EPCOR
43 Stewart Road
Collingwood, Ontario
L9Y 3M7 Canada
epcor.com

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Sent by EMAIL, RESS e-filing

Ms. Christine E. Long
Registrar
Ontario Energy Board
27-2300 Yonge Street
Toronto, ON M4P 1E4

Dear Ms. Long:

Re: Consultation on the Deferral Account – Impacts Arising from the COVID-19 Emergency
Submissions on Ontario Energy Board ("OEB") Staff Proposal - EPCOR Natural Gas Limited Partnership ("ENGLP")
OEB File No. EB-2020-0133

The following are EPCOR Natural Gas Limited Partnership's ("ENGLP") comments on the OEB Staff Proposal received on December 16, 2020 for the OEB's Consultation on the Deferral Account – Impacts Arising from the COVID-19 Emergency ("the Proposal").

While EPCOR Utilities Inc., through its subsidiaries, operates a natural gas utility in the Aylmer and Southern Bruce areas and an electrical distribution utility in the province of Ontario, the focus of this submission is the impacts arising from the COVID-19 emergency on the ENGLP's Southern Bruce operations given the unique circumstances and regulatory context of this utility as outlined further below.

Overview and General Comments

ENGLP supports the principle that recovery of Deferral Account balances requires preservation of financial incentives and balancing pandemic cost impacts and risks as between all stakeholders, in a manner that is fair and reasonable. However, guidance on the recovery of impacts should take into account the unique circumstances and regulatory context of a utility.

The Proposal does not consider or address the impact of the pandemic on a greenfield utility, such as EPCOR Southern Bruce, which has been primarily focused on the construction of its natural gas system and building the operation’s initial rate base, during the pandemic.

Most, if not all, incremental costs incurred by ENGLP Southern Bruce due to COVID-19, are capital costs associated with constructing the pipeline and connecting customers. Furthermore, ENGLP Southern Bruce is operating within the unique regulatory context of being bound by the risks assumed through the Common Infrastructure Plan (CIP) proceeding EB-2016-0137/0138/0139, the resulting revenue requirement and 10-year rate stability period of January 1, 2019 to December 31, 2028, for which rates ENGLP’s were approved in its rates application EB-2018-0264. Accordingly, these unique circumstances and regulatory context warrant treatment outside of that covered by the Proposal.

ENGLP Southern Bruce’s revenue requirement for the 10-year rate stability period has been set through the CIP based on a specified set of assumptions. Accordingly, the rate base and revenue requirement were established based on the utility’s assumption of the risks associated with normal and reasonably expected operating conditions, within which a 1 in 100 year pandemic does not fit. Through the CIP, the 10-year rate stability period and the limitations of its Custom IR Plan, Southern Bruce has assumed certain risks that other utilities do not. However, the Board’s approval of a Z-factor as part of ENGLP’s Custom IR Plan for Southern Bruce is evidence that the risk of events during the rate stability period which are clearly outside the control of management is not a risk that the utility accepted as part of the CIP process.

While the Proposal presents a number of arguments as to why COVID-19 is not the same as a Z-Factor event, ENGLP made no such distinction when assessing the risks and determining the revenue requirement as part of the CIP. Accordingly, ENGLP respectfully submits that in consideration of the additional risks which this greenfield utility accepted through the CIP and the application of the rate stability period, this after the fact distinction of an event outside the utility’s control exposes it to additional risk for which it is not compensated. ENGLP’s recognizes that the Z-factor mechanism included in its Custom IR Plan has specific features with respect to notice requirements, and ENGLP would have filed such notice if not for this consultation process initiated by the OEB.

ENGLP proposes that an additional sub-account of the Deferral Account be established to allow it to separately track incremental capital costs, in particular those costs associated with constructing the pipeline and connecting customers. Since neither the

London Economic International LLC (LEI) reports nor the Proposal considered or addressed the impact of these costs on greenfield utilities, a sub-account will enable these amounts to be segregated such that at the time of disposition, there can be focused and detailed consideration of the recorded amounts.

Due to the number of risks that ENGLP Southern Bruce assumed through the CIP, 10-year rate stability period and limitations of the Custom IR Plan, the utility takes the position that incremental capital costs should be fully recoverable and should not be subject to the Proposal's means test or recovery rate factor.

