Ontario Energy Board | Commission de l'énergie de l'Ontario

BY EMAIL

October 1, 2021

Ms. Christine E. Long
Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4
Registrar@oeb.ca

Dear Ms. Long:

Re: Ontario Energy Board (OEB) Staff Submission
Generic Hearing on 2022 Inflation Factors for 2022 Non-Cost of Service Rate Adjustment Applications
OEB File Number: EB-2021-0212

Please find attached OEB staff's submission in the above referenced proceeding, pursuant to Procedural Order No. 1.

Yours truly,

Keith C. Ritchie

Digitally signed by Keith C. Ritchie
Date: 2021.10.01 15:37:27 -04'00'

Keith C. Ritchie
Major Rate Applications and Consolidations

Encl.

cc: All parties in EB-2021-0212

ONTARIO ENERGY BOARD

OEB Staff Submission

Submission on the 2022 Generic Inflation Factor for 2022 Rate Adjustment Applications

EB-2021-0212

October 1, 2021

Table of Contents

Executive Summary

Ontario Energy Board (OEB) staff submits that setting the 2022 inflation values under either option 1 or option 3 (i.e., updating the existing formula by using an alternative statistic) is a reasonable course of action for setting 2022 rates.

In terms of option 3, OEB staff submits that using Average Weekly Earnings (Ontario, All Businesses except Unclassified) (AWE) may not accurately reflect the inflationary pressures that utilities are likely to experience in 2022. OEB staff instead submits that for the 2022 Input Price Index (IPI), the OEB could replace AWE with Fixed Weight Average Hourly Earnings – (Ontario, All Businesses except Unclassified). This measure is derived from the same data source as other AWE and other Average Hourly Earnings (AHE) statistics but has not been similarly affected by COVID-related business restrictions because of the use of fixed weights from a pre-pandemic normal economic period.

The source of the significant increases to the IPI is solely from the labour inflation component, where the annual percentage change in AWE increased markedly, as temporary and permanent layoffs due to COVID-19 restrictions disproportionately affected lower wage-earning workers.

OEB staff has come to its view after consideration of the IPI methodology and its history, as was established by the OEB in 2013 in the *Report of the Board on Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors* (Report), [1] the options listed in the Notice of Application, and the information compiled in the Fact Sheet. OEB staff recognizes, however, that this would be a departure from OEB policy as established in the Report.

Although OEB staff submits that AWE may not be the best measure of the inflationary labour pressures likely to be experienced by utilities in 2022, the overall impact on rates by using an alternate index (such as AHE) is small. As such, OEB staff recognizes that the OEB will wish to give careful consideration to whether a departure from the OEB's well-established policy (i.e., a departure from option 1) is warranted at this time.

[1] EB-2010-0379, *Report of the Board on Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors*, issued November 21, 2013, corrected December 4, 2013

Background

As noted by the OEB in both the Notice of Application and Procedural Order No. 1 (PO 1), preliminary calculations indicated an IPI of 2.5% for electricity transmitters and 3.3% for electricity distributors for 2022 rate applications. For 2021, the values were 2.0% and 2.2%, respectively.

In light of the uncharacteristic increase to the labour inflation component (AWE), the OEB commenced, on its own motion, a generic proceeding to determine how inflation factors should be set for 2022 rate adjustments to ensure just and reasonable transmission and distribution rates. The OEB outlined the three following options, and also noted that it would consider other options as presented, with supporting rationale, by parties:

1. Continue to apply the existing methodology and formula (including the existing inflation indices) to the 2022 rate adjustments.
2. Extend the approved values for 2021 inflation rates for 2022 rate adjustments.
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.

Schedule B to PO 1 was a document prepared by OEB staff entitled *Preliminary Calculations of 2022 Inflation Factors for 2022 Non-Cost of Service Rate Adjustment Applications: Fact Sheet of Statistics Canada and Bank of Canada Data and Description of Possible Alternative Inflation Indices for 2022 Rates Compiled by Ontario Energy Board Staff* (Fact Sheet).[2] The Fact Sheet provided factual background information on the IPI formula, and on data and analyses from Statistics Canada and the Bank of Canada, to assist parties in their consideration of the issues and options in this proceeding.

OEB staff notes that most of the necessary background is already contained in the Fact Sheet provided in Schedule B to P.O. 1. The Fact Sheet was provided to all registered parties and listed publicly on the OEB's website on August 27, 2021.

The Fact Sheet consisted of the following:

- Description of the history of the inflation factors used for formulaic rate adjustments for natural gas and electricity rate applications, going back to the

[2] EB-2021-0212, Procedural Order No. 1 – Schedule B - Preliminary Calculations of 2022 Inflation Factors for 2022 Non-Cost of Service Rate Adjustment Applications: Fact Sheet of Statistics Canada and Bank of Canada Data and Description of Possible Alternative Inflation Indices for 2022 Rates Compiled by Ontario Energy Board Staff, August 27, 2021

mid-2000s, as well as a description of the current two-factor IPI methodology, the data used, and a brief discussion of the reasons for the methodology and the data series used.

