PUBLIC INTEREST ADVOCACY CENTRE
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Consultation on the Deferral Account –
Impacts Arising from the COVID-19 Emergency
EB-2020-0133

Comments on Staff Proposal

From the
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(VECC)

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Introduction

These are VECC's comments with respect to the OEB Staff Proposal entitled Consultation on the Deferral Account – Impacts Arising from the COVID-19 Emergency, December 16, 2020. They are organized as a summary table followed by reasons for our suggested approach.

While we have critiqued Board Staff's proposal, we would be remiss if we did not also make the observation that we found the work robust and clear. We also found the expert papers by London Economics International on jurisdiction ('LEI Jurisdiction'), cost of capital ('LEI Capital'), load ('LEI Load') and its impact study ('LEI Impact') to be very helpful in coming to our position.

Summary of the submissions

Our submissions are summarized in the table below.

Issue	Staff Proposal	VECC's Position
1) Principles and Approach	OEB staff recommends that the recovery of the Account balance requires each of: • A preservation of the financial incentives inherent in, and consistent with, the OEB's general incentive ratemaking framework • A recognition of the fact that both customers and utilities are adversely impacted from the same events • A need to demonstrate that earnings are beyond the range of reasonably expected fluctuations for a regulated utility OEB staff has also included the principle of "necessity" for stakeholder consideration. The principle of necessity, which underpins the Staff Proposal, can be described as follows: • Recovery of any balances recorded in the Account should be subject to evidence that the costs are not only reasonable, but also necessary to the maintenance of the utility's financial viability.	- Agree with the three principles of account recovery. - The principles of "necessity" is neither well-defined or a principle broadly accepted or understood in utility regulation. - The Board should address how the pandemic affects the well-founded principle of "the fair return standard." The fair return standard is not eliminated during any economic downturn, even as severe as the pandemic, but the measure of "fair" is modified by the extreme circumstances.
2) "Costs" to be Included /Considered for Recovery	• Operating costs incurred due to the pandemic • Bad debt costs incurred due to the pandemic • Lost revenues due to the pandemic • Incremental capital-related costs/savings that are permanent but not those that are due to changes in time.	- Agree with Staff Proposal except for Lost Revenue which should not be eligible for recovery.

3) Criteria for Recovery		
1.1 Materiality	• Use materiality thresholds stablished in last COS proceeding. • Materiality based on the total amount recorded (inclusive of any offsetting savings)	- Agree with use of materiality thresholds established in last COS proceeding- However, as outlined below, VECC's proposal does not separate out cost incurred to meet specific government/OEB directions from other prudently incurred costs due directly to the pandemic
	- The one exception is costs incurred to meet specific government/OEB directions which, in aggregate, subject to a separate materiality test.	
1.2 Causation	- Costs must have only been incurred due to the pandemic	- Agree
1.3 Prudence	• Utilities to demonstrate that pandemic related costs were prudently incurred Utilities to demonstrate they have taken advantage of any cost savings opportunities arising due to the pandemic (e.g., lower financing costs)	- Agree
4) Eligibility for Recovery		
3.1 "Means Test"	- For amounts other than those incurred directly as a result of government/OEB direction – recovery permitted if ROE less than 300 bps below that approved in rates but only up to point where ROE achieves this threshold. - For those amounts those incurred directly as a result of government/OEB direction, allow recovery up to approved ROE plus 300 bps.	- Recovery threshold is ROE less 400 bps below what is established in rates. This amount is found by looking at variation in past earnings of utilities - Same threshold applies for all eligible amounts.
3.2 "Percentage Recovery"	- For amounts other than those incurred directly as a result of government/OEB direction – allow 50% recovery up to approved ROE less 300 bps threshold - For amounts incurred directly as a result of government/OEB direction – allow 100 % recovery up to ROE plus 300 bps threshold	- 100% recovery up to allowed threshold of approved ROE less 400 bps
3.3 Exceptions	- Utilities may apply for relief from the 50% recovery limit if facing financial hardship or other extenuating circumstances	- Utilities unable to meet their obligation to provide safe/reliable service based on allowed recoveries can make separate application based on their circumstances. Such applications would be "separate" from the deferral account recovery process.
5) Timing of Disposition	- Based on audited statements - Prefer awaiting the next COS application but standalone application if utility views waiting is not a viable option	- Agree
6) Period for the Account	- Amounts to be recorded until utility's next rebasing	- Amounts to be recorded until pandemic related restriction lifted or next rebasing- whichever comes first.

Principles & Framework

In essence Staff's paper attempts to answer a series of questions arising from the economic consequences of the ongoing pandemic. These are:

1. What is the test of eligibility to recover any extraordinary pandemic related costs?
2. What portion of those costs eligible should be allowed to be recovered?
3. Should lost revenues also be eligible for recovery and if so how is this amount to be determined?
4. If lost revenues are eligible for recovery and can be determined what portion of those revenues identified should be allowed to be recovered?
5. When and how are any amounts determined eligible to be recovered from customers?

