October 1, 2021

Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4
Attn: Ms. C. Long
Registrar

Dear Ms. Long

Re: **EB-2021-0212**
OEB Review of Inflation Factor for 2022 IRM rate setting

Thank you for the opportunity to provide comments on the Fact Sheet (FS) prepared by Ontario Energy Board (OEB) staff that was attached to Procedural Order No. 1, dated August 27, 2021, in the above-named matter. These are the comments of the Electricity Distributors Association (EDA) on the OEB's review of the Inflation Factor (IF) to be used to set 2022 rates. These comments reflect our members' perspective that the OEB needs to address this issue from a principled perspective so that it can continue to provide predictable economic regulation that benefits all the affected stakeholders.

The OEB's duty to authorize just and reasonable rates is engaged by this review. We note that the review focuses on rates that are to be authorized pursuant to the Incentive Rate-setting Mechanism (IRM). The review raises principled and practical issues. The key principled issue is whether or not the OEB should, in response to an unusual data observation, revise one component of its overall IRM. Should the OEB find that the principled approach requires that it not use an unusual data observation, there are a range of practical issues (e.g., what level of labour cost change to use) to consider.

We propose that the OEB proceed from a principled perspective and adopt a steady handed approach that preserves the operation of its IRM so that all stakeholders benefit from a stable regulatory regime. From a practical perspective, staff's FS shows that the expected total bill impact under Option 1 and Option 2 are 0.6% and 0.4% respectively. We note that neither would be expected to require rate mitigation.

Pandemic conditions are impacting labour markets. It is difficult to accurately forecast when the pandemic will abate and equally difficult to conclude at this time whether the observed disruption in labour markets will be short lived, long lived or permanent. While the OEB's Codes, existing policies and long-standing practices were not developed to serve under such pandemic or other extreme conditions, they were developed to balance the interests and to achieve the OEB's legislative objectives. We suggest that the OEB continue to rely on its existing policies - unless they can be shown to be unsuitable – as it regulates Ontario's energy sector under pandemic conditions.

We are advocating for the OEB to provide a stable rate making regime, where the impact to the level of rates is one of several considerations. Rate level stability from year to year provides one of many forms of consumer protection. We suggest that as pandemic conditions continue, and markets and economic data exhibits variability, consumers will prioritize the consistent application of the OEB's previously

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established rate setting methodologies and that they will benefit from the predictability of that consistent application.

Below are our detailed comments on the OEB's review of the Inflation Factor. They are organized as follows:

- Data issues
- Inflation factor issues
- Rate making issues
- Process issues
- Next steps

<u>Data issues</u>
This review appears to have been triggered by an unusual value of the Average Weekly Earnings (AWE). An unusual value should be investigated and analyzed for whether it is suitable to use. This review provides stakeholders with an organized forum to better understand the information provided by the data point and then to decide whether to use it or not.

As OEB staff point out, Statistics Canada analysis of the 2020 value of the AWE found that the observed value reflects that low wage earners exited the work force during the pandemic resulting in the data set including a somewhat higher proportion of higher wage earners in comparison to previous years. While the EDA does not dispute this point, we question whether it is a fulsome analysis of the situation.

Statistics Canada's analysis implies that at some point in the future the AWE could exhibit another unusual value when low wage earners return to the work force. For the OEB this creates a need to evaluate its choice of IF for how it will operate over several years, rather than how it operates in 2022 in isolation. Modelling for three or more years will support the OEB in understanding how the observed increase in the AWE in 2020 may self-correct through a decrease in a future year, or whether the observed increase in 2020 may be the first of several years of sustained increases, or of how a policy choice that is accurately and consistently applied will operate over time. We note that Statistics Canada's analysis does not address whether:

- the economy is entering into an inflationary phase
- the labour market is experiencing a disruptive change that could play out over the near term
- the labour market is restructuring such that the change in the AWE is the first data point in a new time series.

We also note the current methodology can be expected to serve well whether the economy is entering an inflationary phase, or the work force is experiencing a disruptive change.