- Preliminary calculations using the current approved two-factor formulae, of the electricity transmission and distribution inflation factors for 2022 rate adjustments based on 2021 Q1 data published by Statistics Canada. The calculations were preliminary in that the update, issued in the fall of each year, uses Q2 data publications from Statistics Canada in order to use the most current data available, and that Statistics Canada often makes minor revisions to historical data to reflect late and corrected data, and corrections to analyses for data imputation.
- An observation that the preliminary IPI results were higher than has previously been seen, and that an increase in Average Weekly Earnings (AWE) was driving the increase. Examination of analyses published by Statistics Canada indicated that business restrictions to contain the COVID-19 pandemic had disproportionately removed, either temporarily or permanently, lower wage-earning employees in sectors most affected (e.g., hospitality, retail stores, seasonal and temporary work, entertainment). As a result, the average earnings of the remaining employed work force increased significantly relative to 2019. Thus, the increase in AWE for 2020 was not just reflecting wage inflation.
- A discussion of several alternative subindices of Average Weekly Earnings and of a related statistic, Average Hourly Earnings, that might be useful as substitutes for the AWE sub-index for Ontario, All Businesses except Unclassified.
- A brief discussion of the Consumer Price Index (CPI), which is the most commonly reported and, for the lay public, best understood, measure of inflation. CPI has been examined and rejected in the past by the OEB, as it is not the best measure of input price inflation for most commercial businesses for their operations; this is particularly the case for capital-intensive firms like utilities.
- In Appendices:
    - Preliminary Calculations of the Electricity Distribution and Transmission IPIs for 2022 using the current two-factor formulae
    - Graph displaying the electricity distribution inflation factors used for rate adjustment applications from 2007 to 2021 (approved) and 2022 (estimated)
    - The annual percentage change that would be used in the IPI formula, for GDP-IPI, AWE, alternative sub-indices of AWE and AHE, and of CPI, as published by Statistics Canada and the Bank of Canada

Update of Preliminary Calculations

In the Fact Sheet, OEB staff included preliminary calculations on the 2022 Inflation Factors for Enbridge, electricity transmitters, and for electricity distributors (and the natural gas distributor EPCOR, which uses the same inflation factors and weighting as electricity distributors), along with some explanation. The data, provided in appendices to the Fact Sheet, were based on annual AWE data issued at the end of March, 2021, and 2021 Q1 National Economic Accounts data (i.e., Gross Domestic Product and associated price indices) on May 31, 2021.

Statistics Canada issued the 2021 Q2 National Economics Account data on August 31, 2021. The GDP-IPI data series had only one historical data revision, for 2021 Q1. This data point is not used in the calculation, which only goes to 2020 Q4 for the 2022 Inflation Factors. As such, OEB staff confirm that there are no revisions to the preliminary calculations of the electricity distribution and transmission inflation factors shown in Appendix A of the Fact Sheet.

OEB staff notes that Enbridge uses a single factor IPI (GDP-IPI) and does not use a separate labour component at all, and therefore is not impacted by changes to AWE. Further, a settlement proposal has been filed in Enbridge's application for 2022 rates, whereby the utility and other parties have agreed to the 1.7% IPI proposed in the application.[3] A decision of the OEB panel is pending. OEB staff confirms that Enbridge's IPI of 1.7% for 2022 rates, which is solely based on GDP-IPI, is unchanged with the issuance of the issuance of 2021 Q2 data by Statistics Canada.

[3] EB-2021-0147, EGI_SettlementProposal_20210929, p. 7, September 29, 2021

OEB Staff Submission

The Context of this Proceeding and the Relevance of the Report

It is important to review the context through which this issue arises before the OEB.

The OEB has developed a policy through the Report for annual rate updates under Price Cap IR, Annual Index IR and Revenue Cap IR. This policy indicates that rates will be updated based on a formula (and possibly subject to certain other adjustments, which are not relevant for the purposes of this proceeding). One of the inputs into this formula is the two-factor IPI, which is comprised of the labour component (AWE) and the non-labour component (GDP-IPI).[4] The OEB has applied this formula to all incentive rate-setting applications to date since the 2014 rate year.

The OEB develops policies through a number of avenues, often through formal reports (such as the Report) or guidelines. These policy documents serve an important function by providing guidance to stakeholders regarding how the OEB intends to deal with certain recurring situations. They promote regulatory predictability, consistency, and efficiency for both regulated firms, ratepayers, and other stakeholders.

By their very nature, policy documents are not binding. Panel members retain the discretion to deviate from policy where circumstances warrant.

