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September 1, 2023

VIA RESS

Ms. Nancy Marconi
Registrar
Ontario Energy Board
2300 Yonge Street, Suite 2700
Toronto, ON M4P 1E4

Dear Ms. Marconi:

Re: Request for Generic Variance Account; OEB File: EB-2023-0143

In accordance with the OEB's Notice of Hearing and Procedural Order No. 1 issued on August 1, 2023, enclosed please find the Reply Submission of Alectra Utilities.

Should you have any questions on this matter please contact the undersigned.

Yours truly,

Christine E. Long

Christine E. Long
Vice President, Regulatory Affairs
Alectra Utilities Corporation

REPLY SUBMISSION (EB-2023-0143)

On May 11, 2023 a group of Ontario's largest utilities[1] (the "Large Utilities") wrote to the OEB to request the establishment of a generic, sector-wide variance account for LDCs to track the incremental costs of locates for 2023 and beyond, mainly as a result of unforeseen cost impacts arising from the recently passed Provincial Bill 93 (*Getting Ontario Connected Act, 2022*).

On June 14, 2023 the OEB responded to the Large Utilities' letter indicating that it required further information in order to determine how to proceed. In particular, the OEB required certain evidence to be prepared and filed with the OEB such that it could determine whether a generic hearing is required and/or to determine if the evidence would support approval of the Large Utilities' request. The Large Utilities filed their evidence supporting the establishment of a variance account on July 7, 2023.

The OEB then issued Procedural Order #1, in which they invited written submissions by intervenors by August 18, 2023, and for the Large Utilities to submit reply submissions by September 1, 2023. This is the reply submission of Alectra Utilities.

Substantive Issues for Consideration

In its evidence, Alectra presented its case that pressures emerging from certain legislative changes have dramatically increased the volume and price of locates activity, as a result of both supply and demand factors[2]. The provincial government has pushed these legislative changes in an effort to facilitate faster building of infrastructure. In addition to the impact on supply and demand for locates activity, the shifting policy landscape has also had direct, and material impacts on utility obligations to perform their duties, which are required by law. In this respect, Bill 93 has had a material impact on compliance expectations and enforcement provisions. These require locates to be completed with five days with little to no flexibility, and now subject LDCs to administrative monetary penalties ("AMPs") in certain instances.

In addition, the increased demand for locates has necessarily impacted the availability of labour with appropriate skill sets required to conduct locates work. These new requirements have exacerbated already tight labour market conditions.

Cumulatively, the greater demand for locates, tightening supply conditions, and greater compliance expectations placed on utilities, including the introduction of a penalty regime for failure to comply, has resulted in much higher cost expectations than could reasonably have been anticipated by most utilities when rates were established in their last rebasing.

[1] The Large Utilities group consisted of: Alectra Utilities, Elexicon, Enbridge Gas, Hydro One, Hydro Ottawa, Oakville Hydro, and Toronto Hydro.
[2] These include: Bill 93, *Getting Ontario Connected Act*; Bill 23, *More Homes Built Faster Act*; Bill 171, *Building Transit Faster Act*; and Bill 257, *Supporting Broadband and Infrastructure Expansion Act.*

With that backdrop, the utilities have requested the OEB approve the establishment of a variance account such that costs can be tracked, and utilities be given the opportunity to seek to recover the difference between costs that are currently being recovered in rates and the new level of costs that are expected to transpire as a result of the shifting policy landscape.

Alectra has reviewed and considered the submissions of intervenors and finds that most parties did not dispute the nature or contextual background leading to increased locates costs. Some parties also agreed, either implicitly or explicitly, that the shifting level of costs could not have been reasonably anticipated by most utilities when rates were established. Similarly, it was observed by some parties that those utilities who have rebased recently might be in a better position to have established forecasts that embed some aspect of the shifting policy landscape.[3] For many utilities, and certainly for Alectra, however, the long duration since the last rebasing has created a material disparity between costs recovered in rates and now current expected costs for locates activity.

