EB-2020-0133

ONTARIO ENERGY BOARD

Consultation on the Deferral Account Impacts Arising from the COVID-19 Emergency

COMMENTS ON STAFF PROPOSAL

OF

ASSOCIATION OF MAJOR POWER CONSUMERS IN ONTARIO (AMPCO)

AND

INDUSTRIAL GAS USERS ASSOCIATION (IGUA)

Importance and Conduct of this Consultation

1. AMPCO and IGUA commend the Ontario Energy Board (OEB or Board) for its continuing approach to this consultation.

2. As representative of the interests of Ontario's largest natural gas and electricity users, the transparency, meaningful engagement and responsiveness to customer concerns that has been demonstrated in the course of this consultation to date is recognized and appreciated.

3. Having established the subject deferral account early, as part of an emergency response as the nature and degree of the pandemic was looming but not yet in focus, the Board has subsequently seen fit to pause and take the steps necessary to obtain a broader perspective and range of input from all of those affected, including in particular utility customers, and to obtain the benefit of expert assistance the product of which it has shared with all affected parties.

4. The result will be determinations that benefit from the informed input of all concerned.

Context

5. AMPCO and IGUA's response to the Staff Proposal starts with the obvious; the COVID-19 pandemic is a singular event, unforeseen, perhaps unforeseeable, and certainly without modern precedent. The implication from these obvious observations is important. ***This is not a circumstance envisioned by the conventional rate regulation framework.***

6. The conventional rate regulation framework proceeds on the basis of the oft referred to *"regulatory compact"* which entails setting rates in order to provide the rate regulated entity with a reasonable opportunity to recover costs and earn recovery of and on capital invested to provide the regulated service. This is the bargain offered in exchange for controlling utility profits (i.e. the cost of capital invested) while incenting significant commitment of very long-term capital.

7. The rate regulation framework does not guarantee recovery, rather it provides a reasonable opportunity for recovery. The "reasonable opportunity" aspect of this framework is an allocation of risk. Generally the risks of managing the regulated business rest with the utility, as the party best positioned to manage those risks.

8. Normally, when a risk beyond that for which utility shareholders are being compensated arises, and where they are not best placed to manage those risks (for example, external legislative change to the framework in which they operate), then the cost associated with continuing to provide regulated service in the face of those changes, where material, shifts to the customers who benefit from the service provided.

9. In the balance of this submission AMPCO and IGUA argue that the conventional rate regulation framework is of limited applicability to the extreme circumstance presented by the COVID-19 pandemic, its impacts on all interests, and the disposition of a variance account within a pre-established rate framework as distinct from the matter of setting rates prospectively.

10. First, though, we observe that:

    (a) While there is no doubt that any costs to rate regulated utilities driven by the pandemic arise from circumstance external to the utility, it is not obvious that these are costs which the utility is not best placed to manage, *vis a vis* customers.

(b) The evidence to date is that the utility sector has fared relatively better than most others. As noted by OEB staff[1], London Economics Inc. (LEI) reports that the utility sector has seen a 1.3% dip in production, compared to production impairment on average (across all industries) of almost 10 times that (12.3%).

(c) It is also noteworthy that in LEI's review of other North American jurisdictions, none have to this point determined that utilities should generally recover from customers costs driven by necessary response to the pandemic.

Issue at Hand

11. The issue at hand is not the setting of rates. Rather it is whether relief from the rates already established is required on an immediate basis to address the exigencies posed to Ontario's regulated utilities by the COVID-19 pandemic.

12. The impact – medium and longer term – of the pandemic on setting just and reasonable utility rates will be addressed at the time that the utilities apply for new rates based on a forecast of their costs to serve. The issue at hand is whether an adjustment of revenues arising from currently established rates is necessary to address pandemic driven costs[2].

13. The issue is whether the Board should <u>depart</u> from the traditional regulatory framework, under which rates are established and risks are allocated prospectively,

14. OEB staff rightly emphasize the *"unique nature of the event"* and *"the economic impact on all customers"*[3]. In the context of a global pandemic affecting customers as well as, and the evidence indicates generally significantly more so, than Ontario's rate regulated utilities, the objective should not be to protect the status quo of the expected range of utility earnings. Rather the objective should be to ensure continuation of the provision of essential energy services in a reliable manner at reasonable cost. This objective is best reflected in the Board's statutory mandate to facilitate the maintenance of financial viability in the regulated provision of electricity and natural gas[4].

---

[1] Staff Proposal, page 9.
[2] For the purposes of this submission the term "costs" denotes both incremental expenditures and revenue shortfalls from forecast.
[3] Staff Proposal, page 12.
[4] *Ontario Energy Board Act*, 1998, sections 1(2) and 2(5).

Staff Proposal

15. The Staff Proposal proposes a test for "necessity"[5], the principle behind which is described as to capture costs that *"are not only reasonable, but also necessary to the maintenance of the utility's financial viability"* (our emphasis). This is an appropriate conceptual approach for evaluating the imperative to depart from the pre-established regulatory framework in order to address the circumstances of the COVID-19 pandemic.

16. Staff then goes on, however, to suggest that the Board use its existing 300 basis point deadband as the test for "necessity", on the basis that this deadband demarcates *"reasonably expected fluctuation"* in earnings[6]. Staff further proposes that beyond the lower boundary of this measure of *"reasonably expected fluctuation"*, costs would be shared between the utility and its customers on a 50:50 basis, as a means to *"balance"*[7] utility and customer interests.

17. With respect, the Board's objective in these circumstances should not be protection of utility earnings or cost sharing. The Board's objective should be to facilitate continued financial viability in the provision of essential utility services.

