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April 20, 2012

BY EMAIL & BY COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Dear Ms. Walli:

Board File No. EB-2010-0377, EB-2010-0378, EB-2010-0379, EB-2011-0043
Consultation – Renewed Regulatory Framework for Electricity
Energy Probe – Comments

Pursuant to the letter from the Board entitled *Provision for Written Comments by Stakeholders*, dated April 5, 2012, Energy Probe Research Foundation (Energy Probe) is hereby providing its Comments in the Renewed Regulatory Framework consultation for the Board's consideration.

Should you have any questions or require additional information, please contact me.

Yours truly,

David S. MacIntosh
Case Manager

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**EB-2010-0377
EB-2010-0378
EB-2010-0379
EB-2011-0043**

Ontario Energy Board

RENEWED REGULATORY FRAMEWORK FOR ELECTRICITY

**COMMENTS OF
ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")**

April 20, 2012

EB-2010-0377
EB-2010-0378
EB-2010-0379
EB-2011-0043

RENEWED REGULATORY FRAMEWORK FOR ELECTRICITY

Comments of Energy Probe Research Foundation

Background

Energy Probe Research Foundation (“Energy Probe”) participated in the Stakeholder Conference on February 2, 2011, the Staff Information Sessions on December 8 and 9, 2011 and the Stakeholder Conference March 28-30, 2012.

Energy Probe is pleased to make the following comments in response to the Board letter of April 5, 2012, Attachment A, “Written Comments by Stakeholders” and the questions posed by Board staff in their Staff Discussion Papers released November 8, 2011. The format follows the suggested approach in Appendix A thereto.

The Renewed Regulatory Framework for Electricity (“RRFE”) Consultation consists of 5 inter-related policy initiatives. Energy Probe participated in the four initiatives noted above. However, Energy Probe did not participate in EB-2011-0004: Establishment, Implementation and Promotion of a Smart Grid in Ontario.

As is its custom, Energy Probe has not commented on each and every topic but reserved its comments for topics where it felt it might assist the Board. For clarity, the Comments of Energy Probe in respect of the Board Staff Papers follow the Comments on Attachment A.

Attachment A: Issues for Comment

Energy Probe Research Foundation (“Energy Probe”) participated in the Stakeholder Conference on March 28-30 and is pleased to make the following comments in response to the Board letter of April 5, 2012 “Written Comments by Stakeholders”. The format follows the suggested approach in Appendix A thereto.

The RRFE Consultation consists of 5 inter-related policy initiatives. Energy Probe participated in the four initiatives titled above. However, Energy Probe did not participate in EB-2011-0004: Establishment, Implementation and Promotion of a Smart Grid in Ontario. Hence, its comments will relate only to the other initiatives.

1. General

a) What is your vision for a sustainable and long-term regulatory regime?

Energy Probe supports the Board’s efforts to revise the regulatory framework for electricity insofar as, by reviewing its regulations and reporting requirements, those efforts promote efficiency and lower costs to consumers. However, Energy Probe wishes to point out that, to the extent that changes simply shift the costs from one party to another, no savings have been achieved.

Energy Probe envisages the regulatory process as a substitute for the marketplace. In other words, the goal of regulation is to achieve the outcomes that would occur in a non-regulated environment having due regard for the natural monopoly characteristics of distribution and transmission.

b) What changes would be needed to evolve planning, mitigation, and performance policies towards your vision?

This means, among other things,

- that regulation should encourage full-cost pricing of electricity to business and household consumers without direct or implicit subsidies
- that the regulatory regime should itself be low-cost and least-intrusive
- that decisions on investment by distribution companies be (i) based on their customers’ willingness to pay for service quality, (ii) achievable and (iii) cost-justified. (i.e., a “no brown-out” requirement may be reasonable but not achievable except at extraordinary cost)
- that penalties for poor performance by distributors be based on compensatory costs incurred by their customers

- c) As a means of representing the Board’s vision for the regulatory framework, Board staff prepared a strawman that summarized the key elements of the regulatory framework. In providing their comments on the issues the Board would be assisted if stakeholders also provided comments in relation to this vision.**

Energy Probe finds the strawman to be a useful summary of the vision for the regulatory framework and the current situation. However, it suffers from being overly-technical and is not clear on what the “vision” (apart from its details) consists in.

