. To strike a balance between managing rate increases and the growing NPPRB liability, the Commission approved PNG's request to recover the current service expense in addition to the cash cost of retiree benefits paid.

Although the Commission approved PNG's request, it directed PNG to create a trust structure into which the amount in excess of the cash cost paid (the current service expense) was to be segregated and deposited. PNG requested Commission relief from this condition since the only structure available was a Canada Revenue Agency (CRA) approved retirement compensation arrangement (RCA) trust, where each contribution to the RCA trust had to be matched with an equal remittance to a refundable tax account (RTA) with the CRA. In addition, no interest or other return would be earned or paid on the RTA. Instead, PNG requested the Commission to allow that the cumulative after-tax funds collected be offset against the Company's rate base. PNG claimed this would significantly increase the effective return that would be earned by its customers. The Commission denied PNG's request and directed it to create the NPPRB RCA trust (Trust, RCA Trust Structure). (Exhibit B-1, pp. 8-9)

2009

Up until 2009, from an accounting perspective, PNG was able to rely on a regulatory exemption and was not required by GAAP to recognize any NPPRB accrued benefit asset/liability on its balance sheet. However, effective January 1, 2009, the Canadian Accounting Standards Board removed the temporary exemption providing relief to entities subject to rate regulation from the requirements regarding recognition and measurement of assets and liabilities. PNG's compliance with this change in accounting standard resulted in PNG recognizing the Canadian GAAP carrying value of its NPPRB plan on its balance sheet from that point on.

On January 1, 2009, PNG recorded a NPPRB Accrued Benefit Liability of $2.190 million and at the same time established an offsetting Regulatory Asset of $2.190 million. However, PNG did not seek nor obtain Commission approval for this Regulatory Asset. (Exhibit B-4, BCUC 1.5.1.1, Exhibit B-6, BCUC 2.5.2)

Up until 2011, PNG continued to recover in rates the current service expense in addition to the cash cost of retiree benefits paid. PNG states that it purposefully applied for less than full recovery of its NPPRB expense between 2004 and 2011 simply to reduce rate impact on its customer during a very difficult time for both PNG and its customers. (Exhibit B-1, p. 11)

2011

By January 1, 2011, the NPPRB Accrued Benefit Liability had grown to $2.497 million. In the 2011 Revenue Requirements Application (2011 RRA), PNG requested to no longer recover the cash cost of retiree benefits paid and the current service cost but to instead recover the full accrual accounting expense. Through the negotiated settlement process PNG received approval to recover the full accrual account expense commencing January 1, 2011. (Exhibit B-1, pp. 7-9)

In the 2011 RRA, PNG also requested that the after-tax amount of the non-cash expense (i.e. the full accrual accounting expense recovered in excess of the cash cost paid to retiree) be available to PNG for general corporate purposes and be recognized as a credit to rate base rather than being contributed to the RCA Trust Structure. This request was denied and PNG was required to continue to contribute the excess to the RCA Trust Structure. (Exhibit B-1, pp. 7, 9)

2012

On January 1, 2012, PNG converted to US GAAP.

In its 2012 RRA, PNG applied to have its Regulatory Asset of $2.542 million (composed of the $2,497,000 Canadian GAPP NPPRB Accrued Benefit Liability and a $45,000 US GAAP Transitional Adjustment) plus the Unamortized Transitional Obligation of $861,000 amortized fully and immediately on January 1, 2012, with an equal and offsetting amortization of its deferred income tax balances.

PNG requested a wind-up of the RCA Trust Structure. Without a wind-up of the Trust, the full amortization of the Unamortized Transitional Obligation ($861,000) and the NPPRB Plans' Unrecovered Expense ($2.542 million) would have to be contributed to the Trust.