As a general matter, OEB panels will apply OEB policies unless there is a good reason that they should not do so. In the 2009 *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, the OEB noted:

> The final "product" of this process [i.e. the process to create the policy], of course, is a Board policy. This was not a hearing process, and it does not – indeed cannot – set rates. […] Board panels assigned to [rate] cases will look to the report for guidance in how the cost of capital should be determined. Board panels considering individual rate applications, however, are not bound by the Board's policy, *and where justified by specific circumstances*, may choose not to apply the policy (or a part of the policy).[5] (emphasis added)

OEB staff submits that the starting point in this proceeding is therefore the OEB's Report, which sets out its policy for annual IR rate adjustments, including the appropriate inflation factors. Absent a principled basis for a deviation from this policy, the OEB should continue to apply the inflation factors as set out in the Report.

[4] This does not apply to Enbridge Gas Inc., which uses a single-factor IPI: GDP-IPI for all of its service territories.
[5] 2009 *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, p. 13

OEB staff submits that this may be a situation where a deviation from the OEB's policy is appropriate. In order for policies to achieve the objectives of regulatory predictability, consistency, and efficiency, they are followed unless there is a good reason for not doing so – for example if following a particular policy would result in a rate that is not just and reasonable. Although for the reasons provided below OEB staff believes that AWE may not be the most appropriate labour inflation index to use for the setting of 2022 rates, the actual total bill impact for customers of using a different index (which would better reflect the inflationary labour pressures utilities are likely to face) is small, 0.2% for most customers.[6] In assessing whether a change to the inflation factors for 2022 rate setting is appropriate, the OEB should weigh the benefits of regulatory predictability, consistency, and efficiency against the modest bill changes rate payers would experience if the inflation factors were changed.

The Appropriate Inflation Factors Beyond 2022

The Notice for this hearing is clear that whatever determinations are made in this proceeding will relate solely to the inflation factors that should be used for the 2022 rate year. OEB staff's submissions as set out below, therefore, apply only to 2022.

However, it is foreseeable that the decision made in this proceeding could have ripple effects into future years. For example, the duration and extent of COVID impacts on society and in the economy, in particular, the labour force, are not fully materialized or understood. There is a myriad of potential outcomes such as a full recovery that aligns with pre-pandemic economy, or a recovery that contains a permanent shift in the labour force. As the pandemic continues, the state of the economy, labour force and inflationary pressures continue to evolve. Any change for 2022 rates may be a factor that the OEB needs to consider in the future, as labour trends resulting from a future recovery from the pandemic become more apparent.

Analysis of the Three Options

OEB staff is making submissions on the three options presented in the Notice of Application and PO 1:

1. Continue to apply the existing methodology and formula (including the existing inflation indices) to the 2022 rate adjustments.
2. Extend the approved values for 2021 inflation rates for 2022 rate adjustments.
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

[6] Preliminary calculations based on typical electricity distribution rates for a typical residential customer consuming 750 kWh per month. Option 1 vs. Option 3 - AHE Fixed Weight.

Earnings, that is more representative of labour inflation expected to be experienced by Utilities in 2022.

The OEB further noted that other options presented by parties, with supporting rationale, would also be considered. OEB staff has not identified other reasonable options.

The options are considered in the same order as listed above. As described in further detail below, OEB staff submits that it would be reasonable for the OEB to choose either option 1 or option 3d. As will be explained further below, OEB staff is recommending that the OEB could substitute the Fixed Weight AHE sub-index for Ontario, All Businesses except Unclassified in place of AWE in the IPI formula if it chooses option 3.

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

Having discussed reasons above for why the OEB could continue to apply option 1, this section will assess reasons for why the OEB could justify departing from the current methodology for 2022 rates.

It is the change in AWE, for reasons beyond normal wage inflation and which are related to business restrictions to address the current pandemic, which are driving the significantly higher IPI values for 2022 under the existing formula.

Some parties asked OEB staff to conduct tests to determine if the changes to AWE are statistically significant. The following table presents the mean, sample standard deviation for data from 2002 to 2020, and t-test and p-value for the 2020 annual value for the components of the IPI, namely the annual logarithmic percentage changes in GDP-IPI and AWE (Ontario) and for CPI, based on the data provided in Appendices C, D and G of the Fact Sheet.

Table 1: *t*-Tests of 2020 Values of GDP-IPI, AWE (Ontario) and CPI

Variable	**GDP-IPI**	**AWE (Ontario)**	**CPI**
Fact Sheet Source	**Appendix C**	**Appendix D, p. 27**	**Appendix G**
Mean (2002-2020)	1.792%	2.533%	1.792%
Sample Standard Deviation (2002-2020)	0.465%	1.369%	0.672%
2020 Value	1.794%	7.04%	0.73%
degrees of freedom	18	18	18
***t*-value**	-0.189	3.29	-1.59
***p*-value**[7]	38.61%	0.446%*	11.31%

[7] The p-value is the probability of observing a result as what was actually observed. A p-value of 10% means that there is a 1 in 10 chance of a value as large or larger than the actual one observed, while a p-value of 1% means that there is only a 1 in 100 chance of doing the same.

