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Christine Long  
Registrar  
Ontario Energy Board  
P.O. Box 2319  
2300 Yonge Street, 27<sup>th</sup> Floor  
Toronto, ON M4P 1E4

Dear Ms. Long,

## **RE: EB-2021-0212 - Review of Inflation Factors Used to Set Rates for the Year 2022 – Submissions of London Property Management Association**

### **Introduction**

The Ontario Energy Board (“OEB”) issued a Notice on its own motion to initiate a proceeding to consider the inflation factor to be used to set rates for electricity transmitters and electricity and natural gas distributors on August 6, 2021.

This notice was prompted by preliminary calculations of the inflation factors for 2022, as compared for 2021. While the change for Enbridge Gas Inc. (“Enbridge”) (which is not impacted by labour inflation) was a decrease from 2.0% to 1.7%, the increase for electricity transmitters was from 2.0% to 2.5% and for electricity distributors and EPCOR was from 2.2% to 3.3%.

These latter increases were driven by a significant increase in the labour inflation component of the inflation factor, Average Weekly Earnings (“AWE”) for all business in Ontario, including overtime. The increase in the AWE was about 7% in 2020, compared to 2.7% in 2019. Over the 2002 through 2019 period the increase in the AWE average about 2.3% (Appendix D of Schedule B to Procedural Order No. 1). The impact of the increase in the AWE for electricity distributors and EPCOR is larger than for electricity transmitters because of the higher weighting of 30% for the electricity distributors and EPCOR relative to the 14% used for electricity transmitters in the calculation of the inflation factor.

The unusual increase in the AWE, according to Statistics Canada, was caused largely by temporary and permanent layoffs due to COVID-19 restrictions that disproportionately affected lower wage-earning workers and is explained in detail on pages 7-9 of Schedule B in Procedural Order No. 1. This prompted the OEB to initiate this generic proceeding.

The following are the comments of the London Property Management Association (“LPMA”) with respect to the inflation rates to be used for 2022.

### **Scope of the Proceeding**

The OEB has indicated that this proceeding will focus solely on determining the values for 2022 inflation factors that would result in just and reasonable rates when used in rate adjustment applications for rates

effective in 2022. The OEB has further indicated that this proceeding is not intended to be a review of the overall inflation factor methodology and formula, or the existing framework for setting rates through annual Price Cap IR, Annual IR, Revenue Cap IR or similar rate adjustment options made available by the OEB.

While agreeing that the inflation methodology and formula should remain out of scope for this proceeding, LPMA cautions the OEB that the method ultimately used to determine the values for the 2022 inflation factor will have consequences for the determination of the inflation factor for 2023 and 2024 and potentially longer, depending on the length of the economic impacts associated with the COVID-19 pandemic.

For example, if the OEB were to determine that it would continue to apply the existing methodology and formula, including the existing indices, to the 2022 rate adjustments, then it should continue to do this in the determination of the 2023 rates regardless of what the indices are that would be used in the 2023 determination. As an example, the significant increase in the AWE of approximately 7% in 2020 is driving up the inflation index calculated for 2022. If the actual AWE for 2021 (used to calculate the 2023 inflation index) is close to zero, or even negative, as the number of lower paying jobs begins to recover to pre-pandemic levels, then the OEB should not use a different approach for 2023. It would not be just and reasonable for ratepayers to shoulder the burden of a higher inflation rate for 2022 but not benefit from a lower rate in 2023. Similarly, if the OEB were to determine that a lower inflation rate should be used for 2022 than results from the formula, it would not be appropriate to revert to the formula for 2023 in the AWE is significantly lower than usual (or negative). This would not be fair to the distributors.

In summary, regardless of what the OEB determines to be just and reasonable in setting the 2022 inflation factor, it should recognize that this determination will have consequences on the setting of the 2023 – and perhaps 2024 – inflation factor.

### **No Change in the Use of GDPIPFDD**

The OEB has used the Gross Domestic Product Implicit Price Index for Final Domestic Demand (“GDPIPFDD”) as a measure of inflation for many years, including in both the 2<sup>nd</sup> and 3<sup>rd</sup> Generation Incentive Rate-setting Mechanisms as a one-factor inflation factor for annual rate adjustment applications. It continues to be the sole inflation factor used for Enbridge in their 2019-2023 price cap rate adjustment plan.

A review of Appendix C of Schedule B in Procedural Order No. 1 shows that the GDPIPFDD inflation factor of 1.7% for 2020 that is used in the calculation of the overall inflation factors is very close to the average of about 1.8% over the 2002 through 2019 period. Schedule C also shows that the GDPIPFDD inflation factor is relatively stable, ranging from a high of 2.5% to a low of 1.0% over this period.