ENGLP acknowledges only those capital costs that are prudently incurred and demonstrably linked to the pandemic should be recovered through the sub-account and further, these costs should be subject to some form of recovery criteria and threshold. Accordingly, ENGLP proposes that the OEB apply the principles and criteria of its Z-factor mechanism, as further detailed below.

Previous Comments and OEB Response

ENGLP submitted comments in response to the draft issues list as part of this consultation on June 11, 2020, noting similar concerns and comments to those above.

In its response dated, August 14, 2020, the OEB noted that the recommendations related to new sub-accounts for incremental capital costs and the associated issues raised by ENGLP and other greenfield utilities can be assumed under Issue #5[1]. The OEB further noted that "in the event that there is a need to address matters raised in their comments prior to the completion of this consultation, WPLP, NextBridge and EPCOR may bring forward their concerns and proposals in their respective upcoming rate applications".[2]

During the January 14, 2021 Stakeholder Webinar for this consultation, ENGLP asked for clarification from LEI as to whether their research considered the specific circumstances of greenfield utilities in the midst of constructing the utility's assets to which LEI responded that this was not a consideration. In response to a similar question posed to OEB Staff,

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[1] Issue #5 is "Should additional sub-accounts of the Account be established? If so, what additional sub-accounts should be established and why?

[2] Consultation on the Deferral Account – Impacts Arising from the COVID-19 Emergency – Issues List August 14, 2020, page 12.

they indicated that the unique circumstances of such greenfield utilities were not considered or addressed in the Proposal.

ENGLP Southern Bruce notes that it is early in its 10-year rate stability period, and its next rate application will be for rates effective January 1, 2029. Accordingly, it will not have an opportunity to address its specific concerns in a rate application in the reasonable future and therefore ENGLP is seeking guidance for its specific circumstances as part of this proceeding or through a separate proceeding if that is the OEB's desire.

Specific Comments and Proposed Approach

1. Means Test/Principle of "Necessity"

Reference: OEB Staff Proposal page 3:

OEB staff is of the view that utilities must demonstrate a financial need for recovery of amounts in the Account, subject to certain exceptions described below. OEB staff suggests that a means test based on the lower end of the OEB's dead band of approved ROE ensures that utilities who make recovery claims are doing so to ameliorate the fact that their earnings have been reduced below the point of reasonably expected fluctuations, as opposed to restoration of their full profitability margins.

ENGLP's view is that the application of a means test is not appropriate for the Southern Bruce operations. While mathematically the means test would favour ENGLP Southern Bruce since the utility has little in terms of operating revenue, conceptually such a test does not make sense for a greenfield utility that is still constructing some of the initial rate base and is not operating or early in operations. In general, a greenfield utility's inability to record prudently incurred costs which are related to events outside of its control and are associated with its initial rate base can set the utility up to under earn before it even begins operations.

Furthermore, applying a means test or some measure of necessity to determine ENGLP Southern Bruce's ability to recover prudently incurred costs that are outside of management's control, and the basis on which the revenue requirement was set, is inconsistent with the principles of the CIP process similar to how the inclusion of an earnings sharing mechanism or an earnings dead-band off-ramp in ENGLP's Custom IR Plan for the 10-year rate stability period would have been inconsistent with the CIP. As noted in the approved settlement in ENGLP Southern Bruce's rate application EB-2018-0264, all parties agreed that the exclusion of a productivity factor, stretch factor, earnings sharing mechanism and an earnings dead-band off-ramp are consistent with EPCOR Southern Bruce's CIP proposal.[3]

ENGLP agrees with LEI and OEB Staff's comments noted in the Proposal that "utilities cannot expect to both earn an equity return and have the financial consequences of risk eliminated". However, as noted above, through the CIP ENGLP Southern Bruce has already assumed certain risks that other utilities do not. The OEB did not dictate that the proponents use a certain ROE for the CIP but found that the return on equity is properly considered competitive[4]. In its CIP submission ENGLP elected to adopt the OEB's deemed cost of equity at the time, considering this to be fair despite the additional risk the utility would be taking both because the additional risks were largely within its control and because of the potential upside to that ROE afforded it through the CIP. In setting its ROE for the CIP, it expected that risks associated with prudently incurred costs related to unforeseeable events outside of management's control would be borne by the ratepayers. The OEB's approval of the Z-factor as part of ENGLP's Custom IR Plan for Southern Bruce aligns with this expectation.