* Statistically significant at a 1% level.

The p-value for the 2020 AWE value is statistically significant (at ≤1%), demonstrating that the 2020 AWE value is an outlier.

As accepted in the Report, the OEB uses AWE as an estimate of general wage inflation in Ontario. However, as is described later in this document, referencing Statistics Canada's documentation on the Survey of Employment, Payrolls and Hours (SEPH), AWE estimates are impacted by several factors other than wage inflation. In more normal socioeconomic conditions, wage inflation is considered to be the dominant driver in changes in AWE from period to period, while other factors have smaller and often more random impacts. Meaning that, in normal circumstances, the signal of wage inflation on the AWE estimate is larger than of other factors (including sample and estimation errors). However, the impact of COVID-19 restrictions on the make-up of the active (employed) labour force (i.e., disproportionately removing mainly lower wage-earning workers due to COVID-related restrictions), has increased the influence of non-wage inflation to the 2020 data. There is no easy way to directly disentangle the impact this has on AWE from the data published by Statistics Canada. Notably, Statistics Canada does not publish a fixed-weight AWE. Thus, the issue at hand is to identify – temporarily – another statistic that retains the wage inflation signal, which is the original intent of the IPI methodology adopted in the Report, and is less impacted by the non-wage inflation of COVID-19 restrictions on the labour force.

This is not to say that normal wage inflation (e.g., per wage increases for progression and cost of living clauses in collective agreements) is not reflected in the 2020 value, but the analysis of Statistics Canada is that it is how COVID-19 business restrictions have impacted the tail of the overall distribution (i.e., largely lower wage-earning employees), that resulted in a higher average weekly earnings for the labour force left working.[8]

Statistics Canada continues to note the ongoing impacts of COVID-19 and associated lockdown restrictions, even as restrictions are easing, on the workforce and earnings:[9]

> **Upward trend continues for average weekly earnings**
>
> Average weekly earnings rose 0.7% from March to $1,129 in April as employment gains were driven by salaried—and largely higher-paid—employees.

[8] In it's the release of July 2021 labour statistics, Statistics Canada notes: "In general, changes in average weekly earnings are the result of a number of factors, including wage growth; changes in the composition of employment by industry, occupation and level of job experience; and average hours worked per week." - The Daily, (September 28, 2021)

[9] The Daily – June 24, 2021 (April 2021 SEPH and LFS data – monthly)

> Salaried employment increased by 154,400 (+2.7%) while hourly paid employment rose by 47,400 (+0.5%).
>
> Compared with February 2020, earnings were 8.0% higher in April 2021. *The higher average weekly earnings since the beginning of the pandemic reflects a number of factors, including changes in the composition of employment by type of employee, occupation and industry. For example, the sectors which remained furthest from their pre-COVID employment levels in April—arts, entertainment and recreation (-33.5%) and accommodation and food services (-28.5%)—are among those with the lowest average weekly earnings. This disproportionate loss of lower-wage employment has the effect of increasing average earnings.* (emphasis added)

The same is not the case for the labour market. In its release of SEPH data for July 2021, Statistics Canada stated:

> Payroll employment—or the number of employees receiving pay or benefits from their employer—increased by 324,800 (+2.0%) in July, the largest monthly increase since September 2020. Compared with February 2020, payroll employment was down by 427,800 (-2.5%) in July 2021. Hourly-paid payroll employment was 2.0% below the February 2020 level, while salary-paid payroll employment was little changed.
>
> ...
>
> Payroll employment increased by 95,400 (+9.9%) in accommodation and food services in July, with almost half of the increase occurring in Ontario. … Despite the increase in the month, payroll employment in accommodation and food services was 20.8% below its pre-COVID level.[10]

Statistics Canada further observed:

> Despite employment gains being concentrated in industries typically associated with lower-wage jobs, average weekly earnings rose 1.0% in July to $1,133.[11]

In the June release of SEPH data, Statistics Canada noted that June 2021 AWE was 7.6% higher than February 2020 (pre-COVID) AWE.[12] With the increase in July 2021, this will be even higher. AWE is not returning to pre-pandemic levels quickly, even as people return to the workforce.

Based on all of this, OEB staff sees merit in replacing the wage inflation index component of the OEB's two-factor methodology as approved in the Report. In OEB

[10] Statistics Canada, The Daily (September 28, 2021)
[11] Ibid.
[12] Statistics Canada, The Daily (August 26, 2021)

staff's submission, there is sufficient information, both in the data, and in analysis on Statistics Canada's website, that the reported data for AWE for 2020 (and continuing into 2021) have been disproportionately impacted by COVID-19-related lockdown and other socioeconomic restrictions. In particular, these restrictions have disproportionately resulted in workers in lower wage-earning sectors (temporary workers, seasonal, part-time, and hourly wage-earning employees in sectors such as a restaurant and in retailing), leaving the work force on a temporary or permanent basis. This in turn has resulted in a marked increase in AWE, not solely because the earnings of most workers have increased, but because many low wage earners have left the workforce entirely and are therefore no longer counted in labour statistics like AWE.