LPMA submits that the OEB should continue to use the GDPIPFDD as calculated by Statistics Canada in the calculation of the inflation factor. It is a stable measure of inflation and constitutes the major portion of the inflation factors for utilities in Ontario (100% for Enbridge, 86% for electricity transmitters and 70% for electricity distributors and EPCOR).

LPMA notes that in the OEB Option 2 the OEB would ignore the GDPIPFDD for 2020 and use the 2021 inflation factor for 2022. LPMA disagrees with this approach for the reasons provided above. The only component that should be reviewed as part of this generic proceeding is the AWE measure of labour inflation.

## **OEB Option 1**

*Continue to apply the existing methodology and formula (including the existing inflation indices) to the 2022 rate adjustments.*

The benefit of this option is that it maintains the current approved formula used to calculate the inflation factor, with no changes in the use of the AWE as the labour component of the calculation. Changes in the labour component of the formula should only be done as part of a comprehensive review of alternative indices.

The cost of this option is an inflated inflation factor that is driven by COVID-19 impacts on job losses for lower wage workers. This results in an undue burden on ratepayers because the inflation factor is artificially higher than it would be in the absence of the impact of COVID-19 on the calculation of the AWE index.

Another cost associated with this option would be the uncertainty associated with future inflation factor increases in 2023 and possibly beyond. As the labour force returns to pre-pandemic norms, it may be that more and more of the lower wage workers that lost their job as a result of the COVID-19 restrictions will rejoin the based used to calculate the AWE. This will put downward pressure on the AWE and may, depending on the speed and magnitude of these workers rejoining the work force, drive it into negative territory. Distributors may see a significant decline in the inflation factor for 2023 if this were to happen and would likely pressure the OEB to change the calculation of the inflation factor. This would not be just and reasonable to ratepayers who would have accepted a higher than average inflation factor in 2022 only to be denied a lower than average inflation factor in 2023.

If the OEB were to opt to continue to apply the existing methodology and formula, including the existing inflation indices, in the calculation of the 2022 rate adjustments, LPMA submits that it should take this higher inflation factor into consideration when it comes to the disposal of COVID-19 deferral/variance account balances. Statistics Canada has made it clear that the AWE index is increasing in large part due to the impacts on the hourly work force that directly related to shutdown due to COVID-19 restrictions imposed by governments. It would not be just and reasonable to ignore this impact on 2022 and future year rates paid by ratepayers while at the same time burdening those same customers with COVID-19 related costs. In particular, LPMA submits that the Exceptional Pool of costs should be reduced to reflect the OEB approval of the continuation of the existing methodology and indices, if it chooses to do so.

The impact on a distributor or transmitter could be measured simply at the time of the application of the inflation factor, by calculating the difference between the inflation factor using the approved methodology and indices and the inflation factor that would result from the use of the 2019 AWE increase. The following shows the calculation of this difference for an electricity distributor, assuming GDPIIFDD of 1.7%, AWE of 7.0% for 2020 and 2.7% for 2019.

|                                       |                                           |                        |
|---------------------------------------|-------------------------------------------|------------------------|
| Existing Methodology & 2020 AWE Index | $- 1.7\% \times 70\% + 7.0\% \times 30\%$ | $= 3.29\%$             |
| Existing Methodology & 2019 AWE Index | $- 1.7\% \times 70\% + 2.7\% \times 30\%$ | $= \underline{2.00\%}$ |
| Difference                            |                                           | 1.29%                  |

This difference of 1.29% would be calculated for the distributor based on the last approved billing determinants and credited to the Exceptional Pool. In the EB-2020-0133 Report of the Ontario Energy Board, dated June 17, 2021, the OEB stated that it would allow recovery of the costs necessary to comply with government or OEB actions aimed at providing relief to customers in response to the pandemic. This should be a two-way street. LPMA submits that if the OEB chooses this option, its action of applying an artificially high and COVID-19 caused inflation rate should be taken into account.

## **OEB Option 2**

*Extend the approved value for 2021 inflation rates for 2022 rate adjustments.*

LPMA does not support the extension of the approved value of the 2021 inflation rates for 2022 rate adjustments as this would, for example, increase the inflation factor used by Enbridge for 2022 rates from 1.7% to 2.0%.

As noted above, LPMA submits that the continued use of the most recent GDPIPIFDD inflation measure in the calculation of the overall inflation factor is appropriate, as it remains a stable influence in the calculation of that factor. Further, LPMA submits that if the OEB were to pick this option, it should not be applicable to Enbridge. The inflation adjustment for Enbridge does not include a labour component, which is the subject of this proceeding.

Using the 2021 inflation rates would also ignore the decrease in the GDPIPIFDD inflation factor for the electricity distributors and EPCOR and the electricity transmitters (from 1.9% to 1.7%).

