The Voice of Ontario's Electricity Distributors

EDA | POWER OF LOCAL HYDRO

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

January 25, 2021

Dear Ms. Long:

Re: **EB-2020-0133 COVID Deferral Account**

The Electricity Distributors Association (EDA) represents local hydro utilities, the part of our electricity system that is closest to customers. Local hydro utilities (also know as local distribution companies, or LDCs) are on the front lines of power, and we know that the most important conversations about energy happen around the kitchen table, not the boardroom table. The LDC's customers understand the power of local hydro, and every LDC values the relationship of trust they have built with customers who rely on LDCs to deliver safe, reliable, and affordable electricity.

Ontario's LDCs have been conscientiously fulfilling their duties to their customers by continuing to provide safe and reliable service, and continuing to connect them throughout the pandemic, despite its truly unprecedented conditions and impacts. Ontario's LDCs were among the businesses that were deemed essential workplaces by the provincial government.

These are our comments on the Ontario Energy Board (OEB) staff's proposals for the administration of the COVID Deferral Account (COVID DA). Our members were encouraged by the OEB's expedient authorization of the COVID DA. We are well aware of the challenges facing the OEB, as well as regulators across the country and around the continent, as it seeks to balance the affected interests and to set just and reasonable rates while the pandemic continues.

We have worked with our members, in particular those who belong to our Regulatory Affairs and Finance and Corporate Issues councils, to prepare these comments. On behalf of our members, we look forward to continuing to work with OEB staff, and where appropriate the OEB, to form policies on the administration of the COVID DA that will support the OEB in authorizing just and reasonable rates through a process that is efficient, responds to the issues and is mindful of the interests and needs of all stakeholders.

Electricity Distributors Association

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We have reviewed staff's proposals for whether they will support the OEB in maintaining a financially viable distribution sector and for whether they will result in just and reasonable rates that are capable of recovering the ongoing costs incurred by the distributor to provide safe reliable service, that provide an opportunity to earn a fair rate of return, that are free from undue cross subsidization, and that will support maintaining a financially viable sector. We have identified the potential for inappropriate results as well as some omissions. They are summarized below and set out in greater detail elsewhere in these comments:

- the appropriateness of treating the achievement of the lowest return on equity (ROE) in the deadband as a sufficient demonstration of financial viability,
- not comparing LDCs' achieved ROE to that of comparably risky firms,
- proposing that a portion of the costs incurred to provide service be eligible for recovery through rates,
- not anticipating that the proposals may increase the perceived riskiness of the utility from the perspective of the providers of capital and rating agencies,
- using the term "Lost Revenues" instead of the more transparent "Unrecovered Costs of Service",
- the consequences of using a thin, or shallow, data set to support certain conclusions, and
- not clearly depicting the sequencing of the application of the proposed tests and criteria.

Following our review of the potential for inappropriate results, we present a few alternatives for the OEB's consideration.

Legislative and legal requirements

The *Ontario Energy Board Act, 1998* (OEB Act) tasks the OEB with maintaining a financially viable distribution sector and authorizes it to set just and reasonable rates.

S. 1(1) of the OEB Act sets out the OEB's objective on maintaining financial viability as follows:

> 2. To promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.

Financial viability is a key aspect of serving customers in the long term; it supports the LDC's ability to expand service and to satisfy the obligation to connect. Financially viable distributors are solvent, liquid, appropriately leveraged, appropriately profitable (e.g., they can appropriately compensate their providers of capital by servicing debt according to the agreement between the debt issuer and the LDC, and by compensating their equity providers in a timely manner and in appropriate amounts) and are able to access capital on an ongoing basis

at favourable terms and conditions. Economic regulation is premised on the rate regulated entity functioning as a “going concern”. While “going concerns” are solvent and liquid, they calibrate their financial leverage for the financial risks they incur, and they manage and achieve varying levels of profitability. Among the goals of economic regulation is to protect the rate payers of natural monopoly “going concerns” from inappropriate outcomes such as inappropriate levels of leverage, or inappropriate levels of profitability.

S. 78(2) of the Act establishes the OEB’s power to authorize distribution rates. It states:

Order re: distribution of electricity

> (2) No distributor shall charge for the distribution of electricity or for meeting its obligations under section 29 of the *Electricity Act, 1998* except in accordance with an order of the Board, which is not bound by the terms of any contract. 2000, c. 26, Sched. D, s. 2 (7).