To answer these questions, like Staff, we turned to an analysis of regulatory principles and the Board's existing articulated policies. In our view the approach to what relief to provide utilities should start with these existing principles and policy framework. The question is then to ask: what, if any, departure is required from those principles?

Regulatory Principles

The overarching principles of regulation are well established and the specific form of them is set out in legislation. The basic premise is to set "just and reasonable" rates. Just and reasonable applies equally to the shareholders of the utility as it does to its customers. The existence of the regulator is due to market failure and that, for the absence of regulation, the incentives would be for shareholders to extract monopoly rents.

The Board's governing legislation gives it a broad breadth of authority and judgement to achieve just and reasonable rates. For example, the Ontario Energy Board Act does not require (as it once did) for rates to be set by any specific methodology. The movement away from annual cost of service regulation to incentive-based regulation is the underlying basis of the Board's Renewed Regulatory Framework. That framework articulates the premise that just and reasonable rates can be achieved without continual reference to the underlying costs of service.

When rates are set on a cost of service basis (or 'rebased' in the Board's parlance) the setting of the cost of capital - for anything other than embedded actual debt – is an approximation or a proxy value. In fact, the values of debt and equity are for some utilities partially notional. The allowed return on equity is set using a methodology which has not been reviewed in many years but is based on a premise of "risk premiums" which themselves are based on the study of market return variabilities over time. All of which is to say it is an inexact method. And certainly, it does not anticipate extreme (or as viewed by Board Staff "once-in-a-century) economic disruption.

Our view is that the Board can continue to rely on the established regulatory principles and the regulatory tools without resorting to inventing new ones.

As such we agree in part with Staff's proposal. The use of achieved rates of return as the starting point for determination of whether certain pandemic related costs are recoverable through deferral accounts is a defensible approach. However, we disagree with Staff that a new and rather ill-defined principle, of "necessity" need to be invented on the fly.. Rather the Board should, in our view, focus on how the principles and tools it already has at its disposal can be modified to address the current circumstances.

The fair return standard

The fair return standard is a matter of law, established by the Supreme Court of Canada and the United States Supreme Court and widely accepted by both national and provincial/state utility regulators across the North America. In short it states that the duty of the regulator is to fix rates fair to the consumer on the one hand, and which, on the other offer the company's shareholders an opportunity to earn a fair return on their invested capital The Board's fixing of a rate of return on equity to be incorporated as a cost component of the rate is one aspect of implementing the fair return standard.

Well known among the legal cases for the fair rate of return standard is the Bluefield case. In Bluefield Water Works & Improvement Company vs. Public Service Commission of The State of West Virginia et al, 262 U.S. page 679 at page 692 it is said:

> *"The company contends that the rate of return is too low and confiscatory. What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public* ***equal to that generally being made at the same time*** *and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit to enable it to raise the money necessary for the proper discharge of its public duties.* ***A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally."*** (emphasis added)

In the face of the pandemic the Board does not need to resile from the fair return standard. Rather it needs to put that standard in context. The exercise before the Board is to consider in the current economic climate the extent to which the utilities are affected **relative to all other sectors of the economy**. It is also important to note that it is not the Ontario Energy Board's role or duty to ensure that the companies earn the return used to establish those rates or guarantee that it earns the prevailing returns of similar or different businesses. Like other firms regulated utilities

must also rely on their own good management and a bit of luck in the face of the vagaries of the marketplace.

Necessity

Staff proposes to introduce a new principle called "necessity". They define that term as:[1]

> *Recovery of any balances recorded in the Account should be subject to evidence that the costs are not only reasonable, but also necessary to the maintenance of the utility's financial viability*.

Staff appears to have adopted this "principle" from the finding in the LEI Jurisdiction study that "*22% of commissions stated their intent to consider necessity when reviewing future requests for recovery*." We are not aware of the term having any broadly accepted meaning in regulatory literature or practice. Nor is it clear how it is to be distinguished from more widely accepted principles of 'just and reasonable', 'used or useful' or the regulatory concept of prudence.

The word "necessity" in Staff's definition is a modifier to the term "*the utility's financial viability*", a concept that is left undefined. Is financial viability meant as the bare ability to keep the lights on even if the system is allowed to degrade for lack of investment? Or does it mean that during the pandemic a utility should only maintain an asset if that is less costly and delay the replacement of capital? Is recovery of cost "necessary" for a utility with a negative cash flow but who can still borrow monies to cover shortfalls-an occurrence known to happen to some non-regulated businesses? Or does it mean that a utility should not be entitled to recover pandemic related costs so long as it able to cover it debt covenants thereby not default on its loans?

In our view it is not necessary to delve into these questions because the addition of a new ad hoc regulatory principle is not necessary. The basic premise put forth by Staff is to use a discount from the rate of return established in the rate as a test for eligibility. This test relies on the principle of fair standard return as adjusted for the unique circumstances and to the extent these circumstances are attributable to the pandemic. And this premise is, as we note in the references above, entirely consistent with the application of the fair return standard because it recognizes that what constitutes a fair return can change when economic circumstances changes and that regulated utilities are not entitled to any specific rate of return but must manage to changing circumstances.