As the remaining workers tend to be higher income earners, this results in a significant increase in AWE. The great majority of utility employees are not temporary or low wage earners of the type that tended to leave the work force on account of COVID-related restrictions. It is therefore reasonable for the OEB to determine that the current AWE is not an appropriate inflation factor in the IPI for the 2022 rate adjustments, as it does not adequately reflect the labour pressures that utilities are likely to experience. OEB staff would welcome comments from utilities on this point in their reply submissions.

2. Extend the approved values for 2021 inflation rates for 2022 rate adjustments

The OEB has identified retention of the 2021 values for the inflation factors as one option it will consider.

The question to be considered with respect to this option is whether the 2021 inflation values (2.2% for electricity distribution and 2.0% for electricity transmission) still seem applicable and reasonable for current inflation and that expected for 2022.

In OEB's staff's view, there is no easy answer. In its issuances of monthly CPI data beginning around the middle of 2021, Statistics Canada has routinely noted higher inflation. For example, for June 2021 CPI, Statistics Canada reported an overall CPI increase of 3.1% (June 2021 over June 2020), with further increases in July (July 2021 over July 2020) of 3.7% and in August (August 2021 over August 2020) of 4.1%.[13]

Part of the higher inflation currently is due to the fact that prices for a number of products and services in 2020 were depressed, due to the onset of the COVID-19 pandemic and associated impacts from lockdowns, business restrictions and closures. In essence, lockdowns and business restrictions created supply and demand imbalances. Some actions taken by Governments, such as freezing energy prices in

[13] Statistics Canada, The Daily (July 28, 2021 for June CPI, August 18, 2021 for July CPI, September 15, 2021 for August 2021 CPI). It worth noting that these are year-over-year increases of the monthly statistics compared with the same month one year earlier. Averaging over the months will give a different annual percentage increase.

various jurisdictions, also depressed prices during periods in 2020, and sometimes continued into 2021 due to continuing waves of COVID-19 spread. However, prices for many goods and services have recovered as the economy recovers, even if more slowly in some sectors.

Increased prices in 2021 therefore appear to exhibit significant inflation relative to the depressed 2020 prices, a phenomenon referred to by Statistics Canada as a "base year effect" in its The Daily issuances of CPI statistics in recent months, as noted above.

The Bank of Canada continues to see current higher inflation as being temporary.[14,15] However, as CPI has continued to rise well above the 3% upper bound of the Bank of Canada's normal range (a target of 2%, with an allowable range between 1% and 3%), and with continuing waves of COVID spread and reimposed restrictions even as the economies in Canada and elsewhere re-open, concerns are being raised about the level of inflation, and whether it is as transitory and evidence of base year effects as the Bank of Canada believes. However, as we are still in the pandemic with the fourth wave of the spread of the COVID-19 virus, and restrictions sometimes being re-imposed (or new requirements, such as adoption of vaccine passports, emerging), it is not clear whether the inflation currently being seen is temporary or persistent, and if and when the Bank of Canada (and its peers in other countries) will need to take further action.

OEB staff is of the view that the extension of the 2021 IPI values for 2022 is plausible, but also recognizes the risk and uncertainty posed by current trends in inflation statistics like CPI. While OEB staff recognizes that retaining the 2021 IPI values results in IPI values essentially the same as for option 1, OEB staff believes that using more current data for a substitute of AWE, but one unaffected by pandemic-related business restrictions on the workforce, is a more principled way of dealing with the AWE outlier problem. Further, if similar adjustments prove necessary past 2022 as economic recovery continues, the further use of an alternative measure may better inform future rate-settings up until the OEB's methodology is reviewed in full.

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 Utilities in 2022

The final option presented in the Notice is to proceed with the 2022 IPI update using the two-factor formula, but using an alternative sub-index of AWE or AHE in place of the current AWE (Ontario, All businesses excluding unclassified, including overtime). The

[14] Tiff Macklem, "Tiff Macklem: The Bank of Canada remains firmly committed to keeping inflation under control", Financial Post, July 29, 2021
[15] Bank of Canada, Monetary Policy Report, July 14, 2021, pp. 2, 11, 12 (Table 2), 16-17

choice of alternative sub-indices would be for similar indices, but which are not impacted by the disproportionate change in the labour force from pandemic lockdown restrictions, and hence may provide better measures of wage inflation as it may apply to utilities during the pandemic and as the economy recovers through 2022.