Most also agreed that the utilities have established reasonable grounds to consider that cost causation and materiality appear to have been met.[4] While utilities are moving ahead as prudently as possible given the circumstances, most also agreed that it will still be necessary to establish prudence when and if disposition is sought.[5]

Alectra believes it is important that the OEB understand that this case is simply about recognizing that utilities require a reasonable opportunity to recover costs, and that the shifting policy and compliance landscape have resulted in a material impediment to that end. Approving the establishment of a variance account to track costs until the next rebasing would provide a remedy to that condition; however, utilities will still be required to satisfy the OEB that cost causation, materiality, and prudence have been established when disposition is sought.

OEB staff captured that context best in its submission, as follows:

> *OEB staff submits that anticipated increased locates costs driven by the relevant legislation (and in particular Bill 93) are outside the base upon which rates for most (if not all) utilities were set. Most utilities have not rebased since the enactment of Bill 93 and could not reasonably have foreseen the impacts of Bill 93, and the other noted legislation, would have on their budget for locates. Therefore, any associated costs could not have been included in their revenue requirement. OEB staff observes that the utilities that have rebased since Bill 93 was enacted may have anticipated some of these additional costs, and this may be reflected in their current revenue requirements. However, this proceeding is to consider the appropriateness of generic, electricity and natural gas wide variance accounts. It is not necessary or efficient at this stage to parse the individual situations of each utility. OEB staff submits that the appropriate time to consider any utility specific circumstances (such as the*

[3] See: OEB staff Submission, p. 5; VECC Submission, p. 3; SEC Submission, p.2; CCC Submission, p. 3, PWU Submission, p. 1.
[4] See: OEB staff Submission, p. 5; VECC Submission, p. 3; SEC Submission, p.2; CCC Submission, p. 3, PWU Submission, p. 2, Quinte Manufacturers Submission, p. 1.
[5] See: OEB staff Submission, p. 5; VECC Submission, p. 3; SEC Submission, p.2; CCC Submission, p. 3, PWU Submission, p. 2, Quinte Manufacturers Submission, p. 1.

fact that they may have rebased since the enactment of Bill 93) should be considered at the time any amounts in the accounts are brought forward for disposition. OEB staff is mindful of the recent OPG decision. While there may be some utilities that foresaw or could have foreseen the impact of the locates legislation, it would be administratively burdensome for both utilities (especially smaller ones) and the OEB to insist that each utility file a separate application for an accounting order, and to deal with them on a case-by-case basis. The balance of convenience favours approval of an account on a generic basis and dealing with utility-specific circumstances at the time of disposition.[6]

So, while it appears that there is general agreement and acceptance of the utilities' request to establish a generic variance account[7], there are several details raised by intervenors that do require a reply. These include the following three areas:

- Whether the costs should be considered for Variance Account or Z-factor treatment;
- The determination of incremental costs;
- The appropriate implementation date for the new account.

Alectra addresses each of these items below.

<u>Account Classification</u>

Most intervenors agree with, or do not oppose, the creation of a variance account as the preferred approach to address incremental costs. The School Energy Coalition, however, did propose that the costs should be classified as a Z-factor. Alectra respectfully disagrees.

As a practical matter, it may not matter whether the cost recovery is classified as a Z-factor or as a variance account. That is, neither classification has a bearing on the actual costs that will be incurred, the determination of base rates around which to calculate incremental costs, nor the implementation date. However, as a matter of regulatory precision, Alectra believes it would be more accurate to establish the treatment as a normal variance account rather than as a Z-factor event, for a variety of reasons.

Since the beginning of incentive rate regulation, there has always been acceptance that certain events, which are unforeseen and beyond the ability of management to control, could happen and that relief related to that event could be sought if the conditions of causation, materiality, and prudence were satisfied. Critical to the definition of Z-factor classification, however, requires a certain event to have occurred. What constitutes an extraordinary "event" is straight forward when the event is a matter of some physical disruption to operations (for example, a storm event).