S. 78(3) of the Act requires that the OEB authorize just and reasonable rates. It states:

> (3) The OEB may make orders approving or fixing just and reasonable rates for the transmitting or distributing of electricity, unit smart metering or such other activity as may be prescribed and for the retailing of electricity in order to meet a distributor’s obligations under section 29 of the *Electricity Act, 1998*. 2009, c. 12, Sched. D, s. 12 (1); 2010, c. 8, s. 38 (14); 2019, c. 4, Sched. 4, s. 1 (2).

Just and reasonable rates recover the ongoing costs incurred to provide safe and reliable service, provide an opportunity to earn the Allowed Rate of Return, and are free of undue cross subsidization. As London Economics Inc.’s (LEI) Cost of Capital paper points out, the legal tests of the allowed Rate of Return are that it:

- satisfy the fair return test,
- provide the rate regulated entity with the ability to access capital on an ongoing basis at favourable terms and conditions, and
- support the rate regulated entity’s financial viability.

Our analysis of, and positions on, the staff’s proposals are rooted in the ongoing achievement of these enduring obligations. We find that two aspects of the staff’s proposals below will not support the OEB in authorizing just and reasonable rates:

- staff’s proposal that achieving the lower end of the ROE deadband is an appropriate level of profitability and, by extension, an appropriate demonstration of financial viability, and
- staff’s proposal that 50% of some costs be recovered through rates.

These and other aspects of the staff's proposals are considered in greater detail below; many of these comments are inter-related.

Will the staff proposal allow the LDC the opportunity to earn an appropriate Rate of Return?

Staff's proposal that achieving the lower end of the ROE deadband is an acceptable demonstration that the LDC is appropriately profitable, and by extension financially viable, is not supported by evidence. OEB staff did not provide a financial analysis of whether achieving a level of profitability at the lower end of the deadband satisfies financial viability tests or will support the LDC in accessing capital on an ongoing basis and at favourable terms and conditions.

We propose that the suitability of using achieved ROE as the only test of financial viability should be examined. We note that staff did not address that each aspect of financial viability can be assessed using a variety of metrics (e.g., Return on Assets, free Cash Flow, leverage ratios, Current Ratio, Quick Ratio, Days Cash on Hand).

The current quantification of the ROE and of the deadband were set for business-as-usual conditions. We consider it appropriate that staff's proposals that rely on long-standing regulatory policies and tools be analyzed for whether they are:

- capable of continuing to serve under pandemic conditions, or
- able to be adapted to be capable of continuing to serve under pandemic conditions.

Whereas ROE is one of many metrics commonly used to assess financial viability, the OEB's deadband around the ROE has, to date, been used as an indicator of whether rates are appropriately cost related. We remind all that the 300 basis point range was originally established through consultation[1]. The staff's proposal to use the lower end of the deadband is not supported by objective evidence or the available qualitative information. There is no information on whether this component of staff's proposal is capable of satisfying the legal tests of comparable risk, ongoing access to capital or financial viability. We wish to point out that the range around the ROE can be quantified differently; for example, some Earnings Sharing Mechanisms use a band of +/- 100 basis points.

LEI's report on cost of capital, that was prepared to assist on this matter, makes the following qualitative "observations":

- the cost of debt has decreased since pandemic conditions emerged and the cost of equity capital has increased in that period, and

[1] July 14, 2008 Report of the OEB on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, p.38

- the risks experienced by smaller LDCs and those experienced by larger LDCs are different.

The staff's proposal does not reflect either observation.

Further, LEI's work on the appropriate return on equity is not supported by evidence of the appropriate level of profitability achieved by firms of comparable risk. LEI has provided data on the returns achieved by firms that are included in the S&P 500 index. LEI did not evaluate the firms in the S&P 500 for whether they generally incur risks similar to those experienced by Ontario LDCs or if some of them are of similar risk. There are a number of concerns of using S&P 500 data, including:

- It includes entities that operate in multiple industries and numerous jurisdictions,
- It includes entities that operate under different tax regimes,
- litigation risks vary by jurisdiction, and litigation risk in Canada is different from that in the US,
- their responsibilities (e.g., to their employees for health care and other benefits, environmental, etc.) vary,
- it includes firms that operate under a range of leverage metrics that gives rise to differing levels of financial risk, and
- it includes firms that do not have an obligation to serve.