Summary of the current Regulatory Framework

Economic turndowns (and upturns it should be remembered) are not new and neither are variations in revenues arising from other externalities most notably weather. All can impact a utility's returns as can poor management. The Board's regulatory framework recognizes that for

[1] Staff, page 11

some externalities there may be a case for adjustment to the rate (temporarily through recovery of accounted costs or permanently through rate adjustments). Significant change in the tax laws is one such commonly identified externality. These mechanisms are set out in the table below as well as the process the Board engaged in the last recession.

COMPARISON OF CURRENT COVID-19 PANDEMIC CIRCUMSTANCES WITH CURRENT OEB PRACTICE/POLICIES

POLICY/PRACTICE	TREATMENT	CURRENT PANDEMIC CIRCUMSTANCES	
		SIMILARITIES	DIFFERENCE
IRM Framework	• Utilities falling outside the +/- 300 bps range may request review of circumstances and an off-ramp from plan • However, utilities not required to do so and approval of off-ramp (if requested) is not assured	• Utility ROE likely to be affected (possibly significantly) by the Pandemic due to both added costs and loss of revenue	• OEB seeking to establish framework that establishes circumstances under which additional cost/lost revenue recovery will be allowed
Z Factor	• Allows for recovery of incremental costs if material, incremental and prudently incurred • Does not include recovery of lost revenue or bad debt	• Utilities are incurring incremental costs as a result of pandemic not factored in to approved revenue requirement	• Z-Factor situations usually don't lead to material financial distress for customers
ICM	• Recovery of incremental costs allowed above a certain dead-band (similar to materiality threshold)	• Utilities are incurring incremental costs as a result of pandemic not factored in to approved revenue requirement	• ICM situations usually don't lead to material financial distress for customers
2008/09 Recession	• No special regulatory treatment	• Utilities facing lost revenues • Customers facing financial distress	• Utilities typically not experiencing higher costs

If not explicitly, implicitly this framework works within the fair return standard. That is the having established rates on a cost of service basis the Board maintains a fair return standard within the IRM framework which utilizes a 300 basis point "safety guard." When that guard is breached the Board or the Utility may intercede to examine or seek correction to the rates. The examination does not guarantee relief or redress in the case of high/low earnings, but it allows an opportunity for the regulator or the regulated to re-examine (or have re-examined) how the fair rate of return standard is working in light changed circumstances.

Important to note is that the Board has not generally allowed utilities to seek special treatment within the context of the IRM framework during period of normal or even severe economic fluctuations. This is consistent with the interpretation that changes in economic climate are embodied in the risk principles of establishing rates of returns embodied in rates.

The Staff's premise is that "[T]*he pandemic is a once-in-a-century crisis that has inflicted far-reaching economic and societal impacts across Ontario and globally*." This we think is a somewhat hyperbolic statement or at least one with a limited historical memory given that the last 100 years includes, a 1930's Great Depression ,the oil crisis recession of the 1970's and a global financial crisis beginning in 2008. In fact, using the widely accepted definition of two or more consecutive quarters of a drop in GDP Canada has witnessed four recessions since 1980. And while unemployment is hitting highs of around 12%, this is not dissimilar with the 8% unemployment rates of the last recession or the 11-12% rates seen in recessions of the early *0s'1980s and mid 1990s'.[2]

In fact, while mass lockdowns and proscribed health rules like masks are dramatic and somewhat unprecedented (at least among western industrial democracies) the actual economic impacts are borne out to be less conspicuous. Both the Federal and Provincial government responses to the economic crisis might also be described as "once in a century." The large fiscal stimulus has to date shown itself to help eliminate (or at least defer) a significant part of the potential hardship.

As well, and as shown in the LEI COVID study, the economic impact of the pandemic more than most recessions is concentrated in certain sectors of the economy. The case for special treatment for relatively well-off regulated utilities is therefore much weaker than it would be for say the airline industry. More severely affected are the service sectors which generally employ people are lower wages putting the burden of this health and economic crisis more heavily upon low-income people and low-income ratepayers

Clearly any severe economic downturn will impact the returns made by a large number of firms. However, LEI's analysis shows that the negative impact to the utilities sector is much **less than all industries but** one. That is, at least to date, they have been sheltered from the most severe impacts of the pandemic.

Eligibility for Relief Test

In our view Board's Staff's test of initial eligibility is based on the fair return standard within the Board's regulatory framework. It applies a 300 basis points (bp) discount as from the embedded return in rates as a threshold for recovery of any amounts. Staff draws from the Board's 3rd Generation IR plan which includes a trigger mechanism with an annual ROE dead band of ±300 basis points. When a distributor performs outside of the earnings dead band, a regulatory review may be initiated. In support of this approach, a distributor is be required make a report to the Board no later than 60 days after the company's receipt of its annual audited financial statements,

[2] See Statistics Canada at: https://www150.statcan.gc.ca/n1/pub/75-005-m/75-005-m2016001-eng.htm

in the event that the distributor falls short of or exceeds its ROE by 300 basis points. The report will be reviewed to determine if further action by the Board is warranted. Also, any such review is prospective and would result in modifications to the IR plan, a termination of the IR plan or the continuation of the IR plan.