2. Distribution Network Investment Planning (EB-2010-0377)

The Board Letter of November 8, 2011 clearly states the objective of the initiative on distribution network investment planning:

“ensure that distributor investment plans are economically efficient and cost-effective, and paced so as to match required expenditures with fair and reasonable rate adjustments and predictable changes to the elements of customer bills affected by the plans ” (Attachment A, at p.7)

Energy Probe accepts that electricity prices are rising due, in part to the requirement to replace and upgrade LDC networks (i.e. network investments). It also recognizes the statutory requirements in regard to connecting renewable energy generation to the grid.

Energy Probe supports the various recommendations of Board Staff that attempt to harmonize information requirements.¹ Energy Probe is concerned, however, with the treatment of costs in the Distribution Service Code, in Ontario Regulation 330/09 and in certain aspects of the treatment of infrastructure investment that appear to shift costs to ratepayers that more properly belong to generators. Energy Probe favours full-cost pricing, but it disagrees with subsidies that distort generator decision-making.

- a) How do we optimize planning across the sector to ensure that investment decisions achieve the level of reliability and quality of supply that consumers demand and are paying for? (Appendix A)**
- i. As noted in the Staff Discussion Paper, the Distribution Service Code (“DSC”) puts cost responsibility for Renewable Enabling Investments (“REI”) entirely on the distributor.² This assignment means that renewable energy generators do not consider the costs

¹ Cite Staff Report on 0377 here

² Staff Discussion Paper, Table 1, p.11

of connecting their generators to the grid. In consequence, they take into consideration only a subset of the real costs that their investment imposes on society and their projects, while appearing individually profitable, may not be socially desirable in the sense of economic efficiency.

Energy Probe submits that efficiency is an important consideration in connecting all generation facilities including renewables, and that REI project investors should pay a portion of the connection costs. This would reduce distributor costs and the resulting bill impact would be favourable to ratepayers.

Recognizing that the Board has a statutory obligation to ensure the connection of REI, Energy Probe does not recommend that the investor pays the full cost of connection that it imposes on the local distributor. However, paying none of that cost encourages inefficiency. Accordingly, the DSC should be amended to require some form of cost-sharing between the distributor and the generator.

- ii. As noted in the Staff Discussion Paper, Ontario Regulation 330/09 allows the recovery from all provincial electricity ratepayers of some or all of Board-approved costs incurred by a distributor in making an “eligible investment” for the purpose of connecting or enabling the connection of “qualifying generation facilities” to its system. The regulation further provides that the qualifying generation facility must be a Renewable Energy Generation (“REG”) facility.

The regulation also requires that the investment’s “direct benefits” to customers of the distributor be deducted from Board-approved costs in order that local ratepayers pay for the costs of those benefits, while other provincial ratepayers do not.

The Staff Discussion Paper³ notes that where the direct benefits are a large portion of Board-approved eligible investment costs, the deduction results in higher electricity bills to the distributor’s customers. (However, the Staff Discussion Paper makes no suggestions as to mitigation thereof in this section.)

Note that the converse statement also applies, i.e., that where the direct benefits are small, then all Ontario ratepayers pay for the distributor’s costs through the Wholesale Market Charge that is included in the Regulatory Charges line on customer bills.

³ Op. cit., p.23

Not noted in the Staff Discussion Paper is the resulting incentive for local distribution companies across the Province to undertake those investments whose costs can be “socialized” across all Ontario ratepayers rather than investments in facilities that are not “qualifying generation facilities” and that must be paid for entirely in local rates.

In light of the Board's concern for “pacing” of investment, Energy Probe feels that it would be useful to examine the data on planned distributor investments in qualifying versus non-qualifying generation facilities, in order to determine what impact, if any, the incentive effect has been on distributors’ decisions to invest.

3. Rate-Setting and Mitigation (EB-2010-0378)

Energy Probe regards the Staff Discussion Paper on this consultation (the “Staff Paper”) quite informative and a useful guide to the very complex issues involved in determining an appropriate approach to mitigation.⁴ As these issues are quite technical, Energy Probe will limit its comments to those where it may be able to offer a new or different perspective.