As well, LEI has not statistically analyzed the behaviour of the OEB's cost of capital and the S&P 500's returns (e.g., for whether they are correlated). LEI implied that the S&P 500 data is not a readily comparable data set when it noted the effects of the pandemic to airlines, which are included in the S&P 500. Finally, we point out that if the S&P 500 was an appropriate comparator, it would have been recognized as such during that past proceeding.

In a past proceeding on the cost of capital the OEB heard evidence and testimony on the firms whose risk profiles are comparable to that of Ontario's LDCs. Information gleaned from a review of the returns achieved by comparably risky firms during the pandemic would augment the information provided by LEI.

There is limited data available about the impact of the pandemic and this presents challenges when trying to draw conclusions about Ontario's electricity distributors' ability to access capital at favourable terms while pandemic conditions persist. This data limitation is not an adequate reason for the staff proposal to instead rely on the recent experience of Ontario's largest distribution utility, that is also engaged in the provision of rate regulated transmission service, bond issue to assess ability to attract capital.

In the absence of evidence and because consumers benefit by being served by a financially viable distributor, it is proposed that the currently authorized Cost of Capital and an appropriate deadband be relied on.

Is the proposed means test appropriate?

We seek to understand the interplay between the operation of the proposed means test and the other elements of the staff's proposal. The discussion below assumes that the OEB previously rebased the distribution rates of four LDCs referred to as LDC A, LDC B, LDC C, and LDC D to provide them with an opportunity to earn a Regulated Rate of Return of 9.00% and that the deadband is 6.00% to 12.00%. Based on the staff proposal and on the discussion at the January 14 stakeholder conference, we understand that the proposal will operate as follows:

- Assume that LDC A achieves a regulated ROE of 5.00% in 2020, if it does not record any balances in the COVID DA. We understand that LDC A will be eligible to fully recover through rates in 2021 the portion of the costs it incurred that were mandated or required by government or OEB rules and regulation. For the purposes of this example, assume that LDC A now achieves a regulated ROE of 5.65%. We understand that LDC A, because its achieved ROE is less than 6.00%, would be eligible to recover 50% of a portion of the remaining balance recorded in the COVID DA. The portion eligible for disposition will be quantified so that LDC A's achieved ROE increases to 6.00%, the lower end of the deadband. No further disposition through rates of the balances recorded in the COVID DA would be authorized and LDC A would be required to write off the undisposed balance.
- Assume that LDC B achieves a regulated ROE of 6.01% in 2020, if it does not record any balances in the COVID DA. We understand that LDC B will be eligible to recover through rates in 2021 a portion of the costs it incurred that were mandated or required by government or OEB rules and regulation. For the purposes of this example, assume that LDC B now achieves a regulated ROE of 6.50%. We understand that since LDC B achieved a regulated ROE greater than 6.00%, it would not be eligible to dispose of any of the remaining balances recorded in the COVID DA through rates and that LDC B would be required to write off the undisposed balances.
- Assume that LDC C achieves a regulated ROE of 11.99% in 2020, if it does not record any balances in the COVID DA. We understand that LDC C will be eligible to recover through rates in 2021 a portion of the costs it incurred that were mandated or required by government or OEB rules and regulation. The portion eligible for disposition will be quantified so that LDC C's achieved ROE is no greater than 12.00%, the upper end of the deadband. We understand that LDC C, having now achieved a regulated ROE of the upper end of the deadband would not be eligible to dispose of any of the remaining balances recorded in the COVID DA and that LDC C would be required to write off the undisposed balances.
- Assume that LDC D achieves a regulated ROE of 12.01% in 2020, if it does not record any balances in the COVID DA. We understand that LDC D will not be eligible to dispose of any of the balances recorded in the COVID DA through rates and that LDC D would be required to write off the full balance of the amounts in the COVID DA.

Disparate earning levels occur naturally under business-as-usual conditions. While they can result from the timing of capital expenditures, the emergence of new large loads or other such exogenous factors, they always reflect the results of careful ongoing management. We understand why staff propose that the LDC be able to demonstrate its need to dispose of the balances recorded in the account through rates. However, it appears that the staff's approach risks an unintended consequence of barring some LDCs from being able to recover costs that were incurred in providing safe and reliable service under pandemic conditions; this is addressed elsewhere in these comments. Additionally, it appears that the other components of the staff's proposal (e.g., the proposed quantification of the appropriate baseline amount(s)) could, in combination, act to reduce the amount eligible for disposition through rates.