PNG was denied recovery of the $2.542 million NPPRB Plan's Unrecovered Expense. The Commission also denied the wind-up of the RCA Trust Structure and required PNG to contribute to the Trust any amounts in excess of the expense and the cash cost of providing retiree benefits. (Exhibit B-1, pp. 7, 11)

However, the Commission approved recovery of the $861,000 Unamortized Transitional Obligation but was directed to amortize the balance in rates over seven years (approx $123,000 per year) with the amortization being contributed to the RCA Trust Structure. (PNG 2012 RRA Decision)

4.2.3 The November 30, 2012 Application

PNG is again requesting recovery of the Regulatory Asset at December 31, 2012, that was set up in 2009 to offset the NPPRB Accrued Benefit Liability. PNG stated that the underlying nature of this asset is the difference between the full actuarial accrual expense and the amounts historically recovered through rates. (Exhibit B-6, BCUC 2.5.7)

At January 1, 2009, the regulated asset was $2.190 million. The Regulatory Asset increased in 2009 and 2010 to $2.525 million by the net change in the carrying value of the NPPRB liability. In 2011, PNG recovered the full actuarial expense. Therefore, there was no change in the regulated asset since that time other than the adjustments for US GAAP. (Exhibit B-6, BCUC 2.5.7)

As with the Pension Asset, there is no NPPRB Accrued Benefit Liability reported under US GAAP; however, the amount is equal to the Funded Status plus the Unamortized Net Actuarial Gains and Losses in the financial statements less the Unamortized Transitional Obligation. PNG states the sum of these three amounts is expected to be reported at December 31, 2102, as $2.525 million, which is the same as the Regulatory Asset being requested for recovery. (Exhibit B-6, BCUC 2.8.4) The difference between the full actuarial accrual expense and the amounts historically recovered through rates is $2.503 million, a $22,000 difference, that PNG states is due to rounding. (Exhibit B-4, BCUC 1.13.5)

PNG further states that in the future if the benefit payments become greater than the accrual accounting expense recovered in rates, PNG would not come to the Commission to request recovery of the difference because the future benefit payments would have previously been recovered from customers in the historical NPPRB expense. (Exhibit B-4, BCUC 1.18.5)

4.3 PNG's Rationale

PNG states that the Commission's denial of the recognition and amortization of the Regulatory Asset of $2.542 million in the 2012 RRA has put it in the imminent position of having to recognize a negative retained earnings impact under US GAAP equal to $2.542 million. (Exhibit B-1, p. 11)

Under US GAAP there are specific rules governing the recognition of regulatory assets associated with non-pension post-retirement benefit plans. When asked why PNG is seeking recovery of a regulatory asset that was never approved by the Commission, PNG explained that US GAAP allows the recognition of a regulatory asset related to NPPRB plan liabilities that are not currently recovered through rates. However, there needs to be a reasonable expectation that this asset will be recovered through rates within a prescribed period of time, preferably a through a regulatory order. PNG stated it fully expected the Commission to give this approval. (Exhibit B-6, BCUC 2.5.4)

In the case of PNG's Regulatory Asset, PNG believes it would need to be recovered on a straight line basis by December 31, 2025 (13 years) to meet the US GAAP criteria for recognition as an asset. (Exhibit B-1, p. 11)

<u>PNG Final Submission</u>

PNG submits the Commission has never concluded that PNG's NPPRB plan is imprudent or otherwise not subject to recovery in PNG's rates. The Historical Unrecovered NPPRB Expense (Regulatory Asset) arose when PNG applied to not adopt full accrual accounting following changes in accounting standards. PNG's requests in this regard, which contrasts with FortisBC Energy's immediate adoption of full accrual accounting for NPPRB plans, were motivated by PNG's desire to mitigate the rate impacts on its customers. There was never any suggestion or indication that PNG would not be able to recover its full NPPRB expense. Had PNG adopted full accrual accounting at the same time as FortisBC Energy, PNG believes that this amount would have been recovered in prior years' revenue requirements.

PNG further submits that to avoid any punitive accounting treatment this Regulatory Asset needs to be recovered in a manner prescribed by US GAAP and that it is fair and reasonable for the Commission to allow PNG the recovery in compliance with US GAAP rules.

Finally, PNG submits denial by the Commission of recovery of this Regulatory Asset infers that PNG shareholders are solely at risk for changes to recovery methodologies previously recognized and approved by the Commission. A corollary of this rationale would be the treatment of deferred income tax balances that PNG had previously recovered under the accrual method. If PNG's shareholders are intended to be at risk for changes to recovery methodologies previously recognized and approved by the Commission, then when PNG was ordered by the Commission to switch to the flow-through method of recovering an income tax provision in its rates, the resulting impact should have been solely to the account of PNG's shareholders. Using that allocation of risk, PNG's shareholders would have retained the deferred income taxes previously recovered from customers. (PNG Final Submission, p. 9)