- a) To support the cost-effective and efficient implementation of Board-approved network investment plans by transmitters and distributors and help to mitigate the effects of any unavoidable and significant bill impacts, what mechanisms might be appropriate? (Appendix A)**
 - i. Energy Probe notes the concern in the Staff Paper that mitigation plans, where required, must not simply redistribute the costs from one class of customer to another (p.12). Energy Probe agrees with the Staff Paper in this regard because mere redistribution subsidizes the consumption of one group at the expense of another. If this were the intent of mitigation, there are better ways to arrange that subsidy than smoothing the rate increases for one group while making them less smooth for others.
 - ii. The Staff Paper also notes that mitigation is not a response to “hardship” concerns. Energy Probe agrees with this view, noting that the Board is not as well-positioned to assess hardship as is the Ontario Government.

⁴ Ontario Energy Board. Staff Discussion Paper on Approaches to Mitigation for Electricity Transmitters and Distributors, EB-2010-0038, November 8, 2011

In this regard, Energy Probe does not regard the Ontario Clean Energy Benefit as either a mitigation measure or as a hardship concern. It is effectively a transfer of costs from ratepayers (i.e., the “eligible consumers”) to all taxpayers, as noted in the Staff Discussion Paper (p.26). To the extent that those two groups coincide, there is no “savings” of any kind and certainly no effective mitigation as “rate shock” is merely replaced by the less transparent “tax shock”.

- iii. The Staff Discussion Paper (p.22) notes that one possible method of mitigation is reduction in the allowed ROE. Energy Probe agrees with the Board’s view that such an approach is inconsistent with the principles of sound rate-making and could, if relied upon, affect the utility’s access to the capital market on fair terms.

Moreover, a policy of reducing the allowed ROE masks the underlying causes which, at the Staff Paper notes, include green energy initiatives, the global adjustment and the special purpose charge.

- iv. The Staff Discussion Paper notes that another possible method of mitigation is the inclusion of CWIP in the rate base (pp.17, 50-51). Noting that the Board has already addressed the matter with approval in the Infrastructure Report, Energy Probe agrees that providing for the early recovery of approved construction costs in this way should promote the smoothing of rates.

However, the Staff Discussion Paper does not address the contingency that the constructed asset may not come into service. If utilities are allowed to include CWIP in the rate base, then the construction costs are recovered in rates even if the asset does not come into service, hence the utility does not bear the costs of its mistake. The result could well be excessive construction with reduced incentives for cost-savings and the corresponding increase in the burden on ratepayers, i.e., the opposite of mitigation.

If the Board has not adequately considered this weakness in the argument for including CWIP in the rate base, Energy Probe suggests that it should not be used as a method of mitigation until the Board is satisfied that ratepayers are not bearing risks that properly belong to shareholders.

- v. Energy Probe notes the extensive discussion of Voluntary Customer Payment Plans (p.51) and calls attention to the Staff Discussion Paper's description of "equal payment plans" as a method of smoothing the costs of seasonal fluctuations to participating ratepayers (p.52).

In Energy Probe's view, such plans are, in effect, a form of insurance that the utility provides to its customers. Since no interest is accrued or charged on accumulated credits or debits, the customer pays no "premium" for this insurance which, as the Staff Discussion Paper notes, is provided and reconciled on an annual basis.

Energy Probe is unsure whether utilities could provide this "bill levelization insurance" for periods longer than one year. However, there is no obvious reason (excepting consumer ignorance) why such insurance could not be provided by conventional insurance providers. If it were possible for ratepayers to purchase such insurance, they would be exchanging the risk of large rate increases for the constant annual premium which would thereby convert their exposure to a predictable annual amount.

At this point, the only such insurance providers are electricity marketers. However, the marketers' contracts cover only the electricity commodity cost, whereas the Staff Discussion Paper points out that the need for mitigation arises from a variety of elements on the customer bill.

Energy Probe envisages that transmission and distribution companies may find it worthwhile either to offer such insurance contracts through an insurance subsidiary, or to form networks with conventional insurers, as permitted and as exemplified in the distribution networks of mortgage insurance by conventional lenders.⁵

⁵ Because chartered banks are not allowed to sell mortgage insurance directly, they entered into agreements with conventional insurers, effectively acting as sales agent for the latter.