As noted above, but for the OEB's proceeding with respect to the pandemic, ENGLP would have filed for recovery of these costs as a Z-factor claim in accordance with its Custom IR Plan in order to uphold the principles of the CIP and the basis upon which ENGLP's Southern Bruce revenue requirement was set. ENGLP acknowledges that in order to be considered for recovery, amounts related to Z-factor events must meet certain criteria; however, the application of a means test or duty to demonstrate necessity is not a criterion for recovery of these costs.

To ensure that the principles of the CIP are honored, ENGLP Southern Bruce proposes it be allowed full recovery of prudently incurred additional costs without the application of a means or necessity test. Below ENGLP has proposed alternate criteria to be applied to such costs.

2. Cost Mitigation Steps

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[3] EB-2018-0264 – Decision on Settlement Proposal and Procedural Order No.6, October 3, 2019, Schedule A, page 22

[4] EB-2016-0137/0138/0139 – Decision on Preliminary Issues and Procedural Order No. 8, August 22, 2017, page 5

ENGLP agrees with OEB Staff's comments in the Proposal related to the need for the utility to mitigate to the extent possible the impacts on customers.

The CIP process and ENGLP Southern Bruce's 10-year rate stability period inherently incent the utility to mitigate costs as much as possible regardless of recoverability by ratepayers. This was noted by the Board in its findings in the Board's Generic Proceeding on Community Expansions, where it found that "The selected proponent would then be incented to maintain low rates in order to be attractive to potential customers which would in turn increase its margins."[5] In addition to the utility's ongoing practice of prudence, this mechanism will further keep ENGLP's Southern Bruce pandemic related cost claims in check as it is in ENGLP's best interest to mitigate the impact of the pandemic on its rates in order to continue to incent customer conversions.

ENGLP Southern Bruce is under a fixed price contract with its Design-Build (DB) contractor for the construction of the utility's initial rate base which includes the sharing of risks related to force majeure. This has served to mitigate the impact of the pandemic on the construction costs of these assets and ENGLP's claim related to such construction costs would be limited to the amounts payable to the contractor in accordance with the provisions of this contract.

ENGLP expects to demonstrate the mitigation measures taken for any additional costs claimed as part of demonstrating its prudency in incurring the costs in any claim it brings forward.

3. 50% Rate of Recovery

Reference: OEB Staff Proposal page 3-4:

For utilities that pass the means test, OEB staff recommends that any material and prudently incurred incremental impacts, directly attributable to the pandemic, should be eligible for recovery at a rate of 50%. This net-cost sharing approach recognizes:

- *The need to preserve the financial incentives to mitigate costs and maximize savings attributable to the pandemic, a principle consistent with incentive ratemaking*

[5] EB-2016-0004 – Decision with Reasons, November 17, 2016, Section 6, page 20

- *The fact that ratepayers are experiencing economic hardship from the same events that are driving the incremental impacts to utilities, which is not typically the case with traditional Z-factor events*
- *The striking of a balance between two potentially opposite positions expected to be taken by utilities and other stakeholders – i.e. the balance between full recovery and full disallowance*
- *The need for regulation to serve as a proxy for competition. In the competitive environment, many businesses have incurred, and continue to incur, losses attributable to the pandemic. A recovery mechanism that fully insulates utilities from the pandemic's negative impacts would be misaligned with the regulator's role to mimic competitive forces*

ENGLP acknowledges the widespread societal impacts of the pandemic and understands the added financial strain this has meant to many individuals and businesses in Ontario. However, ENGLP submits that the proposed shared recovery is not appropriate in all circumstances.

To date, the majority of the additional costs ENGLP has identified are related to the construction of the utility's assets for which shared recovery is not appropriate since such a disallowance would impact the utility over the life of the assets not just over the term of the pandemic. By the same token, the impact of such cost increases on customers is lessened since the recovery of the costs is spread over the life of these long term assets. Accordingly, full recovery of these costs would not have the same immediate impact on customers during the challenging economic times as would other types of costs which may be recovered over a much shorter period.