Our members have long experienced the impact of significant capital expenditures on their achieved ROE – our smaller members feel this impact more acutely than do larger members. LDCs invest capital so that they can continue to provide safe and reliable service, responsibly expand service in a timely manner, appropriately renew their infrastructure, adopt technologies that can facilitate cost control or cost reduction and achieve other customer benefits. We restate that ROE is one component of a suite of metrics commonly used to establish the financial viability of an entity. Whether ROE is used as an indicator of whether rates are appropriately cost related or to understand a utility's financial viability, it must be used in context.

We understand that staff seeks to preserve the incentives of the OEB's Incentive Rate Making Mechanism (IRM). We look forward to learning more about how these incentives are preserved and the reasoning behind preserving these incentives under pandemic conditions when they can result in the range of outcomes such as those discussed above. We also seek to understand why OEB staff prioritized preserving the incentives of the IRM ahead of setting rates that are capable of being authorized as just and reasonable.

Will all costs incurred as a result of the pandemic be recovered?

There are two issues to be considered:

- whether all costs will be eligible for recovery, and
- whether the costs incurred as a result of the pandemic, both those that will be experienced while the pandemic is underway and after the pandemic has been resolved, will be eligible for recovery.

The EDA addresses the first point in this section and the second point under the heading "Are staff's proposals on the recoverability through rates appropriate?".

We propose that the OEB consider expanding the costs eligible for 100% recovery to include costs incurred as a result of the pandemic so that the LDC provided safe and reliable service to

its customers at all times (e.g., incremental customer care costs incurred for non-pandemic reasons would not be eligible). This change appropriately prioritizes the full recoverability of the costs to serve customers and will support the OEB in setting rates that are able to be authorized as just and reasonable.

We point out that staff's proposal that only 50% of some costs (referred to as "non-mandated" costs) be eligible for recovery through rates is not supported by evidence (e.g., evidence of the impact of this approach to the LDC's financial viability or of how it could impact the LDCs' ability to access capital at favourable terms and conditions). It is important to recognize that without evidence or other support, this proposal can be expected to result in rates that do not recover the ongoing costs incurred to provide service and that cannot be authorized as just and reasonable.

Will the proposed tests support LDCs in recovering the costs incurred to continue to provide safe and reliable service under pandemic conditions?

LDCs have been authorized to record the costs incurred as a result of the pandemic in the following sub-accounts of the COVID DA:

- incremental costs,
- billing and systems changes for changes to commodity billing,
- bad debt,
- forgone revenue, and
- lost revenue.

We propose that the balances recorded in the account include the costs and the avoided costs, or savings, at a suitable level of granularity. We anticipate that recording entries at an appropriate level of detail will support the OEB in understanding how the LDC has mitigated costs and will support either allocating costs or assigning responsibility for costs so that the resulting rates are appropriately free of cross subsidization. We point out that when an LDC defers a cost, it is simply moving that cost to another period; it is not achieving enduring savings. The OEB needs to ensure that changes due to timing decisions are clearly documented so that rates can be set at just and reasonable levels.

Staff proposes that the amounts recorded in the account and its sub-accounts be assessed for eligibility for disposition through rates using the following criteria:

- prudence,
- causation or whether it was beyond management's ability to incur the cost,
- materiality, and
- necessity.

We understand that financial viability considerations rank ahead of satisfying these tests.

We were assisted by Staff's explanation that "necessity" means that recovery of the amount is "necessary to the maintenance of the utility's financial viability". With this explanation, we understand that the necessity test encompasses aspects of prudence and appears to replicate aspects of the means test. However, staff has not established the need for this additional test. The OEB has been able to set just and reasonable rates without previously relying on this test, and relatively few of the jurisdictions researched by LEI apply this test. We propose that the OEB apply its three long standing tests when deciding the amounts eligible for disposition through rates.

Our members have all incurred incremental costs to be able to continue to provide service under pandemic conditions and they are eligible to be recorded in the COVID DA. As essential workplaces, LDCs have been responsible in adapting their work practices and business policies so that they can continue to serve their customers with safe and reliable service under pandemic conditions. Clearly, it was impossible for an LDC to continue to provide service under pandemic conditions without changing work practices or business policies. LDCs have been able to reduce or defer costs (e.g., costs to administer the disconnection process or to collect delinquent accounts) in the period because of public policies implemented to support customers' ability to cope under pandemic conditions. No LDC has altered its cost controls such that spending was not prudently incurred.