The FS provides one alternative to using this outlier data point: temporarily suspend its operation and replace it with one of two alternative data series. Otherwise, the FS is silent on other statistical techniques to manage this issue.

The EDA and all other intervenors recently learned that OEB staff use a review process before the IF is made public. The process is informal; it compares the AWE and the IF to the Consensus Forecast and relies on news coverage of inflationary expectations and trends when seeking to identify if discrepancies exist. We note that OEB staff did not describe that they use statistical techniques, engage experts or use a disciplined, objective process and that news coverage of inflationary pressures can differ[1]. Significant reviews, such as this one, should be appropriately resourced (e.g., with experts, appropriate internal reviews) so that the right conclusions are reached and for sound reasons.

Our members have experienced the pandemic to varying degrees and responded in varying ways. LDCs were recognized as essential workplaces during the pandemic and did not lay off workers – in fact they found that they needed more productive time to achieve the same end results (e.g., to provide safe work sites by providing appropriate distances between workers). Our members observed that their contractors (e.g., tree trimmers, locators) appeared to lack ready access to labour and our members believe that, as a result, they may have indirectly experienced the exit of low wage earners from the work force. Our members have recounted several situations since the start of the pandemic where they have experienced atypical increases in the prices for materials and parts, consistent with recent reports that the economy is experiencing inflationary pressures. The inflation forecasts that are publicly available provide a wide range of values. We note that several economic indicators have recently exhibited volatility that forecasters suggest can be expected to continue. OEB staff's FS does not explore these other inflationary pressures. We suggest that addressing them would demonstrate balance and objectivity.

For these reasons, we propose that the OEB be cautious when considering the recent change in the AWE and that the OEB only reject Option 1 if it can be clearly demonstrated that it is not Fit for Purpose.

Inflation Factor issues

The observed 2020 value of the AWE is unusual and contributes to the highest IF computed since 2010. Whether this value of the IF is 'fit for purpose' or not requires sound analysis of the facts. As it is important for the OEB to understand how the IF could change over time (e.g., whether the self-correction noted above could occur) we suggest that OEB staff seek expert advice and additional external information. We note that both the OEB's and OEB staff's expertise is in rate regulation, rather than in assessing inflation.

Rate making issues

The EDA's focus is on how the AWE and the computed IF impact distribution rates, whether there are reasons to anticipate that rates will not be just and reasonable, and how to provide rates that exhibit the predictability and understandability that benefit consumers.

Understandable and predictable rates demonstrate a sound rate making structure. We must point out that the IRM has been successfully used to set distribution rates for over two decades and that this 4th generation IRM has been used for the past decade. The benefits of the stability and predictability of the rate making regime's methodology assists consumers in understanding how rates will change and why. It also assists LDCs when they are planning their business activities and investments. It has taken years for the OEB to achieve this level of predictability and the associated consumer benefits, neither should be altered without sound analysis, foresight and a compelling rationale.

[1] https://globalnews.ca/news/8121628/statistics-canada-inflation-data-july, https://financialpost.com/news/economy/canadas-annual-inflation-rate-in-july-accelerates-to-3-7-fastest-since-2011, http://www.rbc.com/economics/economic-data/pdf/economy_can.pdf

Staff's FS provides some analysis of the appropriateness of the three options for computing the IF. We understand that OEB staff provided Options 2 and 3 to indicate how an alternative data point could operate and that Options 2 or 3 are not the only possible alternatives. It would be valuable to learn whether Options 2 and 3 align with, or deviate from, the OEB's thinking as set out in EB-2010-0379. While time is of the essence, since the OEB needs to be able to authorize just and reasonable rates that can take effect as early as January 1, 2022 based on an appropriate IF, we question whether more time could have been made available to review the IF as the AWE data has been available since May.