OEB staff identified four possible sub-indexes at this time:

- 3a: Average Weekly Earnings (Ontario, all businesses, Salaried employees, including overtime)
- 3b: Average Hourly Earnings (Ontario, all businesses, Salaried employees, including overtime)
- 3c: Average Hourly Earnings (Ontario, all businesses, Hourly wage employees, including overtime)
- 3d: Average Hourly Earnings (Ontario, all businesses, fixed weight, excluding overtime)

These statistics are all derived primarily from Statistics Canada's SEPH Guide.[16] Before discussing these alternative measures in more detail, OEB staff notes the following from Statistics Canada's SEPH Guide:[17]

> **Section 7: Use of the SEPH earnings data for contract escalation**
>
> The SEPH earnings statistics are sometimes used in the public and private sectors to index various types of labour costs, usually through contractually set pricing formulae. Statistics Canada neither encourages nor discourages the use of the SEPH data for contract-escalation purposes, but can offer advice of a purely statistical nature on the limitations associated with the use of these data.
>
> SEPH publishes a wide range of earnings estimates, many of which are not advisable for pricing purposes. Generally speaking, it is preferable to avoid using series for highly disaggregated industry groupings (4-digit NAICS), as well as those estimates specific to class of worker, that is hourly, salaried or other employees, as these series are based on a relatively small sample. Similarly, the national trend and level estimates for a given industry are usually more stable than their provincial/territorial counterparts. Users should always consider available quality indicators and the number of employees relevant to the earnings series they are interested in.
>
> *It is important to note that changes in average earnings reflect a number*

[16] Documentation on the SEPH is provided in *Guide to the Survey of Employment, Payrolls and Hours (statcan.gc.ca)*
[17] Ibid., p. 16

> *of factors, including wage growth, changes in composition of employment by industry, occupation and level of job experience, as well as average hours worked per week—not to mention sampling variability. As an attempt to observe earnings over time while controlling for changes in hours and employment, Statistics Canada produces a fixed-weighted index (FWI). This index is closer to the concept of a labour or employment cost index as used in other countries, but does not control for other factors that can have an impact on earnings. The FWI is only available at higher levels of aggregation, and does not include overtime earnings and earnings data from employees on commission or paid by a piece rate.*
>
> In addition, the use of month-over-month changes to escalate costs should be avoided in favour of year-over-year movements based on annual averages. If monthly calculations are required, moving averages of several months should be strongly considered.
>
> Any indexing formula should also take into account the fact that the survey data undergo periodic revision. Users should always use current and complete data series. (emphasis added)

While the OEB uses the AWE for a different purpose – namely to calculate an estimate of input price inflation that Ontario utilities are expected to face as cost pressures from year to year – than for contract escalation, OEB staff submits that Statistics Canada's comments (regarding use of more aggregate statistics at a national or provincial level, and using annual rather than monthly data) apply for the OEB's use of Statistics Canada measures such as AWE and GDP-IPI.

Average Weekly Earnings and Average Hourly Earnings – Current Weights

Average Weekly Earnings – (Ontario, All Businesses except Unclassified, Salaried Employees), option 3a above, is a more disaggregate sub-index of the AWE currently used in the two-factor formula. OEB staff has considered Average Hourly Earnings – (Ontario, All Businesses except Unclassified, Salaried Employees) and Average Hourly Earnings (Ontario, all businesses, Hourly wage employees, including overtime) respectively, options 3b and 3c, but do not recommend these measures.

All of the above sub-indices use current weights,[18] and thus similarly exhibit higher than normal increases in 2020, due to the disproportionate impact of COVID-19 restrictions on lower-paying workers in the labour force. In fact, as expected, the annual percentage change in the AWE for hourly wage-earning employees from 2019 to 2020 was higher at 8.7% than it was for AWE for all workers, at 7.0%.[19] This is expected, as it was the

[18] Statistics Canada and the Bank of Canada make references to "current weights" or "variable weights". The terms are synonymous. See also footnote 20.
[19] Fact Sheet, Appendix D, p. 28

category of hourly wage-earning employees who have been identified as being amongst those most affected by COVID-related restrictions.

As another statistical estimate derived from the SEPH, Average Hourly Earnings controls for one source of variation in AWE, namely that for changes in the hours worked in a week. However, changes in workforce composition, due to normal seasonal volatility or due to more macro impacts of events like the COVID-19 pandemic, and changes in workforce age and experience, remain.

AHE excludes workers who are not paid by salary or hourly wages; this would include pure commission or piece work-paid workers. This may not be a major concern, as utility workers are presumed by OEB staff to be classified as either salaried or hourly wage-paid.