<u>BCPSO Final Submission</u>

BCPSO supports PNG's submission that it is appropriate for PNG to recover historically unrecovered NPPRB expenses. BCPSO, however, submits that the analogy between the NPPRB recovery and the drawdown of deferred income taxes is flawed. BCPSO rejects this analogy because for utilities, the deferred tax issue arises when the utility is collecting amounts from ratepayers in respect of income taxes that may never be paid by the utility. In contrast, BCPSO argues the NPPRB will certainly be paid. (BCPSO Final Submission, pp. 5-6)

<u>PNG Reply Submission</u>

PNG submits it respects the BCPSO's position regarding the flawed analogy. "However, PNG stands by its position that, like NPPRB expense, the deferred income taxes previously collected will ultimately be paid by the utility, albeit possibly over a long timeframe." (PNG Reply Submission, p. 2)

4.4 Regulatory Treatment of Other Utilities

PNG submits that it has been unable to identify any utilities that have transitioned from pay-as-you-go to the full accrual expense method of recovery of NPPRB plan costs in a manner similar to PNG. Therefore, PNG has not been able to identify any utilities that have sought to recover NPPRB expense amounts equivalent to PNG's Historical Unrecovered NPPRB Expense.

Further, PNG submits it has not been able to identify any other utility that has been required to contribute funding to an RCA Trust. A number of utilities, though not all, are recovering the full accrual actuarially determined NPPRB expense in their rates. In British Columbia, FortisBC Energy Inc. (FEI) recovers the full accrual expense and has not been required to contribute funds recovered in rates in excess of cash costs into an RCA Trust. FEI does provide a rate base credit for the funds recovered in rates in excess of cash costs. In Alberta, for instance, Alberta Utilities Inc. and ATCO Gas have 'Pay-as-you-go' regulatory treatment for NPPRB plan costs. (PNG Final Submission, pp. 12-13)

PNG states that "[it] also notes that other utilities under the jurisdiction of the BCUC, including the Fortis B.C. utilities and BC Hydro, have been allowed to recover the full amount of the accounting expense for their NPPRB Plans. PNG believes it is unduly discriminatory for the BCUC to deny PNG the right to recognize and recover the NPPRB Plans' Unrecovered Expenses, particularly when PNG purposefully applied for less than full recovery of its NPPRB expense in the intervening 2004 to 2011 simply to reduce rate impacts on its customers during a very difficult period for both PNG and its customers." (Exhibit B-1, p. 11)

In conclusion, PNG submits that there is no substantive reason that it should not be able to recover its Historical Unrecovered NPPRB Expense (Regulatory Asset), particularly when FortisBC Energy has been allowed to recover its full accrual NPPRB expense from the time that full accrual accounting for these plans was first introduced as the accounting standard. (PNG Final Submission, p. 13)

4.5 Request for Approval of the Regulatory Asset

As mentioned previously, on January 1, 2009, PNG recorded a NPPRB Accrued Benefit Liability of $2.190 million and at the same time established an offsetting Regulatory Asset of $2.190 million; however, PNG did not seek nor obtain Commission approval for this Regulatory Asset. By way of an explanation, PNG stated the Company does not believe that it is always necessary to obtain Commission approval for its Regulatory Assets. "Regulatory assets are items that PNG recognizes on its financial statements based on management's reasonable expectation that the amounts associated with the asset will be recovered in rates in the future. While a regulatory order is the strongest evidence to support the recognition of a regulatory account under GAAP, other evidence can be considered. The recognition of this asset was supported by management's reliance on BCUC's decisions to allow other utilities to recover this expense and PNG's belief that it was prudently incurred." (Exhibit B-6, BCUC 2.5.3)

It is expected that if the recovery of the Regulatory Asset is approved, once the current balance is amortized, the Regulatory Asset balance will be nil and the account will no longer be required. PNG stated that even if the Commission were to approve the full amortization of the Regulatory Asset immediately the obligation and the asset (Funded Status) will continue to be measured under US GAAP (Exhibit B-4, BCUC 1.18.1) as well as the Unamortized Net Actuarial Gains and Losses. However, there would no longer be an equal and offsetting Regulatory Asset. (Exhibit B-4, BCUC 1.5.8)

Commission Determination

Even after reviewing PNG's submission, the Commission Panel questions why PNG set up a regulatory account without approval or consideration by the Commission. The fact that PNG was not proactive in 2009 has resulted in unintended consequences. For instance, at the time the Regulatory Asset was established in 2009 for $2.190 million, PNG could have requested that a deferral account be set up for recovery in the future and the Commission could have reviewed the calculation at that time.