A few key points should be noted about the Board's application of 300 basis points dead band:

- it only triggers a review as to whether or not any specific action is required;
- over the past 5 years more than 30 electricity distributors have experienced one or more years where their ROE fell below the 300 basis points dead band and VECC is not aware of any situation where, as a result, the electricity distributor has approached the Board seeking a special review nor has the Board initiated one on its own on the basis of earned ROE.

This would suggest that the 300 basis points is not an appropriate threshold for determining if a utility's financial circumstances are such that the fair return standard was compromised and/or it was unable to continue to safely provide reliable service to its customers.

The following table is taken from the Electricity Distributor Scorecards as compiled by the OEB. It shows that on average utilities earned less than their allowed ROE. There was also a wide variation in the difference between actual and allowed ROE in each of the past five years and in each year a number of utilities' actual ROE was lower than their allowed ROE by more than 300 basis points.

ONTARIO ELECTRICITY DISTRIBUTORS

ALLOWED VS. EARNED ROE

	Number	ROE				Number with
	of	Average	Average	Average	Standard	Diff. below
	Utilities[1]	Allowed	Earned	Difference[2]	Deviation[2]	ROE-300 bps[3]
2019	58	9.06%	8.29%	-0.77	3.61	10
2018	58	9.08%	8.10%	-0.98	4.32	9
2017	57	9.11%	7.01%	-2.10	3.73	16
2016	59	8.99%	6.81%	-2.18	3.61	16
2015	70	9.21%	7.82%	-1.39	5.13	12
Aveage	60	9.09%	7.61%	-1.48	4.08	13

Notes:
1) Utility Scorecards reporting allowed ROE
2) Expressed as perentage points
3) Number of utilities where actual ROE more than 300 bps below allowed

Given that the above circumstances have not triggered the need for review of a utility's finances on the basis of earned ROE, VECC believes that the average historical standard deviation in the difference between electricity distributors' actual and allowed ROE is a useful metric for determining what is a fair return. As a result, it is VECC position that that trigger for establishing cost recoverability should be an ROE that is no greater than 400 basis points (based roughly on the average standard deviation) below a utility's allowed ROE.

Recoverable Costs

In many ways the circumstances facing Ontario's utilities as a result of the COVID-19 pandemic are similar to those envisioned by the Z factor mechanism. The event is outside the control of the utility's management and has given rise to costs clearly outside the base upon which rates were derived. The distinguishing factor in this case from what might be applied for under a typical Z-factor event such as a tax rate change or ice storm, is that both the utility and its customers are facing economic hardship because of the event. The other important difference is that the event is common to a greater or lesser extent to all parts of the economy. .

The Board has established clear Z factor cost eligibility criteria which are set out in the Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors (Appendix, page 5) and are summarized below:

Table 8: Z-Factor Amount Eligibility Criteria

Criteria	Description
Causation	Amounts should be directly related to the Z-factor event. The amount must be clearly outside of the base upon which rates were derived.
Materiality	The amounts must exceed the Board-defined materiality threshold and have a significant influence on the operation of the distributor; otherwise they should be expensed in the normal course and addressed through organizational productivity improvements.
Prudence	The amount must have been prudently incurred. This means that the distributor's decision to incur the amount must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

We can take from past practice the application of the Z factor criteria and derive the following refinements to those criteria:

- Causation: In this case, cost sought for recovery should be directly linked to the COVID-19 pandemic and demonstrably incremental to what is built into rates.
- Materiality: Where the Board has determined that the following materiality thresholds will apply:

i. $50 thousand for distributors with a distribution revenue requirement less than or equal to $10 million;
ii. 0.5% of distribution revenue requirement for distributors with a revenue requirement greater than $10 million and less than or equal to $200 million; and$1 million for distributors with a distribution revenue requirement of more than $200 million.

- Prudence – The Z-factor criteria require that utilities demonstrate that the costs incurred are prudent. However, given the wide spread impact of the COVID-19 pandemic it would reasonable for the Board to require that utilities have been prudent in the overall management and operation of the utility during the pandemic and sought other ways to control or reduce costs where possible. Potential areas for savings would include financing costs (due to the lower borrowing rates available) and lower staff levels (due to an inability to fill vacant positions).

The latter point is important. In seeking to recover pandemic related costs (having met the threshold test) a utility should be obliged to demonstrate what efforts it has taken to minimize both these costs and its overall operating costs.