As indicated in the Fact Sheet included in Schedule B of Procedural Order No. 1, the uncharacteristic increase in the input price index (“IPI”) for 2022 electricity distribution (and EPCOR) and transmission is solely from the labour component of the IPI. LPMA submits that there is no valid reason for ignoring the largest component (70% for electricity distributors and EPCOR, and 86% for the electricity transmitters) in the setting of the 2022 IPI.

LPMA would, however, support the use of the 2.7% increase in AWE that was used in the setting of the 2021 IPI, while incorporating the actual GDPIPIFDD figure for 2020. This would result in the following inflation factors for 2022 (there would be no change to the 1.7% used for Enbridge):

Electricity Distributors & EPCOR:  $1.7\% \times 70\% + 2.7\% \times 30\% = 2.00\%$   
Electricity Transmitters:  $1.7\% \times 86\% + 2.7\% \times 14\% = 1.84\%$ .

This approach is just and reasonable in that it reflects the use of the most recent actual figure (2020) for the major component (GDPIPIFDD) in the calculation of the inflation factor, recognizing that this component is relatively stable over time.

This approach would also eliminate the need to calculate an adjustment to the Exceptional Pool noted above under OEB Option 1.

This option could also be used on a going forward basis for 2023 and beyond by simply adjusting the AWE component in the future in order to return to using the most recent data available for the AWE. This would be appropriate as the impact of the COVID-19 impacts on the labour market are gradually removed from the calculation of the AWE over time. For example, if the AWE increase for 2021 was 1.0%, the AWE used in the calculation of the 2023 inflation factor could reflect the 7% increase in 2020 and the 1% increase in 2021, as well as the 2.7% used in the 2022 calculation (i.e.  $7\% + 1\% - 2.7\% = 5.3\%$  (ignoring compound impacts for simplicity)). If the OEB considered the 5.3% increase in the AWE to be used in the 2023 calculation as still being too high, it could further smooth out the increases used into 2024 and/or future years.

The advantage of this approach is a smoothing of rate increases over a number of years, while at the same time, maintaining the use of the AWE and eventually having the labour component used in the OEB formula having a cumulative increase that matches that of the AWE.

A disadvantage of this approach is that it may require adjustments to the AWE component of the inflation factor calculation to be made for several years in the future.

### **OEB Option 3**

*Update the 2022 inflation rates under the existing methodology using a suitable sub-index of Average Weekly Earnings or a related statistic, Average Hourly Earnings, that is more representative of labour inflation expected to be experienced by distribution and transmission utilities in 2022.*

The major problem that LPMA sees with this approach is that there is no clear indication of what labour inflation is expected to be experienced by distribution and transmissions utilities in 2022, or in the economy as a whole. The impacts on the labour force of the COVID-19 emergency are still being felt late into 2021 and will likely persist in 2022 and potentially even beyond.

LPMA also does not support the use of the Consumer Price Index ("CPI"), or any of its sub-indices as a replacement for the AWE. As the name indicates, the CPI is a measure of consumer inflation and not of labour inflation. For example, the CPI includes components, such as food and housing, which do not directly impact utilities.

If the OEB is looking for a stable index to temporarily replace the Ontario AWE in the calculation of the inflation factor for 2022, LPMA submits that it should stay within a narrow range of labour inflation statistics. For example, it should maintain the use of an Ontario specific labour inflation indicator, and not a Canada-wide based one.

The OEB should also avoid the use of sector specific inflation rates for utilities, whether in aggregate or split out for natural gas distributors and electric power generation, transmission and distribution, as these indicators are much more volatile than the industrial aggregate excluding unclassified businesses currently used for the AWE. As an example, the Ontario utilities inflation factor has ranged from a high of 8.0% to a low of -5.9% over the 2002 through 2019 period, whereas the industrial aggregate has ranged from 1.1% to 3.8% over the same period. For 2020, the utilities increase is actually a decline of 0.6%, compared to the increase of 7.0% for the industrial aggregate. Further, Statistics Canada generally recognizes that the quality of the data used for the utilities sector is less than it is for the industrial aggregate.

The same is true with respect to average hourly earnings for the utility sector in both Canada in Ontario. In fact, for several years, Statistics Canada classifies this data as too unreliable to even report.

A review of the breakdown of the AWE factor used by the OEB (i.e. Ontario industrial aggregate including overtime and excluding unclassified businesses) on page 28 of Appendix D to Schedule B of Procedural Order No. 1 shows that the significant increase in 2020 of 7.0% is largely the result of an 8.7% increase in employees paid by the hour, somewhat moderated by a 3.5% increase for salaried employees paid a fixed salary.

The industrial aggregate data for Ontario shown on page 28 noted above illustrates two things of importance. First, the average increase for all employees over the 2002 through 2019 period is 2.28%, very similar to the average increase of 2.16% for salaried employees, versus a 1.93% for hourly employees. Second there is a high degree of correlation of the increases between all employees and salaried employees (0.815) as compared to between all employees and hourly employees (0.432) or between salaried employees and hourly employees (0.193).