Specifically, if PNG had anticipated recovering the full accrual pension expense in the future, it should have said so explicitly. PNG could also have requested to add the difference in a deferral account for recovery in the future and the Commission could have made a determination on the appropriate expense at that time. There were also other ways to mitigate the rate impact; for example, PNG could have amortized the full pension expense and offset some of it with the amortization of the deferred income tax balance.

In summary, the Panel has noted the circumstances where PNG purposely did not want to take the expense in the past years to mitigate rate increases and questions whether it seems fair that PNG can recover the balance now retroactively; especially, when PNG never sought approval for the Regulatory Asset when it was set up.

After considering the concerns articulated above, the Commission Panel is persuaded by arguments put forward by PNG and the support of BCPSO in general. The Panel in particular notes the atypical financial challenges faced by PNG in the past and the complex regulatory and accounting treatments PNG has been exposed to over a long period. **Accordingly, the Commission Panel accepts the recognition of a Regulatory Asset equal to the historical unrecovered NPPRB expense at December 31, 2012**. **PNG is allowed to establish a NPPRB Regulatory Asset Deferral Account calculated at December 31, 2012, under US GAAP in the amount of $2.525 million. The NPPRB Regulatory Asset Deferral Account must be a non-rate base, non-interest bearing deferral account with no further additions allowed.**

5.0 NPPRB – CONSIDER WIND-UP OF THE RCA TRUST

PNG did not request to wind-up the RCA Trust Structure in the Application because in the 2012 RRA the Commission determined that it was too risky to do so. Nevertheless, the option of a wind-up was fully explored through the information request process, and in its Final Submission, PNG requested reconsideration of the Commission's decision in 2004 to require PNG to use the RCA Trust Structure. (Exhibit B-4, BCUC 1.1.3 and PNG Final Submission)

5.1 Background for the RCA and Tax Account

As described in Section 4.2.2, in 2004 PNG was granted an approval for a change to a partial accrual methodology for recovery of the NPPRB expense but the Commission directed PNG to create the RCA Trust Structure into which the amount in excess of the cash cost paid (the current service expense) was to be segregated and deposited. PNG's request for relief from this condition and the Commission's subsequent denial in 2004, as well as in 2011 and 2012, were also described as part of the chronology of the historical regulatory treatment of PNG's NPPRB plan.

The beneficiaries of the RCA Trust Structure are PNG retirees, so the funds withdrawn from the Trust can only be used to purchase benefits for retirees under the NPPRB plan. (Exhibit B-1, p. 12)

5.2 PNG's Rationale

PNG submits the RCA Trust Structure is an inefficient structure that, due to the poor investment returns which can be achieved, results in significant costs to PNG's ratepayers over time. PNG states it "is not supportive of a scenario where the RCA is funded with very large sums of money effectively locking in the very poor returns achievable under the structure for many years." (PNG Final Submission, p. 11)

PNG points out that in many aspects an RCA is very similar to a registered pension plan. Funds contributed to PNG's RCA Trust Structure can be used solely for the purpose of paying the costs of non-pension post-retirement benefit premiums on behalf of the beneficiaries/plan members. Like registered pension plan funding, contributions are tax deductible for the RCA sponsor.

However, the RCA Trust Structure is very inefficient compared with registered pension plan funding. When contributions are made to an RCA Trust, a 50 percent refundable tax is applied such that only 50 percent of the contributions actually go in to the trust. The 50 percent refundable tax is held by the CRA and earns no return or other compensation. When benefits are paid from the trust, 50 percent of that cost is then refunded from the tax account. PNG states it invests the RCA trust funds, much like it invests the funds of its registered pension plan. Yet, on an annual basis, 50 percent of the income earned in the RCA Trust must also be contributed to the refundable tax account (RTA). Since both contributions and income under the RCA Trust Structure are subject to the 50 percent refundable tax, while registered pension plan contributions and income are not, the RCA Trust Structure has the opportunity to earn a return of only one-half of the return of a registered pension plan.