Past Board decisions regarding Z-factor application have also excluded recovery of both bad debt and lost revenues. These are precedents that can inform the approach to be used for the current situation. In this case we believe the Board should allow bad debt to be considered for recovery. The exception is based on the premise that the pandemic is akin to a tax change in fundamentally altering the basis for which bad debt costs were calculated in rates. We do not support treating lost revenues in a similar fashion.

In addition to bad debt, it is our view that all costs prudently incurred and attributable to the pandemic should be allowed into the “pool of costs” from which an LDC may draw upon if it has passed the eligibility threshold and to the extent, as articulated by the Staff proposal, it needs to meet the threshold level.

We think Staff’s proposal of 100% of prudently incurred cost incurred to comply with government or OEB actions and 50% for all other amounts does not reflect a consistent regulatory principle. It is also overly complicated. Either the costs were incurred prudently to deal with the pandemic or they were not. Attribution may make the costs more easily identifiable and the evidence of their need simpler but it should not be determinative of eligibility for recovery.

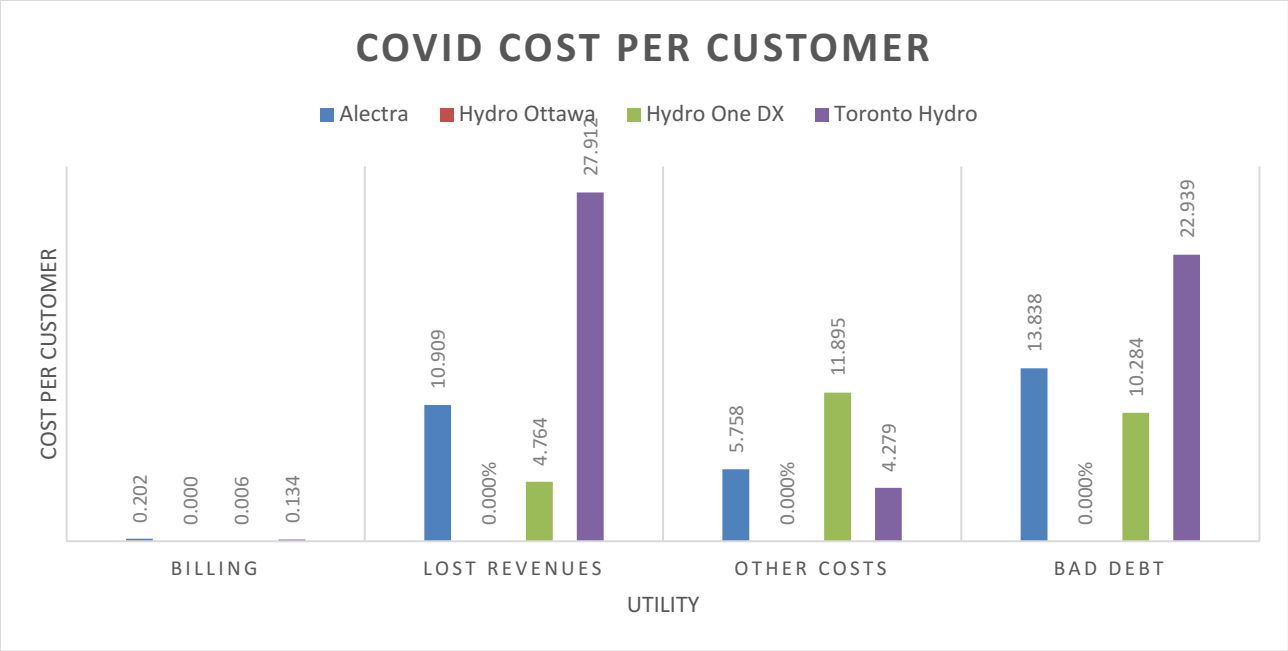
It should also be considered that costs directly attributable to government or OEB direction might be more easily identifiable but they might also not be attributable to a single event. Take, for example, CIS costs incurred to modify billing systems to allow both tiered and time of use rates for customers. IT costs can be difficult to clearly assign to one function when many other functions are being undertaken simultaneously as for example happens when a utility is purchasing a new

system or harmonizing billing systems. It may also not be clear that some programming exercises would not have been undertaken simply out of the need to have future flexibility and are therefore not truly attributable to the pandemic

These problems are difficult and so the Board should seek to, where possible, simplify the exercise. It makes no sense, for example, to draw a distinction between bad debt incurred as a result of the extension of the Winter Shut-Off Ban and bad debt incurred as a result of the pandemic leaving customers unable to pay. What needs to be understood is what is the bad debt amount that was "baked" into rates and how significant is the increase in the amount booked since the beginning of the pandemic due to these government changes. Some utilities will have already considered winter shut change in rebasing their rates – others not have had that opportunity. While the Winter Shut-Off Ban may not strictly be a "pandemic" related event it is ancillary and supportive and something the Board would reasonably allow to be adjusted in the circumstances of a utility who is no longer able to reach the fair return standard test we have articulated. In any event these costs would only be recovered to the level of the discounted (400 basis points in our proposal) return.