The above observations about prudent spending apply equally to the costs incurred by LDCs to make billing changes and systems changes to be able to bill commodity according to prices set by the provincial government.

All LDCs have incurred changed levels of bad debt expense because of the pandemic. While the level of this expense is exogenous to the LDC and beyond management's ability to control, the timing of when the expense is recognized is the subject of LDC policy. The level of bad debt recorded in 2020 is expected to reflect the combined effects of:

- business-as-usual conditions,
- the moratorium on disconnection for non-payment, and
- the effects of the pandemic and the unusual policies and decisions that LDCs have taken to support their customers in managing the impacts of the pandemic (e.g., extending the period of the moratorium).

Distribution rates have been set to recover bad debt expense since market opening. It is important to recognize that bad debt expense includes all bill amounts: the amounts that the LDC retains and the amounts that the LDC flows through to other parties (e.g., transmitters, generators) which, in the case of a "Large User" customer, can be over 90% of the amount billed. While the financial consequences of loss of load and loss of customer are among the risks for which the OEB's Allowed Rate of Return compensates the LDC, the quantum of the risk

is not available. There is no evidence to support any party, including the OEB, in concluding or refuting that all bad debt risk is appropriately compensated for by the Allowed Rate of Return. There is a compelling and intuitive argument that the bad debt risk that is compensated for under business-as-usual conditions and the bad debt risk incurred under pandemic conditions are different; specifically, the bad debt incurred under pandemic conditions is greater.

The OEB has recently authorized rates that recover foregone revenues arising from LDC elections to defer rate changes. These orders demonstrate how the OEB will adjudicate the disposition through rates of foregone revenue amounts. Foregone revenues are different from lost revenues. We propose that the more insightful way to think of lost revenues is as unrecovered costs of service. LDCs had no choice but to incur the overwhelming majority of their ongoing costs and they were expected to be recovered through the amounts billed to customers. With the advent of the pandemic, some customers were unable to pay their bills and so the LDC was unable to recover a portion of its costs incurred to provide service. These unrecovered costs were previously reviewed by the OEB and authorized for recovery through rates. The issue now is how to recalibrate rates so that the LDC can recover all the costs incurred to provide safe, reliable service and continue to have an opportunity to earn the Allowed Rate of Return. We assert that it is inappropriate to apply the newly proposed "necessity" test, and that there are no arguments about prudence, whether management had control or materiality that impact their eligibility for recovery through just and reasonable rates.

We note that recharacterizing "lost revenues" as unrecovered costs of service overcomes the need to weather normalize load data or to adjust charge parameters for growth. It can support the OEB in testing for whether due or undue cross subsidization exists as responsibility for unrecovered costs can be analyzed, e.g., by using the cost allocation model.

Our members will continue to safely and reliably service their customers. They need to charge just and reasonable rates so that they can have access to the resources to sustain this provision of service.

Is staff's proposal on the sharing of cost responsibility appropriate?

Implicitly, staff's proposal is that the shareholders of Ontario's rate regulated LDCs should share in the financial responsibility of the non-mandated costs incurred to provide safe and reliable service to the LDC's customers. This introduces a new risk to shareholders that few of them have previously incurred[2]. We seek to understand the staff's evidence of the fairness of this proposal and of its long-term consequences to the providers of capital.

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[2] In the past, shareholders were financially responsible for costs that were not prudently incurred.

Holding the LDC's shareholder(s) financially responsible for certain costs incurred by the LDC risks cross subsidization, either because the shareholder absorbs them or because they are indirectly passed on. Cross subsidization reduces the explanatory power of electricity distribution rates and risks distorting investors decision making (e.g., whether to invest in distributed energy resources).

We consider it inappropriate for the regulator to reallocate cost responsibility after the costs have been incurred, without prior notice and without supporting evidence that can withstand scrutiny. We suggest that this policy change be carefully examined for its impact on perceived riskiness from the perspective of the providers of capital, whether debt providers or equity investors, and from the perspective of rating agencies and for whether it could put upward pressure on the cost of capital and, by implication, on rates.

Are staff's proposals on the recoverability through rates appropriate?

Aside from the above concerns, there are also concerns arising from the staff's proposals with respect to the data required to support disposition of the balances eligible for recovery through rates, whether undue cross subsidization could occur, how to manage the rate implications of unsmooth changes to charge parameters. Many of these issues are inter-related.