One issue OEB staff has considered is whether unionized staff at utilities are categorized as hourly wage earning or salaried. A review of Statistics Canada's SEPH methodology is unclear about this. Some of the data is reported monthly for certain larger firms and comes from payroll data that is reported to the Canada Revenue Agency, while the same is reported on a survey form from a random sample of smaller firms in the same sector.[20] The base of hourly wage-earning employees is larger than that of salaried employees, but even the latter group of employees is substantial. OEB staff is of the view that for some firms, categorization of unionized employees as hourly wage-earning or salaried may depend on the firm, the union and the terms of the collective agreement. In particular, whether wage escalation is specified as occurring on an hourly rate or on an annual salary may be a key differentiator. Thus, the choice of AHE for either salaried employees or for hourly wage-earning employees may omit some material portion of utility employees.[21]

However, in OEB staff's submission, the main concern with these other current-weighted (or variable-weighted, the term the Bank of Canada uses) AWE and AHE statistics is the fact that, like the AWE – (Ontario, All businesses except Unclassified), all of these measures are impacted to a greater or lesser extent by COVID-related business restrictions on the active work force since the onset of the pandemic. As such, these do not address the issue and do not provide purer measures of wage inflation applicable to utilities (and to other "essential" businesses) for 2020 over 2019 while controlling for pandemic-related impacts. As such, OEB staff does not recommend these sub-indices as preferable to the current AWE measure.

[20] Guide to the Survey of Employment, Payrolls and Hours (statcan.gc.ca), *op. cit*., pp. 6-8
[21] Ibid., pp. 13-14. The definition for "Employees paid by the hour" is "Any employee whose basic remuneration is expressed as an hourly rate." For "Salaried employees" the definition is "Employees whose basic remuneration is a fixed amount for at least one week."

Average Hourly Earnings – Fixed Weight

Average Hourly Earnings (fixed weight) is a fixed weight index that combines salaried and hourly wage employees, but uses fixed weights for all years, for aggregating data across business sectors and between salaried and hourly wage employees; the weights reflect a 2005 year. Statistics Canada provides the following documentation on the fixed weight AHE statistic: [22]

> Fixed-weighted earnings index*: The fixed-weighted average hourly and weekly earnings indices have been constructed to better reflect the underlying changes in earnings by holding hours paid and employment composition among industries, provinces and territories and type of employee (hourly paid and fixed salary employees) constant through time.* At present, the fixed weights (basket) are based on the 2005 annual SEPH data. The base year, which is the year in which the indices are equal to 100, is 2002.
>
> Overtime hours and pay could skew the assessment of underlying wage trends since they tend to be volatile; therefore, overtime components are excluded from the calculation of the indices.
>
> *These indices are better indicators of the underlying trends in wage rates than the variable-weighted earnings series. They are useful for monitoring inflation due to wages, regardless of structural changes in employment.*
>
> Table 14-10-0213-01 provides a monthly fixed-weighted index of average hourly earnings for all employees, excluding overtime, by 2-digit NAICS industries. (emphasis added)

As noted by Statistics Canada, the intention of a fixed weight index is to create a statistic that more directly measures wage inflation, and is less impacted by other factors (e.g., fluctuations in overtime, changes in workforce composition,[23] and by capital/labour substitution). With fixed weights from a pre-pandemic period (2005), impacts of the pandemic and associated business restrictions that affected the

[22] Ibid., p. 14

[23] The changes in workforce composition represent several factors driving both temporary and often gradual but more permanent changes in the workforce: 1) growth and decline of industry sectors and at different rates; 2) the transition from a manufacturing-based to a service-based economy as has been observed in the U.S. and Canada, and other developed countries over a number of decades; 3) changes in the proportions of commissioned, piece-rate, hourly wage-earning, and salaried employees in the work-force over time. In normal economic times, these changes in workforce composition are gradual, but the COVID-related business restrictions have been an apparent “shock” to the active workforce in 2020 and from which we are in the midst of recovering from.

composition of the labour force are avoided.[24]

In the Fact Sheet, OEB staff also quoted from the Bank of Canada's July 14, 2021 Monetary Policy Report, regarding the differences between variable weight labour statistics of AHE and AWE:[25]

