EB-2021-0212

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF a proceeding commenced by the Ontario Energy Board on its own motion to consider the values of the inflation factors to be used in rate adjustment applications for rates effective in 2022

SUBMISSIONS BY THE COALITION OF LARGE DISTRIBUTORS

October 1, 2021

SECTION 1: INTRODUCTION

The Coalition of Large Distributors ("CLD") is comprised of Alectra Utilities Corporation, Elexicon Energy Inc., Hydro One Networks Inc., Hydro Ottawa Limited and Toronto Hydro-Electric System Limited. Each of the members of the CLD has intervened individually in this proceeding. In the interests of regulatory efficiency, the CLD will provide a single submission on behalf of all its members.

Collectively, the members of the CLD provide service to approximately 70% of the electricity distribution customers in Ontario. The members of the CLD serve customers in rural, suburban and urban areas of the Province, including industrial, small business, commercial, government and institutional customers of all sizes and many residential customers. The unified voice of the CLD offers the Ontario Energy Board (OEB) a unique perspective on the implications of regulatory issues such as the issue under consideration in this proceeding.

These submissions are filed by the CLD in accordance with Procedural Order No. 1 ("PO#1") issued by the OEB on August 27, 2021. PO#1 refers to the OEB's Notice that was released on August 10, 2021 ("Notice"). In the Notice, the OEB said it was initiating this proceeding to consider the inflation factor to be used to set rates for 2022. PO#1 also referred to analysis showing that the 2019 to 2020 increase in the labour inflation component of the inflation factor was "caused largely" by temporary and permanent layoffs due to COVID-19 restrictions disproportionately affecting lower wage-earning workers.

The CLD is sensitive to the impacts of the COVID-19 pandemic that have been experienced by Ontarians. Through the course of the pandemic, CLD members (and other Ontario utilities) have supported their customers in many different ways. Efforts by CLD members to support customers have included, but are certainly not limited to, voluntary extension of disconnection moratoria, efficient administration of the COVID-19 Emergency Assistance Program, expedient implementation of emergency commodity rates and everyday customer service to work with customers on payment options.

However, the pandemic has not lessened the importance of a principled, predictable approach to rate-setting by the OEB. Indeed, it is all the more important that the OEB follow a steady, principled, predictable approach during uncertain times like those of the COVID-19 pandemic.

The predictability of the regulatory framework is a consideration of ratings agencies and lenders when utilities seek capital in markets. To the extent that a jurisdiction is perceived as predictable, utilities are more easily able to attract capital at favourable rates for customers. This is evident in the criteria used by rating agencies to evaluate the creditworthiness of utilities. For example, Standard & Poor's indicates the following criteria used in the assessment of risk:

Regulatory stability

- *Transparency of the key components of the rate setting and how these are assessed*
- *Predictability that lowers uncertainty for the utility and its stakeholders*
- *Consistency in the regulatory framework over time.*[1]

Under the headings below, the CLD will comment on the background to this proceeding, and it will provide submissions on a principled approach to the issue regarding the 2022 inflation factor set out in the Notice and PO#1.

SECTION 2: BACKGROUND TO THIS PROCEEDING

As stated in the Notice, the OEB made preliminary calculations of inflation values for the purpose of 2022 rate adjustments. The results of these preliminary calculations led the OEB to review "reasons for the changes in the inflation rates" and "the differences in the inflation rates between … energy sectors".

The comments in PO#1 pertaining to reasons for changes in the labour component of the inflation factor refer to information issued by Statistics Canada in "The Daily". The issue of "The Daily" referred to in PO#1 was released on July 29, 2021 ("July 29th Daily"). The July 29th Daily says that the increase in Average Weekly Earnings ("AWEs") from April to May of this year was caused "in part" by the concentration of employment losses in lower paying industries.

The July 29th Daily also says that AWEs were higher in May of this year than February 2020 and that this increase "reflects a number of factors". The July 29th Daily notes inflation in earnings not only for hourly workers, but also for salaried employees, during the time of the COVID-19 pandemic.

While the July 29th Daily refers to a number of factors, the record of this proceeding lacks details about the factors driving the increase in AWEs and the proportionate or relative impact of the factors. Also, there is no evidence addressing the extent to which other impacts on costs of utilities – such as those arising from supply chain issues – could or will have an inflationary effect in 2022.

[1] Key Credit Factors for the Regulated Utilities Industry, S&P Global Ratings, November 19, 2013, p. 4.