18. The proposed 300 basis point test is not a financial viability test. The 300 basis point deadband is intended to signal that a *"regulatory review by the OEB may be required …to assess whether a utility's costs and its revenue stream require realignment for the sake of maintaining financial viability and/or reasonable rates"*[8]. That is, the 300 basis point deadband is, even in normal circumstances, a signal for a potential review, not a marker for permitting recovery.

19. In respect of financial viability, School Energy Coalition has compiled and filed data showing that Ontario LDCs have in the past continued to operate, at times for consecutive years, with earnings well below -300 basis points of Board approved ROE without risk to continuing financial viability. The Board has made clear that any individual utility that

[5] Staff Proposal, page 11.
[6] Staff Proposal, page 13.
[7] Staff Proposal, page 10.
[8] Staff Proposal page 13, our emphasis.

anticipates financial or operational viability issues in the near term should contact the OEB immediately.[9] Apparently none have.

20. In respect of whether rates remain *"reasonable"* at earnings below -300 basis points, that is a matter that can be determined in the context of an application to reset rates. The Board acted, on the basis of the then apparent "emergency", to establish the variance account in order to preclude the need, should one arise, to adjust rates retroactively. The issue at hand is whether immediate relief through recovery of an in-year variance is required to maintain utility financial viability prior to resetting rates.

Test for Financial Viability

21. As evidenced by the historical information compiled by School Energy Coalition, the 300 basis point deadband is not an appropriate measure of continuing financial viability. (At the current 8.34% Board prescribed ROE, deferral account relief would be triggered at earnings of more than 5% on invested capital, which far outstrips the 2020 and continuing experience of many of Ontario's natural gas and electricity customers who are truly experiencing financial viability risks.)

22. Rather, as alluded to by OEB staff[10], there are commonly used liquidity and solvency measures (such as current ratios and interest coverage ratios) used by the Board which provide a better measure of continuing financial viability.

23. ***Applicants for recovery of COVID-19 driven costs should be required to demonstrate potential impairment to continuing financial viability should recovery of costs already incurred not be provided for.***

24. Where the potential for impairment to continuing financial viability absent recovery of costs incurred is demonstrated, then recovery should be permitted to the extent required to remove the demonstrated risk of impairment, no more but no less. This approach should apply to <u>all</u> categories of costs, including lost revenues and costs incurred to implement

---

[9] OEB Letter, September 24, 2020, page 3.
[10] Staff Proposal, page 23, including footnote 42.

government or OEB directed emergency response to this unprecedented public health crises.

25. If protecting ongoing financial viability entails recovery of 75% of incurred COVID-19 driven costs, or 80%, or 100%, that should be approved. It is in the interests of both utility shareholders and utility customers that reliable provision of regulated utility services be maintained until rates can be reset with due consideration for longer term COVID-19 impacts.

26. AMPCO and IGUA see no reason why this approach should not apply in principal to "greenfield" utilities (NextBridge) or those under development (EPCOR South Bruce) as to those already in full operation.

Recovery of Qualifying Costs

27. Where it is determined that costs incurred have been directly driven by necessary response to the COVID-19 pandemic and recovery of some or all of those costs is required to maintain the financial viability of the regulated utility, AMPCO and IGUA agree that the *"longstanding regulatory principles"* of prudence and materiality should also be applied.[11]

28. These principles dictate that need for cost recovery should be assessed on the basis of net costs.

29. In respect of prudence, we agree with the Staff Proposal that the utility seeking recovery to address the impacts of costs driven by the COVID-19 pandemic should *"demonstrate that it has acted prudently to minimize those impacts and has fully exploited all available cost reductions and savings, including those that have become available in light of the pandemic"*.[12]

[11] Staff Proposal, page 14.
[12] Staff Proposal, page 15.

30. Payment of dividends or bonuses, for example, should be taken as indicative that finances have not been prudently managed in the context of a once in a lifetime global pandemic, and cost recovery in such circumstances should be denied.

31. When recovery is permitted, the regulatory principle that costs should follow benefits directs that qualifying costs be recovered from all customers.

32. If the objective of cost recovery is to maintain the financial viability of the regulated utility, which is what AMPCO and IGUA submit the objective should be in these circumstances, then all customers benefit from achievement of that objective.

33. The Staff Proposal suggests that approved costs should be recovered from those rate classes driving those costs. In the context of a global pandemic, allocating COVID-19 driven costs (in particular when those costs are lost revenue/bad debt related) to those rate classes from which the costs arise could result in seeking recovery from those customer classes <u>most impacted</u> by the pandemic and <u>least able</u> to pay incremental costs. In the context of allowing recovery of costs in order to ensure the continued viability of the utility to serve all customers, the customer allocation suggested in the Staff Proposal would violate the "costs follow benefits" principle and would be a strikingly regressive approach.

Conclusion

34. While AMPCO and IGUA have critically reviewed the Staff Proposal and differ from the approach therein proposed in a number of key respects, these differences should not be taken as being critical of the effort or thinking that OEB staff have put into the effective conduct of this matter in general, and the formulation of the Staff Proposal in particular. As stated at the outset, AMPCO and IGUA appreciate the continuing effort of the Board, through Board staff, to robustly consult with, and take into consideration the views of, all stakeholders. Staff has invited comment on the central aspects of its proposal and the thinking behind it which it has transparently outlined. AMPCO and IGUA have taken advantage of, and fully appreciate, this invitation.

35. We look forward to reviewing the submissions to be filed by others and will offer further comments in response as warranted.

ALL OF WHICH IS RESPECTFULLY SUBMITTED by:

GOWLING WLG (CANADA) LLP, per:
Ian A. Mondrow
Counsel to AMPCO and IGUA

January 25, 2021

ACTIVE_CA\ 43067554\2