The Chapter 3 Filing Guidelines indicate that a requirement for Z-factor recovery is for utilities to demonstrate that the costs were incurred within a 12-month period and are incremental to those already being recovered in rates.[8]

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[6] EB-2023-0143, Request for Generic Variance Account, OEB Staff submission, p. 5, August 18, 2023.
[7] Energy Probe was the only party to oppose the establishment of a variance account.
[8] Chapter 3 Filing Guidelines, section 3.2.8.1

In Alectra's view, it does not seem appropriate that a series of legislative changes can be construed as constituting an "event" and further that either the set up or the future cost implications of the changes can be contained or confined to a 12-month period.

In the first instance, as described above, the overarching policy shift in Ontario, and the enhanced, stringent compliance expectations characterized in Bill 93, emerged as a result of a confluence of changes to various legislative Acts. There was no single event which caused the shift in the policy landscape which has materially affected the supply and demand for locates activity.

In the second instance, the cost implications of the shifting policy landscape can be, and is, expected to result in higher costs from the time of implementation and going forward. In other words, the shift is not contained to a 12-month time bound period. It represents the "new normal" going forward for the level of locates costs.

Finally, Alectra sought to review the definition for a Z-factor event in the Renewed Regulatory Framework. That body of work declared no change to the definition and referenced the Second Generation IR Mechanism. A review of that body of work included the following:

> *For 2nd Generation IRM, the Board will limit reliance on Z-factors to well-defined and well-justified cases only – specifically, Z-factors will be limited to changes in tax rules and to natural disasters.* [9]

The subject matter of this application, being the establishment of a variance account to track incremental costs due to locates activity, is neither the result of a change in tax rules, nor due to a natural disaster event.

<u>Determination of Base Rates</u>
In its presentation of evidence, the Large Utilities provided estimates for the determination of how much cost recovery for locates is included in base rates. Generally speaking, this was accomplished by escalating the OEB-approved amount[10] included at a utility's last rebasing by the IR escalation formula[11] since that last rebasing.

No party indicated any specific opposition to the approach adopted by the Large Utilities and only OEB staff made any comment about the approach. In particular, OEB staff argued that the base level budget approved in the last rebasing should be adjusted by the rate of growth in revenue instead of the rate of growth in rates. Alectra disagrees.

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[9] Ontario Energy Board, Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors, December 20, 2006, p. 34.
[10] For most utilities, the amount included for recovery in base rates would have been included in a total O&MA cost recovery. That is, the OEB may not have specifically approved a particular budget for Locates per se, but the budget amount would have been included in an overall O&MA envelope amount.
[11] The IRM escalation rate is determined as: OEB-approved Inflation Factor less a Productivity Factor less a Stretch Factor. Algebraically, the formula can be expressed as: I - (X + Stretch Factor).

The activity of conducting locates has no bearing on revenues. It is only a cost. That is, the growth rate in the cost factor (here, locates) has no association with the growth rate in revenues. To wit, the entire point of the application made by the Large Utilities is that the growth rate in the cost factor for locates far exceeds the growth rate in revenues, and there is no correlation between the two.

In addition, the concept that revenue growth arising from growth in customer connections would be enough to compensate for higher locates costs contains a flaw in logic. That is, even as OEB staff have articulated, the incremental revenue associated with growth in customer connections leads to both incremental revenue as well as incremental costs[12]. As a result, the incremental growth in customer connections is not a good proxy for revenue growth. Taken to its logical conclusion, the OEB staff method suggests that the growth in revenues must be evaluated against the incremental growth in costs. Alectra estimates that the growth level for locates costs to be roughly 11.28% on a compound annual growth basis.

Alectra maintains that the most efficient and prudent path forward is to escalate the amount approved in base rates by the IRM adjustment formulaic adjustments for each year. Indeed, this is the point of a price cap escalation factor, which is intended to allow some price growth, dampened by an expectation for productivity gains, to compensate for cost growth. To implement a revenue cap escalation factor would require a restatement of the inflation and productivity factors to be conditioned to revenue growth rather than rate growth. No such study has been conducted to accommodate or support such an outcome.