The Notice and PO#1 are focused on one factor affecting the increase in AWEs and do not provide a broader perspective on inflationary cost pressures in the Canadian economy. Although it is not used for the purposes of the OEB's rate-setting frameworks, the Consumer Price Index ("CPI") is a broad indicator of inflation in Canada as seen through the lens of price changes experienced by consumers. According to information released by Statistics Canada on September 15, 2021, the CPI rose 4.1% on a year-over-year basis in August, "the fastest pace since March 2003".[2]

Furthermore, the issue of The Daily released by Statistics Canada on August 31, 2021 ("August 31st Daily"), includes information about the Gross Domestic Product – Implicit Price Index, under the heading "Continued rise in prices and nominal gross domestic product". In this context, the August 31st Daily says: "The GDP implicit price index, which reflects the overall price of domestically produced goods and services, rose 2.2% in the second quarter, driven by prices of construction materials and energy. This growth followed a 3.0% increase in the first quarter."[3]

Finally, as post-pandemic recovery takes place, it is to be expected that the effect of the pandemic relied on by the OEB as the reason for this proceeding will turn the other way. In other words, to the extent that the increase in the labour inflation component is to be attributed to pandemic impacts "disproportionately affecting lower-earning workers", then, when that disproportionate impact ends, there will be an opposite decrease in the labour inflation component. An improvised, one-year change of methodology for 2022 would be unbalanced and unfair because it would adjust for a perceived impact in one direction in one year, without allowing for, or even recognizing, the impact in the opposite direction that will occur in the future.

SECTION 3: OPTIONS

The Notice identified three options that the OEB is considering. The first ("Option 1") is to continue to apply the existing methodology and formula (including the existing inflation indices) for 2022 rate adjustments. The second ("Option 2") is to extend the approved values for 2021 inflation rates for 2022 rate adjustments. The third ("Option 3") is to "update" the 2022 inflation rates under the existing methodology using a suitable sub-index of AWEs or a related statistic, Average Hourly Earnings.

The submissions of the CLD with regard to these options follow.

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[2] https://www150.statcan.gc.ca/n1/daily-quotidien/210915/dq210915a-eng.htm
[3] https://www150.statcan.gc.ca/n1/daily-quotidien/210831/dq210831a-eng.htm

Option 1

The elements of the OEB's rate-setting frameworks are the result of careful consideration during the course of policy consultations and other proceedings. They were arrived at through a principles-based approach and through expert evidence which informed decision-making. Principles-based methodologies for determining elements of rate-setting frameworks such as the inflation factor have been in place for a number of years and have proven their durability over time.

An ad hoc departure from the OEB's principles-based rate-setting methodologies due to a relatively small and perhaps transitory labour market phenomenon runs counter to the predictability of rate-setting, which, as noted in Section 1, above, is an important goal and outcome of regulation. The consistent use of objective measures that have proven their durability in established rate-making methodologies fosters predictability. Ad hoc re-assessment of carefully and objectively determined measures used in setting rates undermines the predictability of regulation.

Moreover, if changes are made without a principled basis to guide when any such re-consideration can or should occur, predictability suffers all the more. Deviating from established methodologies sets a precedent that deviations can be made on an ad hoc basis, yet there is no principled basis or standard to guide such deviations now or for the future. If a level of variability in one component of one factor means that it is open to re-examination, then there is no principled basis why variability should not drive re-consideration of any or all components of the rate-making model or formula.

The OEB's recent consideration of prescribed interest rates for Deferral and Variance Accounts (DVAs) is a helpful illustration of the point that variability, or even volatility, in data used for a particular regulatory methodology should not drive the OEB to depart from a principles-based approach.

In its letter of June 16, 2020 regarding 2020 Q3 prescribed interest rates for DVAs, the OEB referred to interest rate volatility resulting from the COVID-19 pandemic. The OEB noted that the referenced rate for the DVA prescribed interest rates (the three-month Banker's Acceptance rate) had been declining sharply in line with reductions in the Bank of Canada's key overnight rate. The OEB also noted that other central banks had reduced key rates precipitously and that Canadian corporate bond yields had shown volatility.

In these circumstances, the OEB set the 2020 Q3 DVA prescribed interest rate at 1.38%, with a view to maintaining stability for the interest rates in light of the unprecedented state of emergency arising from the COVID-19 pandemic. The 1.38% rate was calculated as the average of the posted 2020 Q2 interest rate of 2.18% and the 2020 Q3 interest rate of 0.57%, both calculated with the OEB's Approved Prescribed Interest Rates methodology. The OEB stated that it would continue to monitor market conditions and it invited stakeholders to provide comments on factors the OEB should consider when setting the interest rates for 2020 Q4.

However, after consideration of comments filed by stakeholders, the OEB issued a letter on July 30, 2020 in which it revised the 2020 Q3 prescribed interest rate for DVAs that had been set at 1.38%. In the July 30th letter, the OEB noted that intervenors had "generally asked the OEB … to use the existing approved methodology" for the 2020 Q3 DVA prescribed interest rate. The OEB acknowledged comments by stakeholders and re-established the 2020 Q3 DVA prescribed interest rate at 0.57%.