Other than bad debt and direct pandemic related costs like PP&E the Board would have to examine carefully any costs so as to understand that (1) they were truly related to the pandemic; (2) that the utility did its due diligence is minimizing these costs and that (3) incidental savings were also considered.

To aid in this exercise the Board should consider the data it is gathering from utilities COVID accounts. To the extent these costs are common (for example billing system changes for TOU/Tier rates) any significant variations among utilities is cause for further investigation. The Board carried out a similar exercise with respect to the purchase and implementation of smart meters and investigated more thoroughly the outliers. The importance of this exercise can be shown by a simple (and by no means exhaustive) examination of the four largest electricity distributors and their entries into the COVID accounts as of October 2020.



https://www.oeb.ca/sites/default/files/COVID-Account-Monthly-Balances-20210120.xlsx (October)

While far from a comprehensive analysis what this casual look at the existing data suggests is that there exists a wide variance in "pandemic" costs ranging from zero in the case of Hydro Ottawa to over $42 million for Toronto Hydro. The Board must be able to understand why some utilities might incur minimal (or no) CIS related costs while others seek to recover millions of dollars from ratepayers. Given the Province wide nature of the issue perhaps more important the Board must consider why some utilities may incur (or at least book) any pandemic related costs, while others are seeking large sums.

We also agree with Board Staff that any offsetting grants provided by governments should be used in the calculation of any cost to be recovered from ratepayers.

Capital Costs – CIS costs

While the economic severity of the downturn can be measured by employment, output and impact on electricity production what is different is the unique costs to utilities caused by pandemic related restrictions on mobility. The inability or restrictions of working in groups may have unique impacts on the rate of capital replacements or maintenance schedules. This might cause disruption in the implementation of distribution system plans previously reviewed by the Board. Conversely it may allow some work to be completed more quickly and cheaply due to those same factors allowing some work to be less impeded by population mobility.

We agree with staff that temporal shifts in capital spending should not be part of plans for cost recovery. How any significant deviations from prior review DSP are considered at the time of rebasing should be a matter for those proceedings. Incremental capitalized labour costs can be dealt with in the context of prudence of rate base additions and given the evidence of that in those proceedings.

The only direct pandemic related capital cost we anticipate from utilities is changes made to CIS systems. As we have noted above in order to understand the reasonableness of these costs (as they are incurred for pandemic issues) the Board should first make a study of the response of the electricity utilities to this challenge.

Lost Revenues

Lost revenues are something entirely different than cost incurred to deal with the pandemic. First and foremost, they are not a true "cost" rather they are a "lost opportunity", much in the same way that a warm winter and cold summer are a lost opportunity to sell more heat or cooling required energy. This is why the Board attempts to "normalize" weather when trying to ascertain an appropriate load profile for a utility. Lost revenue opportunities are also difficult to measure because economic assumptions must be made as to what the "opportunity" would have been in the absence of the pandemic. Would we have continued in a growth economy or would the overheated financial markets have collapsed leading to another recession? To "attribute" the opportunity cost to the pandemic one has to address or remove these factors – not just the most notable difficult matter of weather, but one making guesses as to the economic conditions that might have prevailed but for the pandemic. However, this might be done the booking of revenue loss is not a "cost" that has been incurred it is the accounting of a notional or theoretical value.

In considering these problems the words of the Indiana Utility Regulatory Commission quoted in the LEI Jurisdiction Study bear repeating[3]

> *"**we fail to see how creation of a regulatory asset for lost revenues would be in the public interest under current circumstances absent a financial emergency to the utility that impacts its ability to provide safe and reliable service**. … The balance of this Order seeks to work toward allowing customers to meet their obligation while providing utilities the reasonable relief they need to help such customers do so. **However, asking customers to go beyond their obligation and pay for service they did not receive is beyond reasonable utility relief based on the facts before us. A utility's customers are not the guarantors of a utility earning its authorized return. Instead, utilities are given the opportunity to recover their costs and a fair rate of return, which includes a certain level of risk attributable to variable sales."*** (emphasis added)

[3] LEI, Jurisdiction, page 30

It is certainly not an accepted regulatory practice to provide ratepayer compensation for lost revenues. As noted in the LEI Study on Jurisdictions there is no consensus on the eligibility to recover lost revenues with only 4% of surveyed jurisdictions allowing for consideration of revenues due to lost load. [4]

We have argued above that the pandemic is akin to an economic recession, albeit a severe one. To the extent the impact is extraordinary utilities can avail themselves to the Board to review the basis of their rates considering the entirety of the challenge faced. It matters little what the cause is of a major customer who closes leaving a utility with significant losses. If the impact is so severe as to threaten the continued safe and reliable service then the Board is obligated to consider the issue. However, in those cases it will need to be necessary to understand the specific nature of the problem, whether the issue is temporary or long term and what impact it might have on other rate classes.