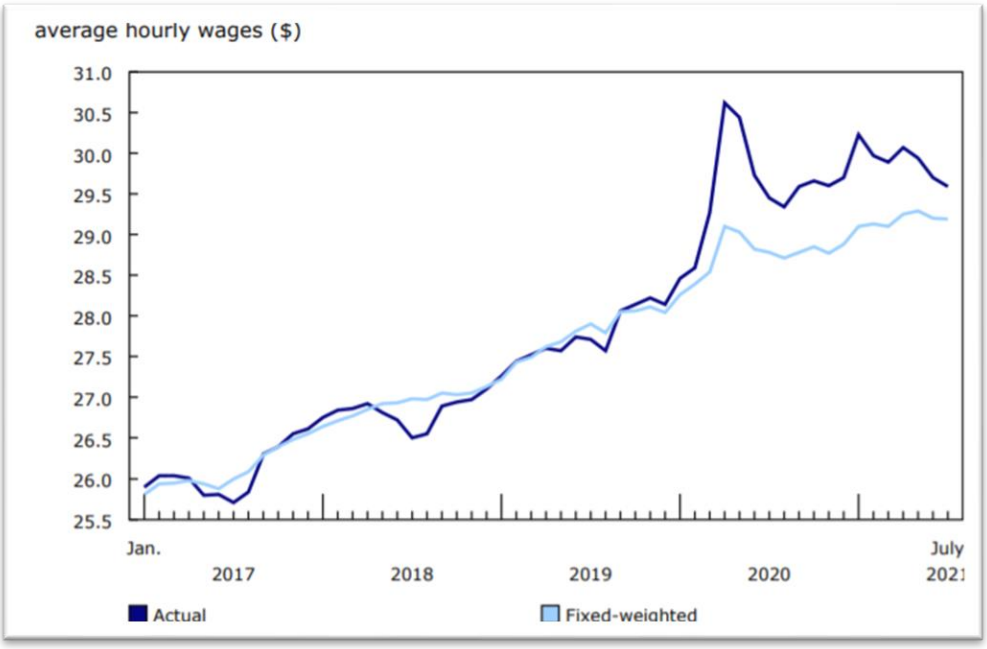
> Measures of wage inflation remain subdued … Swings in the number of workers in low-paying jobs during the pandemic have been making these measures volatile. Variable-weight measures have fluctuated the most, with high rates of wage growth when employment in low-wage jobs dropped. *Wage measures that are less influenced by such composition effects, including fixed-weight measures, have been more stable.* (emphasis added)

The statements of both Statistics Canada and the Bank of Canada regarding fixed-weight wage measures, indicate that they provide a purer measure of wage inflation during the pandemic and subsequent economic recovery. This is important if in the event the OEB is inclined to make a change to the labour component of the IPI for 2022 rates, as this approach minimizes, or controls for, COVID-19-related business restrictions on the composition of the active labour force during this pandemic.

Statistics Canada has confirmed this as it relates to their comparison of AHE current weight vs AHE fixed weight.

[24] For-example, COVID-related premiums paid to certain front-line workers, in supermarkets, pharmacies, and long-term care workers and nurses are temporary wage increases that are likely reflected in AWE and AHE statistics, including the fixed weight AHE. There may be an offsetting rebound when they are removed, as some have been in 2021. These are wage-related impacts of COVID. However, how the COVID pandemic and associated business restrictions have disproportionately removed lower wage-earning employees from the active workforce is not a wage-related impact, although it has resulted in a materially higher average weekly earnings and average hourly earnings for the remaining workforce.
[25] Bank of Canada, Monetary Policy Report, July 14, 2021, p. 16. A more complete reference is provided on page 17 of the Fact Sheet.

Table 2: Changes to Labour Market Composition Impact on Hourly Wage Trends



Actual average hourly wages are calculated using the distribution of employees by occupation and job tenure in the reference month. Fixed-weighted average hourly wages are calculated using the 2019-average distribution of employees by occupation and job tenure. *The fixed-weighted measure better approximates the real change in employee wages over the course of the pandemic because it shows what average wages would have been had the distribution of employees been the same as in 2019.*[26] (emphasis added)

In the Fact Sheet, OEB staff identified and provided the data for the Fixed Weight AHE for Canada – All Businesses excluding Unclassified and for Ontario – All Businesses excluding Unclassified.[27] OEB staff noted that the logarithmic annual percentage change in the Fixed Weight AHE for Ontario – All Businesses excluding Unclassified would be 3.31% (2020 over 2019). This would result in an IPI of 2.2% for electricity distribution and 1.9% for electricity transmission, when combined with the GDP-IPI annual percentage change of 1.7%. In OEB staff's view, the Fixed Weight AHE for either Canada or for Ontario would be a suitable alternative should the OEB be inclined to change the formula for 2022 rates. Examination of the trends of the data over time indicates less volatility than is shown by the current AWE series or by other current weight AHE series.

[26] Statistics Canada, Labour Force Survey July 2021
[27] Fact Sheet, Appendix F

Conclusion

OEB staff acknowledges that the OEB has a well-established policy and methodology for calculating the inflation factor – the IPI – for incentive rate applications for formulaic annual rate adjustments. The OEB can depart from the policy, if after consideration of the circumstances pertaining to a specific situation, it determines that it is warranted. OEB staff submits that either option 1 or 3 are a reasonable course of action to take. If the OEB determines that the AWE is not the index that best reflects the wage pressures that utilities are facing (and OEB staff believes that this may very well be the case), and that the impact is of sufficient materiality to warrant a variance from the policy as set out in the Report, then for the reasons described above OEB staff submits that the fixed weight AHE for Ontario (option 3d) is a preferable measure of wage inflation.

~ All of which is respectfully submitted ~