Treatment of Pension Costs for Regulatory Decision-Making

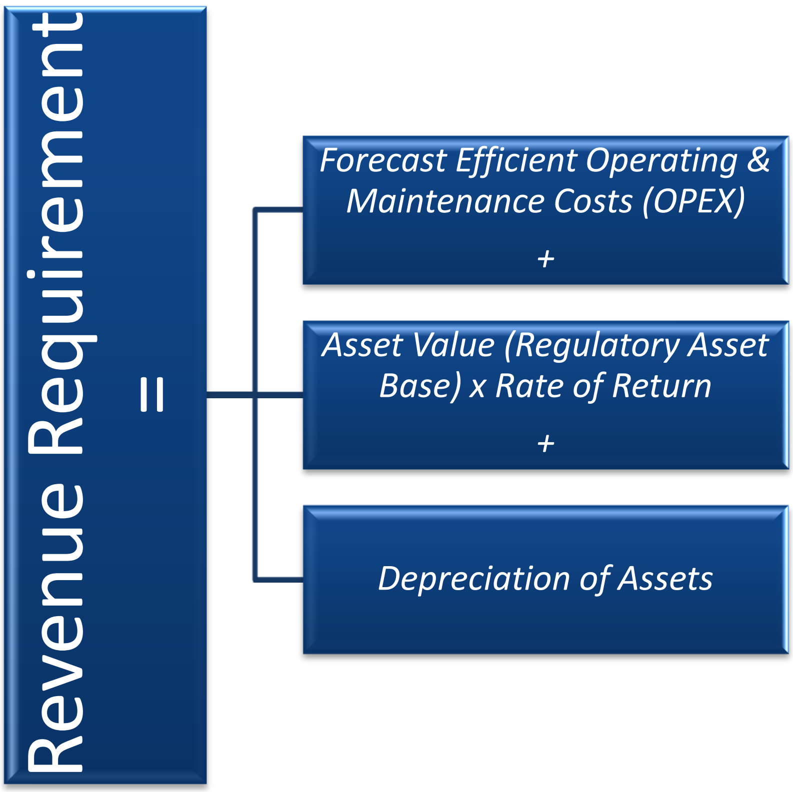
January 2018

This document is a summary of the RIC's consultative paper exploring a specific aspect of the treatment of pension costs for regulatory decision making in the electricity sector.

Summary Document

Why Assess Pension costs for Rate Reviews

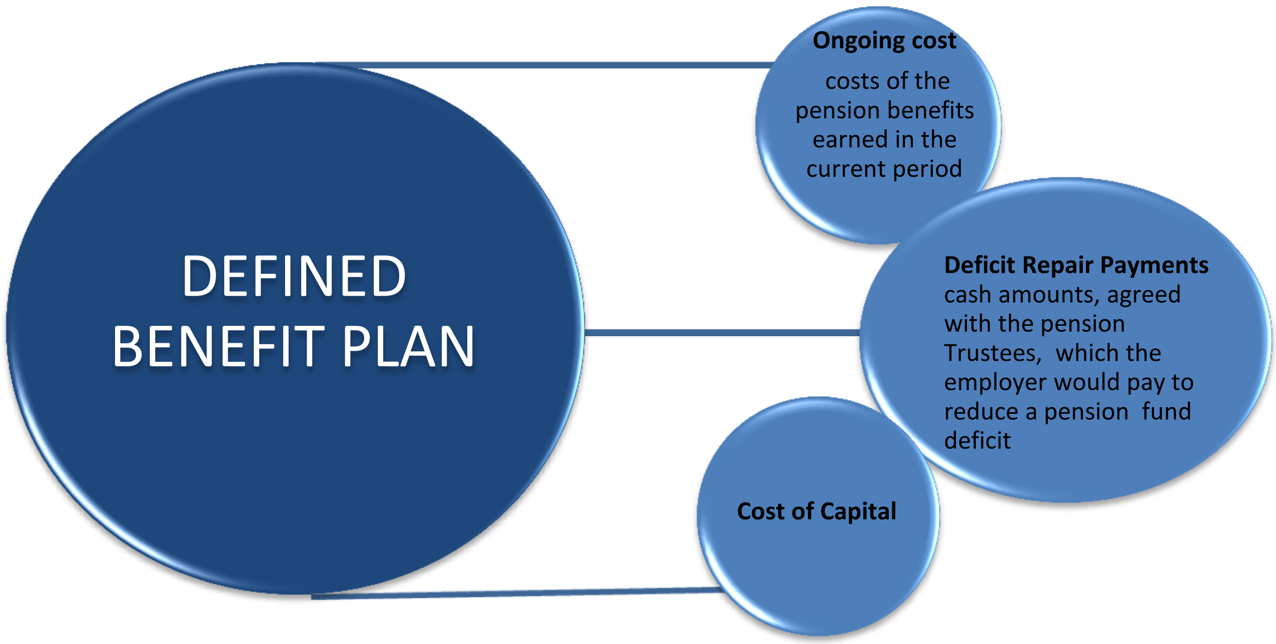
The Regulated Industries Commission's (RIC) core duty is to set price limits that allow an efficient utility to properly finance its operations. The RIC utilizes a "building block" methodology to determine the total revenue requirement that the service provider can collect from customers via tariffs. This methodology derives a total revenue requirement from the following cost components:



As part of setting the revenue requirement, the treatment of pension costs is one area of importance considered in operating expenditure.

RIC's Principles for Assessing Pension Cost

The RIC will assess allowed pension costs based on its principal duties and functions as set out in the RIC's Act which require it to consider only efficient costs.. There are two types of pension plans, which include the Defined Contribution plans[1] and the Defined Benefit plans.[2] T&TEC currently operates a Defined Benefit plan for its permanent employees. There are three issues that arise with respect to a Defined Benefit plans and these are shown in the diagram below.



These issues are important and relevant to regulators for assessing the efficiently incurred costs of providing regulated services which ultimately impact final tariffs. Furthermore, in the first rate review for the period 2006 - 2011, only the ongoing pension costs were taken into account for T&TEC. The problem arises when deficit repair payments are to be funded by employers (service providers) to reduce the pension fund deficit through regulated charges. Related to this issue of deficit refund payments is whether the deficit would be funded by a loan taken out by the service provider and thus be included in the cost of capital. The RIC proposals concerning the three issues relating to the defined benefit plan are shown below.

[1] With a defined contribution plan the employer pays fixed contributions into a separate entity (a fund) and has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service.
[2] With a defined benefit plan, the employer is obligated to pay an employee the agreed pensionable amount regardless of the pension plan's performance.

RIC’s Proposals for the treatment of Pension Costs and other related issues

Ongoing Pension Costs

- The ongoing pension costs include all employee and employer contributions made to T&TEC’s pension plan and are a legitimate expense and the RIC must, therefore, include T&TEC’s contribution towards the pension plan in the determination of tariffs.

Deficit Repair Payments

- The RIC proposes that any loss incurred in the pension plan due to high risk investments (pension deficit payments) should not be passed onto customers when setting regulated charges, as this deficit may be as a result of management’s poor decision-making in managing its pension plan assets.
- The exclusion of deficit repair payments would be quite consistent with the RIC’s duties as set out in the Act, especially with respect to the promotion of economy and efficiency.

Cost Of Capital

- The RIC’s proposes not to allow deficit repair payments in price controls, as such it would be inconsistent to make any adjustment to the cost of capital. The service provider must bear the risks and rewards of the pension scheme.

All of these issues are fully discussed in the main document.

The RIC invites comments and views on all the ideas presented in this paper

Responding to the Document

All persons wishing to comment on the main document are invited to submit their comments by February 9th, 2018 by post, fax or e-mail to:

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All responses will normally be published on the RIC's website unless there are good reasons why they must remain confidential. Any requests for confidentiality must be indicated. A copy of this document is available from the RIC's website at **www.ric.org.tt.**