Based on the high correlation between all employees and salaried employees, along with the average increases over the 2020 to 2019 period, which is 2.2% for both categories rounded to one decimal place, LPMA submits that the 3.5% increase in 2020 for salaried employees would be an appropriate substitute for the 7.0% shown for all employees, given the level of historical correlation and averages over the 2020 through 2019 period.

The use of the 3.5% in place of the 7.0% for the AWE would result in the following inflation factors:

Electricity Distributors & EPCOR:  $1.7\% \times 70\% + 3.5\% \times 30\% = 2.24\%$

Electricity Transmitters:  $1.7\% \times 86\% + 3.5\% \times 14\% = 1.95\%$ .

If the OEB chooses Option 3, LPMA submits that an appropriate substitute for the AWE is the AWE for salaried employees. This approach maintains the use of an Ontario based labour inflation factor and uses a component of the factor that is currently used in the formula that is highly correlated with the current factor, but one which reduces the volatility in the 2020 increase.

### **An Additional Option – Use GDPIPIFDD Only**

As the EB is aware, the GDPIPIFDD was first used as the inflation measure for IRM applications for electricity distributors as part of the 2<sup>nd</sup> Generation IRM in EB-2006-0088. It was selected for use by the natural gas distributors in the same general time frame.

This statistic continued to be used as the measure of inflation for electricity distribution IRM purposes for the 3<sup>rd</sup> Generation IRM in EB-2007-0673 and was subsequently selected as the non-labour component of the two-factor inflation factor for the 4<sup>th</sup> Generation IRM in EB-2010-0379.

GDPIPIFDD continues to be used as the sole inflation factor for Enbridge's price cap IRM for 2019-2023.

LPMA submits that the GDPIPIFDD measure of inflation has been used successfully for many years in both the electricity and natural gas sectors. It has historically been a very stable measure of domestic inflation, ranging from a low of 1.0% to a high of 2.5% and averaging 1.8% over the 2002 through 2020 period (Appendix C of Schedule B of Procedural Order No. 1). This stability leads to stable increases in rates that are determined through IRM applications. Unlike the issue raised by the increase in the AWE labour component in 2020, there have been no issues related to the use of the GDPIPIFDD.

LPMA believes that the OEB should seriously consider use of the GDPIPIFDD as a one-factor inflation factor for setting the 2022 value. This is because all of the labour related measure of inflation, whether they be for Ontario or Canada, for the industrial aggregate of industries or specific sectors of the economy, and whether for all employees or salaried employees or hourly paid employees, have all been impacted by the COVID-19 related shutdowns and impact on employment.

Gross domestic product ("GDP") is the value of all goods and services produced in the economy and this value is driven by the costs of inputs into the production of the goods and services. These inputs include materials, cost of capital assets including financing, and labour. In other words, the impact of labour is already included in the GDPIPIFDD. While the weighting of labour in the GDPIPIFDD may be different than what is used in the two-factor inflation factor calculation for electricity distributors and transmitters, its inclusion ensures that the impact of labour-related inflation is taken into account.

Rather than trying to find a suitable replacement for the AWE component of the inflation calculation, LPMA submits it is more appropriate to remove the labour factor from the two-factor inflation calculation for 2022 and to revert, for 2022, to a one-factor inflation calculation that uses the GDPIPIFDD to represent inflationary pressures.

### **Summary**

LPMA has ranked the four options discussed above in order of preference based on the comments provided above.

LPMA believes that the preferred option for the calculation of the 2022 inflation factor would be to simply use the GDPIPIFDD growth rate in 2020 of 1.7% for all utilities.

The second best option would be OEB Option 2, assuming that the actual 2020 figure for GDPIPIFDD continues to be used in the formula, and only the AWE factor is held at the actual 2019 rate.

The third best option would be OEB Option 3, with the AWE replaced with the AWE for salaried employees. In LPMA's view, this is similar to OEB Option 2 (excluding the impact on Enbridge) of simply using the 2021 inflation rates for 2022 for the electricity distributors and EPCOR and for the electricity transmitters.

The worst option, in the view of LPMA, is OEB Option 1. This option increases rates to ratepayers as a direct result of the COVID-19 impact on the calculation of the AWE and provides no assurances as to what may or may not happen when it comes time to calculate the 2023 inflation rate. As discussed in the comments above, these impacts can be addressed, but at the cost of added complexities. If the OEB picks this option, LPMA submits that it needs to take into account the COVID-19 impact on rates and ratepayers, especially for any distributor that applies for disposition of Exceptional Pool related costs.

Yours very truly,

Randy Aiken  
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