The OEB has shown leadership in relying on careful, rigorous and forward-looking processes to develop elements of rate-setting frameworks that are durable over time. The risk of an ad hoc adjustment to an element of a rate-setting framework is that, if the exercise becomes one of working backwards from an outcome for one particular year (in this case, the 2022 inflation factor), then this may diminish the principles-based approach that laid the foundation for the original framework.

In fact, the OEB's rate-setting frameworks already include features such as off-ramps and earnings sharing mechanisms that accommodate variability of outcomes and that protect customers. The frameworks are robust and ad hoc reconsideration of model components or factors is neither needed nor justified given the mechanisms that are intended to accommodate variable results. Indeed, if the frameworks are not seen as sufficiently robust to accommodate variability, then this begs the question of the extent to which they are subject to re-opening as areas of variability emerge in the future.

More broadly, there is no evidence indicating that the preliminary 2022 inflation numbers calculated by the OEB for 2022 (the highest of which is 3.3%) are so materially out of line with inflation that utilities could experience in 2022 as to warrant an ad hoc change to the measures used for determination of the inflation factor. Indeed, there is considerable uncertainty at this time about the future course of inflation, including much debate about whether recent increases in inflation will persist or will be transitory. And it is still far from clear whether and to what extent the pandemic will transform the labour market over the longer term.

In these circumstances, a change of methodology to react to data for 2019-2020 would be premature and would not be grounded on a full or even adequate evidentiary record. Further, these are extremely uncertain times for the OEB to form a specific judgment that the inflation factor determined in accordance with longstanding methodologies is "not representative" of inflation that utilities can expect to experience in 2022.

For these reasons, the OEB should adopt Option 1 identified in the Notice.

<u>Options 2 and 3</u>

The CLD submits that the OEB should not adopt Option 2 or Option 3, or any alternative other than Option 1, for a number of reasons.

First, in view of the background to this proceeding canvassed in Section 2 above, it is not appropriate to make changes to methodology, whether under Option 2 or Option 3, at this time. As set out in the submission above on Option 1, a change of methodology to react to data for 2019-2020 would be premature and would not be grounded on a full or even adequate evidentiary record.

Second, Options 2 and 3 are both contrary to, and undermine, a principled and predictable approach to rate-making. Options 2 and 3 cast doubt on the predictability and durability of robust, principles-based rate-setting frameworks established by the OEB with features that were intended to accommodate variability of outcomes from year to year.

Third, Options 2 and 3 are both improvised changes of methodology to adjust for one year, without accounting for the impact in the opposite direction that is expected to occur in the future.

Fourth, the OEB should not take action to change a longstanding component of its rate-setting frameworks without full consideration of the implications of any such change. The evidentiary record in this instance fails to adequately consider the potential risks and consequences of deviating from current policy. Options 2 and 3 do not represent a simple substitution of one value of the inflation factor for another, but a policy deviation with broader repercussions.

For these reasons, the CLD encourages the OEB to disregard Options 2 and 3 and continue with Option 1.

SECTION 4: CONCLUSION

The initiation of this proceeding appears to be based on an observation about increases in the AWEs index. To the extent that the driver of increased AWEs is "in part" due to the impact of pandemic measures on below-average income earners in the workforce, it is anticipated that this will be corrected naturally through lesser than expected growth in the AWEs index in subsequent years as those individuals re-enter the workforce on a more sustained basis. In the event that the change in AWEs is predominantly driven by other factors causing sustained changes in the workforce, then the default methodology yields the right outcome.

Either way, there is no evidence on the record of this proceeding that maintaining the existing approach to determining the inflation factor (*i.e.*, Option 1) will not result in rates that are appropriate.

Given the nature of the issue, it is important to preserve the predictability of the regulatory framework by maintaining the established approach to calculating the inflation factor. The CLD submits that the current proceeding lacks the rigour and careful and comprehensive consideration which was characteristic of the consultations and proceedings in which the rate-setting frameworks were developed. Changing an element of the methodology in the circumstances of this proceeding runs counter to the principles-based approach that underpinned the OEB's determination of rate-setting methodologies.

The OEB's 2021-2025 Strategic Plan ("Plan") highlights the importance of a principles-based approach to regulation. The first Strategic Goal referred to in the Plan is focused on the OEB evolving towards becoming a top-quartile regulator. The first action item for this Strategic Goal is to ensure the regulatory function is fit for purpose with principled and data-based approaches and best practices. The CLD respectfully submits that an ad hoc departure from a predictable and durable ratemaking framework, on the basis of the narrow factual record in this proceeding, would be inconsistent with this action item.

If you have any questions regarding this submission, please contact the undersigned.

Sincerely,

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