As noted above, ENGLP agrees with OEB Staff's comments that there is a "need to preserve the financial incentives to mitigate costs and maximize savings attributable to the pandemic". ENGLP submits the implementation of a sharing mechanism is not appropriate for its Southern Bruce operations since such financial incentives are already embedded within its regulatory context given that the CIP and 10-year rate stability period incent the utility to reduce any upward pressure on rates in order to ensure its customer conversions as noted above. Furthermore, ENGLP agrees with the principle that regulation serves as a proxy for competition in respect of the net-cost sharing approach. However, in the case of ENGLP Southern Bruce regulation has already served this purpose through the CIP whereby the utility was subjected to a competitive process. The principles of that competitive process are applied to the utility's revenue requirement throughout the 10-year stability period and, in some cases, beyond.

ENGLP recognizes that by their nature, operations, maintenance and administration (OM&A) costs would likely be recovered over a shorter term than capital costs thereby potentially having a bigger near-term impact on ratepayers. To date, ENGLP Southern Bruce has not identified any material one-time or ongoing impacts to its OM&A costs and therefore does not expect the recovery of such costs to be a significant impact on its customers during economically sensitive times. Given that the pandemic is ongoing and may have lasting impacts on the operations of a utility, in the event that ENGLP Southern Bruce does identify material OM&A costs it would explore methods of recovery which reduce the near-term impacts on customers such as stretching out the recovery period.

Given the above circumstances, ENGLP proposes that no recovery rate factor be applied to the cost claims for its Southern Bruce operations.

4. **Proposed Methodology**

In order to align with the principles of the CIP and its 10-year rate stability period ENGLP Southern Bruce proposes the OEB allow it unique treatment with respect to the recovery of prudently incurred, directly related incremental pandemic costs. ENGLP submits that the appropriate treatment for these costs for its Southern Bruce operations would be to apply the principles and criteria of its Z-factor mechanism: causation, materiality, prudence and management control.

In summary, the treatment ENGLP proposes is as follows:

- no means or necessity test be applied as a criteria for recovery;
- claims submitted must meet the criteria established for its Z-factor of causation, materiality, prudence and management control; and
- recovery rate for costs be at 100%.

ENGLP proposes that incremental capital amounts claimed be treated differently than OM&A related amounts and this would be best facilitated with the establishment of a capital specific sub-account for ENGLP Southern Bruce. ENGLP proposes it be allowed to record the revenue requirement associated with the amounts in the account until such time as the costs are brought into rate base.

5. Timing of Recovery

The Proposal suggest that amounts should be recorded in the applicable deferral accounts until the utility's subsequent rebasing application at which time utilities will have an opportunity to reflect on the new operating "normal". ENGLP agrees that this approach makes sense for utilities who have the opportunity to rebase in the near term.

Given ENGLP Southern Bruce's unique circumstances as described herein, including the amount of time until the next planned rebasing (2029), ENGLP proposes it be allowed to:

a) dispose of any capital cost related deferral account balances as part of a future IRM filing. This would take place when the full impact of the pandemic is known and such balances have been audited;
b) bring the approved capital costs into rate base and include the associated revenue requirement in rates in a future IRM filing at which time it would cease recording any future related amounts in the deferral account. This would take place when the full impact of the pandemic on these costs is known;
c) dispose of any OM&A related deferral account balances as part of a future IRM filing. This would take place when the full impact of the pandemic is known and such balances have been audited;
d) bring the ongoing/new "normal" OM&A related costs into rates in a future IRM filing and cease recording future related amounts in the deferral account. This would happen once ENGLP has enough data to forecast such costs.

At the time the balances are brought forward for disposal ENGLP will propose the manner for disposal and will demonstrate that the items meet the criteria it has proposed above, including prudency.

All of which is respectfully submitted.

Sincerely,

Tim Hesselink
Senior Manager, Regulatory Affairs

EPCOR Natural Gas Limited Partnership
(705) 445-1800 ext. 2247
THesselink@epcor.com

cc. Fiona O’Connell, OEB Staff
Daniela O’Callaghan, EPCOR Utilities Inc.
Susannah Robinson, EPCOR Utilities Inc.