As it is, the method proposed by the Large Utilities would capture the delta as between the actual costs incurred and a reasonable proxy for cost growth that was expected to have been experienced as proxied by the price cap index. In other words, the difference accumulated for disposition would represent the amount of "extra-normal" cost growth due to the shifting policy environment.

Implementation Date

Some parties took the position that the implementation date for the variance account should be established as of May 2023, as this coincides both with the date that Bill 93 came into force and matches the period with which the utilities raised the issue.

Alectra disagrees. First, Bill 93 received Royal Assent on April 14, 2022, and its relevant provisions came into force on April 1, 2023. However, utilities began incurring incremental costs in advance of April 1, 2023, in order to meet the new performance standard. Accordingly, it is appropriate that incremental costs resulting from legislation incurred from January 1, 2023 onward be eligible for the variance account.

Second, other influential Acts came into effect earlier[13] and had already begun to impact the pace and level of locate activity. However, it was not until the new compliance regime began to take root that the utilities recognized that a material shift in costs would need to be accommodated. As Alectra described

[12] EB-2023-0143, Request for Generic Variance Account, OEB Staff submission, p. 7, August 18, 2023.
[13] Bill 23, *More Homes Built Faster Act* came into force November 28, 2022; Bill 171, *Building Transit Faster Act* came into force July 8, 2020; Bill 257, *Supporting Broadband and Infrastructure Expansion Act* came into force April 12, 2021.

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in its evidence, even by October 2022 discussions with authorities continued on the treatment of penalties. The outcome of these discussions were not known even at the end of 2022, and the outcome would necessarily have a material impact on compliance enforcement, and therefore the establishment of operational plans. In other words, the utilities could not have been in a position to have made application to the OEB for a variance account at that time. The utilities posted their letter to the OEB as soon as the implications for the legislative changes, including the change to the compliance regime, were known.

As VECC points out in their submission:

> *We note that in their letter of December 8, 2022 the Large Utilities made several reasonable suggestions toward making the objectives of modernizing Ontario's One Call system. Further suggestions were made in a letter of May 10, 2023 after the introduction of Bill 93. Again, these show the Utilities acting in the interest of ratepayers to mitigate unintended consequences of the immediate introduction of the proposed locate changes.*[14]

Further complicating the issue of a May implementation date is that utilities do not have a January to April budget. In fact, as stated by many of the applicants, the pace and level of locates activity almost universally coincides with the construction season which begins in May, typically.

Conclusion

In conclusion, Alectra believes that on the whole there is no wide-spread opposition to the establishment of a mechanism to track higher than expected locates costs beginning in 2023 as a result of the changing policy landscape. The utilities seek a reasonable opportunity to recover costs that are being experienced at a level that was unanticipated at the time of rebasing, arising as a result of government priorities and policies. The utilities accept that any future case seeking disposition will require a clear and explicit review of causation, materiality, and prudence to establish a basis for the OEB to approve the relief.

While most stakeholders do not oppose the establishment of a variance account, certain key parameters do require the OEB consideration so that the conditions for recovery can be understood by all. To this end, Alectra believes these issues, and their resolution are as follows:

- Account Classification: The account should be established as a variance account, rather than as a Z-factor, because the nature of the costs do not lend themselves well to certain Z-factor criteria. Namely, the changes are not the result of a specific 'event' per se and are not time bound to a specific 12-month period.

- Determination of Base Rates: The establishment of base rates should employ IRM adjustment formulae to proxy the growth rate of amounts available for cost recovery in current rates.

[14] EB-2023-0143, Request for Generic Variance Account, VECC submission, p. 4, August 18, 2023.

- Implementation Date: The utilities continued to work with government to understand the conditions for compliance up to and until April 2023. With the uncertainty at that time regarding the scale, scope, and conditions of work, the utilities could not have been in a position to bring application before the OEB any sooner than May. When the conditions for compliance were finally determined, the utilities put forward their request for a variance account as quickly as possible.

Alectra believes that the establishment of a variance account that is constituted according to the discussion points above are reasonable and fair to both the utilities and ratepayers. The variance account will help to ensure that the utilities are in a position to work to implement the policy direction established by the government.