PNG understands that the Commission denied its prior requests to wind-up the RCA Trust Structure because of a concern that PNG would not be in a position to pay the NPPRB premiums as they became due in the future in spite of the fact that the funds had previously been recovered from customers. In other words, PNG believes that it was not treated the same as other utilities under the Commission's jurisdiction because it was regarded by the Commission as too risky. (PNG Final Submission, pp. 11-12)

5.3 Analysis of PNG and the RCA Trust

5.3.1 Risk Profile

In the 2012 RRA, it was determined that PNG's financial stability has not improved since 2004, even after the recent change in ownership. PNG does not believe that there have been material changes to its risk profile since the 2012 RRA evidentiary record was closed.

PNG's unfunded pension and non-pension obligations to the plans' beneficiaries would be considered in the third party creditor category from the risk assessment point of view. PNG stated that its risk profile, as far as third party creditors would view it, is probably best measured by PNG's debt rating, which has been as follows over the period in question:

- Nov. 17, 2003 thru Aug. 31, 2005 – BBB(low) Stable
- Sept. 1, 2005 thru July 23, 2007 – BBB(low) Under Review – Negative Implications
- July 24, 2007 thru Aug. 10, 2009 – BBB(low) Negative Trend
- Aug. 11, 2009 thru current – BBB(low) Stable (Exhibit B-6, BCUC 2.17.2)

PNG's corporate risk profile on a stand alone basis was BBB(low) Stable in 2004 when the Commission directed the RCA Trust to be set up and currently remains the same.

5.3.2 Returns on the RCA Trust

PNG states that the RCA Trust Structure is inefficient and harms PNG's ratepayers. Based on the current investment mix, PNG's actuaries expect that pension plan asset to return on average 7 percent versus the NPPRB plans' asset return of 3.5 percent. This is directly due to half of the NPPRB plan assets being placed in the CRA refundable tax account. This impact on returns will increase PNG's NPPRB plan's expense throughout the entire life of the plans. (Exhibit B-1, p. 9, Exhibit B-4, BCUC 1.1.3)

Since January 1, 2004 through to December 31, 2012, PNG has recovered $2.498 million more in rates than its cash costs of NPPRB, all of which have been contributed to the RCA Trust Structure. (Exhibit B-6, BCUC 2.9.1) PNG stated that if the wind-up were approved it would use the funds in excess of those paid to retirees for general corporate purposes in exactly the same way it has utilized deferred income taxes previously recovered in rates, and provide a rate base credit in the after-tax cumulative amount of such funds recovered. (Exhibit B-4, BCUC 1.1.4)

Currently, benefits paid to retirees as well as contributions to the RCA Trust and refundable tax account are deductible for the purposes of calculating taxable income such that the full amount of the NPPRB expense recovered from customers is not taxable as income to PNG.

Under the scenario where PNG is approved to use the funds for general corporate purposes, only the retiree benefits paid would be tax deductible and not the additional expense that has been recovered from ratepayers in excess of the retiree benefits paid. However, the after-tax funds credited to rate base will earn a pre-tax (rate base) return for the ratepayers. (Exhibit B-4, BCUC 1.17.2.2)

Should the Commission approve the wind-up of the RCA, PNG stated that the plan asset will shrink resulting in an increase in the annual accrual expense, while it will be very difficult to predict what would happen to the accrued benefit obligation as there are more significant assumptions when measuring the obligation including the discount rate. PNG also stated that the future expense is difficult to predict due to the discount rate and its impact on net actuarial gains and losses. (Exhibit B-1, BCUC 18.2.1, 1.18.3.1)

5.3.3 Reconciliation with the Audited Financial Statements

Under the existing funding arrangement, the Regulatory Asset can be directly tied to the year-end financial statements because it is equal to the Funded Status plus the Unamortized Net actuarial Gains & Losses less the Forgone Transitional Obligation (from the regulatory statements). If the RCA Trust Structure funding arrangement is discontinued these balances will no longer be equal. (Exhibit B-6, BCUC 2.8.6)

Commission Determination

The Commission Panel is not prepared to approve the wind-up of the RCA Trust Structure at the present time for the following reasons:

1. There has been no demonstrated change in PNG's Risk Profile since the purchase of the Company by AltaGas Ltd. Moreover, PNG's risk profile is exactly the same today as it was when the 2004 decision to establish the RCA Trust was made.
2. Financial benefits from the wind-up seem undeterminable. For instance, in response to BCUC IR 17.2.2.1, PNG demonstrated the potential savings of winding up the RCA Trust Structure; however, several assumptions were made, which could significantly change the outcome of the analysis. PNG noted that changes in the discount rate and the impact on the net actuarial gains and losses are very hard to predict. These differences could have significant impact on the benefits shown in the IR response. The Panel acknowledges it is likely that there would be financial benefits to a wind-up of the RCA Trust Structure but the real benefits are very hard to predict. Although the RTA Trust Structure does not earn any interest, this benefit is offset by the fact that the amount in excess of the cash contribution will no longer be tax deductible and the compounding interest effect of the RCA Trust Structure. Finally, PNG stated that for each of the divisions the wind-up of the RCA Trust Structure would result in a change in rates in 2013 of less than half of a percent. (Exhibit B-4, BCUC 1.15.4, 1.15.5.1)
3. Maintaining the status quo will also keep future reconciliations and verifications more manageable. The current funding arrangement is easier to verify for rate making as all the excess funds are contributed to the RCA Trust Structure and the balance of the Regulatory Asset can be directly tied to the audited year-end financial statements and regulatory schedules. Furthermore, in the case of a wind-up, the funds would be used for general corporate purposes and not segregated for their intended purpose – paying future NPPRB.

Accordingly, the Commission Panel would expect that, except for a significant change in circumstances, the RCA Trust Structure is to stay in place for at least the next six years, after which the issue can be revisited.

The Panel directs that any NPPRB expense recovered in rates, including the amortization of the NPPRB Regulatory Asset and the transitional obligation, in excess of the cash cost of providing retiree benefits must continue to be contributed to the RCA Trust Structure.

In the future, if the NPPRB retiree benefits payments become greater than the accrual accounting expense recovered in rates, PNG must not request recovery of the difference.

6.0 AMORTIZATION OF THE REGULATORY ASSET

In Section 4.5, the Commission Panel approved the recognition of a Regulatory Asset equalling the historical unrecovered NPPRB expense at December 31, 2012. PNG provided three alternative methods for the recovery of this Regulatory Asset. Two methods are presented in the Application and an additional option was presented through the IR process that would be applicable if the Commission approved the wind-up of the Trust. The overview of these three methods is provided below.

Method 1: Fully amortize the Regulatory Asset in 2013 with an equal and offsetting concurrent amortization of PNG's deferred income tax balances. PNG would then contribute these funds, in the amount of $2.5 million, to its RCA.

This would involve PNG making a contribution of $2.5 million to the RCA from PNG's existing financial resources. PNG stated that while it believes it will have the liquidity required to make such a contribution, the process would have to be managed without adversely impacting PNG's marginal investment grade rating. In other words, while PNG is confident that it can manage the required contribution, it would be beneficial to have sufficient notice in order for PNG to manage its cash flows to avoid a sudden increase in PNG's debt leverage, which could result in a debt ratings downgrade. (Exhibit B-6, BCUC 2.16.1)

PNG states that Method 1 would be the most administratively simple but it would require the maintenance of the RCA Trust structure for many years to come even in the event that PNG were approved to wind-up the Trust (because it would be so large). Based on current assumptions, it would require an extended period of time (almost 20 years) to wind the Trust Structure up. (Exhibit B-1, p. 12)

Method 2: Amortize the Regulatory Asset straight-line over a period of 13 years. This would be the lowest rate of amortization that would still allow PNG to continue to recognize the Regulatory Asset and, therefore, avoid a write-down of this balance to retained earnings in accordance with US GAAP. The amortization is recovered in rates and contributed to PNG's RCA Trust Structure but there is not an equal and offsetting concurrent amortization of PNG's deferred income tax balances; rather the amortization is recovered in rates in each year and the deferred income balance is unaffected. Method 2 is reflected in the 2013 RRA requested rate increase and supporting schedules. (Exhibit B-1, p. 12)

If the 13 year amortization was offset against the deferred income tax regulatory account and contributions to the RCA Trust Structure were still required the annual depreciation and rate impact would be as follows:

Table 2 – 13 Year Amortization Offset Against Deferred Income Tax Account

Division	Amount ($000s)	Revenue Requirement Impact ($000s)	Rate Impact on RRA (%)
PNG-West	117	(153)	(0.47)
PNG(N.E.) FSJ/DC	26	(34)	(0.26)
PNG(N.E.) Tumbler Ridge	4	(5)	(0.31)

Source: Derived from Exhibit B-6, BCUC 2.16.3, 2.16.3.1

If the amortization period was changed to 6 years (to match the Foregone Transitional Liability) and offset against the deferred income tax regulatory account and contributions to the RCA Trust structure were still required, the annual depreciation and rate impact would be as follows:

Table 3 – 6 Year Amortization Offset Against Deferred Income Tax Account

Division	Amount ($000s)	Revenue Requirement Impact ($000s)	Rate Impact on RRA (%)
PNG-West	254	(149)	(0.45)
PNG(N.E.) FSJ/DC	55	(33)	(0.25)
PNG(N.E.) Tumbler Ridge	8	(5)	(0.30)

Source: Derived from Exhibit B-6, BCUC 2.16.4, 2.16.4.1

Method 3: Fully amortize the Regulatory Asset with an equal and offsetting concurrent amortization of PNG's deferred income tax balances with a wind-up of the RCA Trust Structure and a rate base credit for the NPPRB funds recovered in rates in excess of the cash costs of paying NPPRB premiums.

<u>PNG Final Submission</u>

PNG submits that Method 3 is the most favourable solution for its customers, while meeting all US GAAP requirements. However, PNG recognizes that the Commission may not want PNG to commence winding up its RCA Trust Structure in spite of its inherent inefficiencies. In that event, PNG submits that Method 2, where the Historical Unrecovered NPPRB Expense is amortized into rates over 13 years and the amounts recovered are contributed to PNG's RCA, is the most appropriate solution since it provides the most flexibility in the future should the Commission determine that PNG's financial circumstances have improved and contributions to the RCA are no longer required or desirable. (PNG Final Submission, pp. 13-14)

<u>BCPSPO Final Submission</u>

BCPSO submits that the analogy between NPPRB recovery and the drawdown of deferred income taxes is flawed: for utilities, the deferred tax issue arises because the utility is collecting amounts from ratepayers in respect of income taxes that may never, and in the case of a utility with increasing rate base, will likely never be paid by the utility. On the contrary, NPPRB will certainly be paid. Therefore, BCPSO rejects this analogy.

Notwithstanding the preceding, BCPSO submits it is persuaded of the inefficiency associated with funds put into the RCA and therefore supports Method 3 as an appropriate method for recovering the $2.5 million of NPPRB at issue. (BCPSO Final Submission)

In reply, PNG submits it respects the BCPSO's position that PNG's analogy between NPPRB recovery and the drawdown of deferred incomes is flawed. However, "PNG stands by its position that, like NPPRB expense, the deferred income taxes previously collected will ultimately be paid by the utility, albeit possibly over a long timeframe." (PNG Reply Submission, p. 2)

Commission Determination

As the Commission Panel already denied the wind-up of the RCA Trust Structure, commencing in 2013, Method 3 is not further considered. The Panel notes that Method 1 has a number of advantages but appreciates the cash flow challenges PNG might be facing when making a $2.5 million one-time cash contribution to the RCA from existing financial resources.

This leaves the Panel with Method 2 to consider. The Regulatory Asset is based on pension expense in the past being lower that what was required under GAAP and recovery of the balance will allow PNG to recover those historic unrecovered expenses. Recovery of the amortization from current ratepayers can create an intergenerational equity concern. However, because PNG has a deferred income tax balance collected from past ratepayers, amortizing the Regulatory Asset against the deferred income tax balances would resolve that concern and result in more fair rates.

The Panel finds that 13 years is too long a period. Furthermore, the rate impact of a six year amortization period seems almost the same as the 13 year amortization, except that the rate impact will be eliminated after six years. A six year period is also appropriate as it matches exactly with the treatment provided in the 2012 RRA for the Foregone Transitional Obligation and will also add to some efficiencies. **Based on the above analysis, the Commission Panel determines that the NPPRB Regulatory Asset Deferral Account must be amortized over six years, commencing January 1, 2013, with an equal and offsetting amortization of the deferred income tax balance. The NPPRB deferral account must be closed when fully amortized.**