In our view lost revenue due to load change should not be subject to COVID account recovery . This approach/position is consistent with the Board's approach to both Z factors and the circumstances of the 2008-2009 recession. Regulated utilities are compensated for the risk of weather (which can both raise or decrease earnings) and the economic risk of the economy as a whole through their ROE – as they were in last recession. If an LDC believes it is not appropriately compensated any more it can seek to have its rates reviewed.

If the Board were to entertain such an exercise of determining a notional lost revenue amount it is in for many difficulties. Staff's Proposal supports the approach set out by LEI for determining Lost Revenue. However, there are fundamental problems not only with LEI's proposal but also with the ability of many electricity distributors to apply the methodology.

Issues with LEI's Methodology

At a very high level, LEI's methodology identifies the load impacts attributable to the COVID-19 pandemic by estimating what the load would have been for 2020 (referred to as the adjusted 2020 load), establishing "reasonableness bounds" around this value based on historic variances in monthly load and then comparing the result with the actual 2020 weather normalized load. However, Board Staff notes (page 25) that the determination of reasonableness bounds would not be required if the Board adopted its means test. Lost revenues are then determined by applying the applicable rates to the differences in load.

The LEI proposal also outlines how the adjusted 2020 load could be calculated by determining the growth rates between the utility's last approved load forecast billing determinants (customer numbers, load and peak demand) and the last (pre-COVID) actual values available (i.e., 2019) and

[4] London Economics International LLC, A report on regulatory principles, policies, and accounting treatments applied in other jurisdictions in response to COVID-19, December 15, 2020, page 5

then applying these growth factors to the last actual (pre-COVID) billing determinant values to determine the adjusted values for 2020.

Among the issues with the LEI methodology are:

- **The determination of the growth factors for the billing determinants.** LEI bases the growth factors on the difference between the load forecast for the test year and the actual values for the year prior to COVID (i.e., 2019). However, a more appropriate approach would be to use the actual growth rate in the billing determinants, using weather normalized values where applicable (i.e., for demand and energy). This requires that utilities weather normalize the actual load for both the most recent test year and 2019.
- **Identification of Revenue Impacts Caused by COVID.** VECC does not agree with the Staff's claim that a "means test" or similar criteria obviates the need to demonstrate that the "cost" being claimed (in this case the loss of revenue) is due to the cited cause, i.e., the pandemic. There are a variety of reasons as to why the actual weather normalized load forecast for 2020 could be different from the adjusted 2020 load as calculated using LEI's average historic growth factor approach. Among these are year to year variations in normal economic activity, changes in the penetration of electricity (or natural gas) using equipment and customer adoption of energy efficiency measures. These were the types of variations that LEI proposal with respect to establishing "reasonableness bounds" would have tried to separate out. However, LEI has not really fleshed out how these "reasonableness bounds" would be calculated. While the proposal calls for looking at variations in actual monthly load, it does not indicate what the actual monthly loads would be compared to in order to determine the variations.

<u>Ability of Utilities to Implement LEI's Methodology</u>

Application of LEI's methodology requires utilities to weather normalize their actual loads. While a few of Ontario's electricity distributors have the ability to do so our experience is that most do not. Indeed, this is the reason why most electricity distributors in Ontario are still relying on the weather normal load profiles developed by Hydro One in 2004 for purposes of their cost allocation models.

Suggestions have been made that utilities could use the same approach as for their weather normalized forecasts. However, it is questionable as to whether the relationship between weather and load as used in the last rebasing of application of a utility would still be applicable to 2020 loads, as the number of customers and the both the penetration and efficiency of technologies and equipment sensitive to changes in weather will change overtime. Furthermore, the majority of utilities do not prepare individual rate class forecasts on a weather normalized basis. Rather, total purchased power is forecast on a weather normalized basis and then allocated to customer

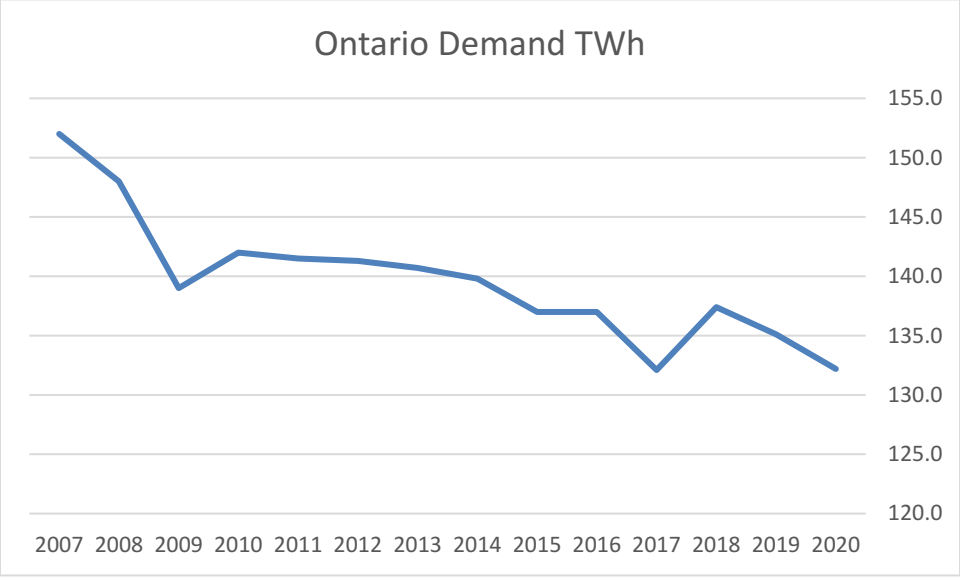
classes using fairly simplistic approaches[5]. While such approaches may be appropriate for determining overall customer class load forecasts, they are not sufficiently refined to allow for the determination of individual causes in the variation of load by customer class. Finally, LEI's methodology calls for using of monthly data and the methodologies used by most utilities to produce weather normal load forecasts only do so on an annual basis. Overall, in VECC's view, there would be serious concerns regarding the use of weather normalized actual loads prepared using such approaches to determine the impact of the COVID-19 pandemic on revenues.