Just and reasonable rates recover the ongoing costs incurred to provide service, provide the LDC with the opportunity to earn the allowed rate of return and are free of undue cross subsidization. A key question in this review of the IF is whether rates will be set at levels that can be found just and reasonable. In practical terms, just and reasonable rates lie in a range of reasonability. We note that OEB staff's FS does not analyze the options for whether they result in just and reasonable rates. The FS does quantify the rate impact of Option 1 as 3.3% and the total bill impact as approximately 0.6% whereas the total bill impact expected under Option 2 is 0.4% - a 20 basis points difference. As is noted elsewhere, neither estimated bill impact is so high as to result in rates that require mitigation. There is no evidence that shows that maintaining the status quo will or may result in rates that cannot be found just and reasonable, either in 2022 or over time.

<u>Process issues</u>

The OEB's Renewed Regulatory Framework for Electricity (RRFE) includes the following features:

- 3 rate setting mechanisms
    - The (IPI-X-Stretch Factor) being one of the 3
- The IPI term proxies Inflation, which in this review is referred to as the IF
- The AWE is one of 2 factors used to compute the IF

The RRFE did not address how to treat unusual data that may be experienced during the term of the IRM. The RRFE provides a package of mechanisms designed to balance the operation of the individual components. The FS does not address the appropriateness of altering one element of the RRFE in isolation.

This review is resourced very differently than was EB-2010-0379 (the proceeding that resulted in the design of this generation of the IRM). EB-2010-0379 provided for extensive consultation with stakeholders and relied on experts (e.g., econometricians) to develop the package of positions that culminated in the RRFE. As the timeline for the OEB's current review seeks to resolve the issue in somewhat less than 18 weeks, it risks an inappropriate – and potentially unprincipled – outcome.

<u>What to do next?</u>

The EDA proposes that the OEB adopt a principled decision-making process that prioritizes following sound regulatory principles and sound rate making principles. The key regulatory principle is to ensure that, to the extent possible, regulatory certainty and predictability are provided. The rate making principle is to test that rates can be authorized as just and reasonable, and that they lie in the range of reasonability. We advocate for a fact-based approach that considers the effect on 2022 rates and the rates in following years, where forecast rates are estimated using a range of reasonable input data. The OEB should analyze the AWE for whether:

- it will self-correct in 2023 (or in a later year) and revert to normal values

- it will reflect a longer-lived disruption to the labour market
- the labour market is experiencing a restructuring
- the economy is entering an inflationary phase.

We do not support the OEB amending select components of its long-standing approved framework without due diligence, foresight and analysis supported with an appropriate level of rigour. We encourage OEB staff to formalize and enhance its review process. We also propose that the OEB clarify that its decision is not precedent setting.

We wish to commend the OEB for some aspects of the procedures it has made available in this review. We note that the OEB was recently faced with a similar decision on whether it should depart from its established practices and policies when it was setting Carrying Charge rates for Quarter 3 of 2020. The OEB is proposing a different approach to managing how to set the IF than it did when it was managing setting Carrying Charges. For example, whereas in the Carrying Charges review the OEB proposed to respond to changing market conditions in an expeditious manner using a novel approach, in this review of the IF it is, instead, seeking to be informed of the appropriate regulatory response. The IF review process has provided additional time as well as alternatives whereas the Carrying Charge process provided very little time and only one alternative. We observe that ultimately the OEB set Carrying Charges using its long-standing approach and that this contributed to continued regulatory stability and predictability. We suggest that the OEB adopt a similar approach here that is principled and provides both regulatory certainty and regulatory predictability.

In conclusion, the EDA supports the OEB preserving the operation of its IRM by setting the IF using the observed value of the AWE. This will result in a stable regulatory regime that is predictable and understandable, all of which benefits all stakeholders. We propose that OEB staff rely on fact-based analysis (e.g., that addresses the range of inflationary pressures LDCs experience), that they augment their analysis (e.g., for the effects of changes in materials prices, to evaluate how the alternative quantifications of the IF will operate over several years) and that they formalize and enhance their review process.

Thank you again for the opportunity to comment. If you have any questions on these comments or require any clarification, please do not hesitate to contact Kathi Farmer, the EDA's Senior Regulatory Affairs Advisor at kfarmer@eda-on.ca or at 416.659.1546.

Sincerely,

Teresa Sarkesian
President and Chief Executive Officer