Staff proposes that applications for disposition through rates be supported by audited balances. The staff's proposal contemplates that some LDCs will apply for interim relief, potentially while the pandemic is still underway and potentially before audited balance are available. We infer that relying on audited balances is a preference rather than a requirement and understand that using audited balances is not expected to result in delay; rather it is expected to improve the quality of the information available to the OEB. The LDC will be, as is the case presently, fully responsible for the quality of the data.

Staff proposes that the eligible balances may be disposed of through applications filed over a range of dates, and potentially as late as when the LDC next rebases. We support the flexibility of the staff's proposals as they support the LDC, which is best situated to know when it needs relief through rates and in what amounts, in filing an appropriate application for relief through rates. We trust that should an LDC seek disposition when it next rebases, whether next year or in five years' time, that it will not risk the OEB finding that the costs are sufficiently out-of-period such that there is no need for the OEB to authorize their recovery through rates. We note that staff propose that the COVID DA be treated as a Group 2 account and assumes that this is for record keeping and presentation purposes only.

While we concur that the risk for intergenerational inequities should be mitigated, it considers some intergenerational inequities as inevitable; they will arise because some businesses will, as a result of the pandemic, fail and be wound up. The LDC's ongoing costs will likely be little changed. They will be allocated over fewer customers whose charge parameters will exhibit

variability versus business-as-usual conditions. Additionally, the LDC's surviving customers will be responsible for the disposition through rates of the balances recorded in the COVID DA.

We also propose that the OEB eliminate the COVID DA at a point in time when it is no longer expected to be needed. Longer term impacts of the pandemic to the economy, and to customer behaviour, could impact the LDC for some time after the pandemic abates.

Staff's proposal is silent on the appropriate disposition period. A disposition period can be set to result in a specific bill impact to customers, or to align with the period over which the costs were incurred, or at shortest period possible so that intergenerational issues can be mitigated. We note that the OEB's 2006 Electricity Distribution Rates (EDR) guidance that bill impacts exceeding 10% should be mitigated was provided under business-as-usual conditions, not pandemic conditions, and when inflation was rather higher than it is now. We also note that the 2006 EDR mitigation policy did not anticipate unsmooth changes to charge parameters that could contribute to unsmooth rate changes and, hence, unusual bill impacts. We propose that LDCs are best situated to propose an appropriate disposition period that reflects their knowledge of their customers' needs and their capacity to pay.

The disposition through rates of the eligible balances is to result in just and reasonable rates that, among other things, are suitably free of undue cross subsidization. This raises the issue of whether and how to use the OEB's cost allocation model or whether to adjust rates using another mechanism (e.g., the socialization that was used in the 2006 EDR proceeding). The cost allocation model is an available analytical tool that was developed under business-as-usual conditions to use charge parameter data and other data to support the development of just and reasonable rates.

Is the staff proposal suitable and can the OEB adopt it?

As explained herein, we have identified several concerns with the staff's proposal and suggest that, at a minimum, it be revised so that it can support the OEB in authorizing just and reasonable rates.

We acknowledge that there are fewer than eight months of actual data available on how Ontario's LDCs have provided service under pandemic conditions. We propose that the staff consider how the OEB can proceed to set just and reasonable rates with such a thin data set when the duration of pandemic conditions is uncertain.

Staff's proposal addresses the need for an appropriate baseline to quantify the change in the amount recoverable through rates, whether the amount is a new cost, an incremental cost, a new saving or an incremental saving. We propose that the amount recovered through currently authorized rates is the appropriate baseline, and we cannot support staff's proposal that historic cost data from 2015-2019 can serve as an appropriate baseline - regardless of whether

the average for the period or the single highest or single lowest value is to be used. Using historic cost levels inappropriately compares the costs incurred under business-as-usual conditions to the costs incurred under pandemic conditions. It suggests that the LDC's historic costs that were managed to the levels incurred for a wide range of reasons (e.g., as a result of capital spending decision or management's response to the challenges of those past period) are somehow comparable to the costs incurred under pandemic conditions. It is questionable whether the amounts recovered through previously rebased rates should be adjusted for inflation; given how low inflation has been recently, this calculation may create an artificial level of precision and may not be cost effective. Equally, adjusting costs for growth is questionable as growth realized in a prior period under business-as-usual conditions may not endure as the effects of the pandemic work their way through the economy and alter people's behaviour.