Long-term and short-term issues on load

Finally, it may be the case that (perhaps unlike some recession impacts) the disruption in load/revenues is only temporary. There is no regulatory precedent for providing utilities relieve from short term revenue disruptions and certainly not for a utility maintain a reasonable cash flow and rates of return. On the other hand, long-term load disruptions cannot be resolved by temporary recovery of amounts in deferral account. In those cases, the utility needs to either fundamentally readjust rates (in case of financial hardship) or simply accept the circumstances until its next rebasing.

Transmission Utilities

The case for revenue COVID-19 rate related relief for transmission utilities is tenuous. What has to first be established is that the utility is suffering any harm. While not total indicative (as it does not show the charge determinants of peak values) the following table is informative.



Source: https://www.ieso.ca/en/Power-Data/Demand-Overview/Historical-Demand

[5] For example, in some applications, the proportion of forecast weather normal purchases for the test year is based on an historic average of the class' proportion of past purchases.

The revenue received by each transmitter is based on a pre-determined share of the overall province-wide transmission revenues collected by the IESO. While, at first glance it would appear that the pandemic has caused a large drop in demand, what it also shows is that the 2020 total Ontario demand was just slightly higher than that in 2017. In other words, there is no clear and compelling case that suggests transmitters are being significantly impacted by the pandemic at least on the revenue front.

OPG

Like transmitters the revenue stream of OPG is dependent upon the production of power. At this time there is little evidence of a prolonged steep decline in Ontario demand. OPG has already indicated that there will be incremental COVID-19 related costs with respect to the Darlington refurbishment in its upcoming payments application EB-2020-0290. In our view these costs should be dealt with in the context of that proceeding.

Disposition

OEB staff recommends that utilities should propose any disposition based on accepted approaches to matters such as rate rider construction (including billing determinants, allocation methodologies and recovery periods), and bill mitigation. The OEB staff also recommends that appropriate rationale for any deviations proposed from that which have been previously approved for each utility should be provided. Finally, OEB staff suggests that, where practicable, utilities track incremental impacts based on their respective rate classes and rate zones, as applicable.

The principle of recovery of COVID-19 related costs is to allow for the minimum required to ensure a fair return in keeping with the economic circumstances. Provided the utility is not in financial distress (for example a prolonged negative cash flow or unable to meet debt covenants) we would anticipate recovery of any amounts could be deferred until rebasing and hopefully when the economic conditions of ratepayers who will have to pay these amounts has improved.

If circumstances require rate relief in order to maintain safe and reliable operations then these utilities should file applications to re-establish rates based on the unique circumstances they face.

We also believe that in the interest of transparency the Board should require public notice that specifically notifies of any request for the recovery of pandemic related costs. This would be in keeping with the Board's policy of gaining the input of customers.

With respect to the recovery of "costs" it is VECC's view that utilities should be required to look to the cost allocation methodology underpinning their rates to determine how the costs should be assigned to and recovered from customers.

VECC is recommending that lost revenues not be eligible for recovery. However, in the event that the Board decides to permit the recovery of lost revenues, VECC generally agrees with the approach recommended by Board Staff (i.e., The recovery of amounts associated with net load impacts should be from the customer class in which it occurred, unless it is not practical or reasonable to do so.) Recovery from the same rate class is consistent with the Board's past practice with respect the recovery of lost revenues due to CDM and the recovery of bad debt. However, exceptions should be allowed where even if recovery was extended to 2-3 years the bill impacts would be unacceptable (i.e., exceed the 10% total bill threshold used by the Board for identifying the need for rate mitigation). In such circumstance the balance of the amount recoverable should be spread over all remaining customer classes based on their relative distribution revenues. Finally, both Staff's and VECC's proposals would potentially cap the amount recoverable at less than the total amounts eligible. In such an event, it is VECC's view that, if the recovery of lost revenues is approved by the Board, the amounts to be recovered should be prioritized such that lost revenues are "removed" first.

These are our comments on Staff's proposal.