We understand that the regulator previously authorized rates as being just and reasonable and that they were expected to be capable of enduring, unless material changes in cost(s) level(s) occurred. The pandemic has caused material changes to both costs and charge parameters. Accordingly, we can support preserving the OEB's materiality criteria if it means that the resulting rates are capable of maintaining a financially viable sector, per the OEB's legislated objectives.

We note that while the staff proposal has a number of components, they are not clearly organized or sequenced (e.g., through a schematic or flow chart representation). We seek such a presentation to better understand the interplay between and among all the proposed components. As an example, we seek to understand whether the materiality criteria will be applied at the level of the prudently incurred costs or at the level of the prudently incurred costs eligible for recovery through rates, assuming that, despite the concerns raised herein, the staff proposal that a portion of the costs eligible for 100% recovery while others are eligible for 50% recovery is adopted for the purposes of setting just and reasonable rates.

Staff seeks to make their approach familiar so as to create certainty. It tries to position the familiar as being valuable in an unfamiliar time. While we are not opposed to certainty, it recognizes that the priority is setting rates that are just and reasonable.

Are there alternatives to the staff's proposal?

Staff's proposal is a detailed, multi-layer approach that repurposes existing regulatory instruments. In addition to the concerns identified herein, it also risks being costly and consuming time to administer. We recognize that staff's proposal was released in December 2020 when fewer than eight months of actual data on the consequences of the pandemic to Ontario's LDCs was available. We anticipate that, as the pandemic continues, more data will become available.

In the meantime, we suggest that the OEB consider whether or under what circumstances it may be appropriate to use a simpler approach based on a past Decision; some of these approaches are identified below. To be clear, we consider that any simplifications will need to be supported by evidence filed by each applicant that can withstand scrutiny and must support the OEB in authorizing rates that are just and reasonable.

1. Authorizing rate adders/riders specific to each customer class:
    - requested rate rider by customer classification,
    - justification of the requested rate riders (including a stakeholder analysis, a financial forecast supported by scenarios or sensitivities or both, a demonstration that the rate rider satisfies the criteria of just and reasonable),
    - this is an adaptation of the Smart Meter approach and, like the Smart Meter funding mechanism, can include a true up process.

2. Socializing responsibility using the 2006 EDR method by allocating responsibility for the balance recorded in the COVID DA to customer classes in proportion to their share of distribution revenue.

3. Adapt the Regulatory Assets (also known as Market Opening) proceeding approach:
    - require a select few LDCs to apply for disposition through rates, and
    - subsequently develop a streamlined administrative approach for all other LDCs to use when seeking disposition through rates of the balances recorded in their COVID DA (e.g., filing guidelines, prepared models, guidance on whether adjudication is appropriate, or if an application can be processed by way of settlement or a written hearing, or if preset rates can be authorized, or if the disposition of a significant portion of the balance can be authorized through rates so that minimal regulatory oversight can be provided)

We repeat that each LDC will need to file an application supported by evidence.

Some of these alternatives can be relied on to support advance funding, which will make increased levels of cash available to the LDC proactively and can be expected to avoid the risk that an LDC will file for a rate adjustment to reactively remedy any deterioration of the LDC's financial viability, or to support the recovery of incurred costs after the pandemic is resolved.

These alternatives may be considered on a stand-alone bases or in combination. We acknowledge that some (e.g., uniform levels of rate riders for all LDCs) will be simpler to administer than will others. The OEB can appropriately supervise the operation of any of these alternatives (e.g., for whether they over or under collect) by augmenting the continued operation of the COVID DA with a revenue sub-account.

We recognize that staff developed their proposal without the active engagement of Ontario's rate regulated entities and offer the above suggestions in an effort to achieve a workable end product that will support the OEB in authorizing just and reasonable rates.

Our review of the staff's proposals shows that there are several reasons why they may not support the OEB in setting just and reasonable rates. We have identified some alternative proposals that, using a range of reasonability, can be expected to support the setting of just and reasonable rates. We look forward to exploring these proposals, and other possible alternatives, with you to develop solutions that serve all stakeholders. Our members know the benefit to customers of being safely and reliably served on an ongoing basis and, for new customers, of being able to be connected and served. We know that LDCs require ongoing access to the required resources if they are to be able to fulfill these outcomes. We look forward to participating in the next steps of this initiative.

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

Sincerely,

Original signed by

Ted Wigdor
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