4. Performance and Incentives (EB-2010-0379)

Energy Probe supports the introduction of performance measurement systems in the regulation of electricity transmitters and distributors. The Staff Discussion Paper on this topic⁶ provides a thorough canvass of the current environment and of possible changes that would link utility performance to the central issue of the RRFE, i.e., customer bill impact. Accordingly, Energy Probe offers the following comments in areas where it has a particular interest or concern.

a) What outcomes for customer service and company cost performance should be established? (Appendix A)

Energy Probe agrees that the conventional cost-of-service approach to ratemaking does not reward innovation and improved performance, neither does it penalize utilities for poor performance and failure to innovate. Incentive regulation addresses some concerns in this regard, but its rather narrow focus does not ensure that the Board's various statutory objectives will be attained. It may, for example, provide incentives for innovation, but it does not address objectives relating to customer service, reliability, and the environment.

b) What incentives, if any, are appropriate to reward utilities for cost-effective and efficient performance, including appropriate rewards for exceeding standards for customer service? (Appendix A)

Energy Probe favours the "outcome-based approach" presented in the Staff Discussion Paper (p.26). Measuring and rewarding a utility's performance on the basis of its physical outputs alone sets up incentives in which consumer satisfaction receives a low priority from utility management.

While the Board generally takes this broader view, the regulatory environment may not provide the most appropriate tools. For example, the Board's codes establish minimum standards at the licensing stage but do not address outcomes that are above the minimum requirement. Energy Probe agrees that the conditions of license are insufficient. Similarly, the "standards approach" to service quality for electricity distributors makes compliance mandatory but does not reward superior performance.

⁶ Ontario Energy Board. Staff Discussion Paper on Defining and Measuring Performance of Electricity Transmitters and Developers, November 8, 2011.

Energy Probe endorses the view expressed on p.27 of the Staff Discussion Paper that

“Regulation that promotes economic efficiency in the energy sector ultimately serves the best interests of ratepayers, investors and the province as a whole.”

Incentives, benchmarking and service quality standards should be judged according to whether they promote economic efficiency.

c) What are the characteristics of a “high-performing entity”? (Appendix A)

Energy Probe also agrees with the four criteria for defining and measuring performance presented in the Staff Discussion Paper (p.27). However, the framework may not be “practical”, in the sense of the Paper, as the criteria may be incompatible (e.g., sustainability and predictability). Conceptually, this situation calls for an index in which the various criteria are weighted and performance measures are introduced so as to maximize the index level.

As the Staff Discussion Paper notes (p.28), practicality also implies that the utility’s cost of administering the performance measurement system should not exceed its benefits. This may seem obvious in certain respects, but it is quite clear that installing a new measurement system can become quite costly to the organization in questions and to other organizations that measure performance.

As an illustration, consider the cost of administering the conventional accounting system used by any large organization. Decisions to change that system are not undertaken lightly, in part because the accounting system is a fixed cost and may be seen as not providing much value except as compliance with external regulations (e.g., producing financial statements by privately-owned businesses).

The issue is clearly stated at p.38 of the Staff Discussion Paper. Imposing new standards may raise the customers’ total bills. Thus, installing a performance measurement system may be an instance where the private benefits (i.e., to the utility) are less than the social benefits. Energy Probe suggests that, as is likely, the “benefits” referred to be defined as the social benefits.

These social benefits will include the impact on related organizations. Thus, the OEB will incur both benefits and costs in order to monitor the performance of its regulated utilities. In general, regulatory measures should, and likely do at some level, take into account the impact on the regulator.

d) What incentives, if any, are appropriate to reward utilities for cost-effective and efficient performance, including appropriate rewards for exceeding standards for customer service? (Appendix A)

I. General considerations

In Energy Probe's understanding, the setting of appropriate incentives is a complicated process with a number of inter-twined concepts within the Staff Discussion Paper. In Energy Probe's view, the choice between financial incentives and standards, the use of "marginal incentives", and choice between absolute performance and relative performance are related and therefore require implementation on a consistent basis.

This is not to say that all the answers are known, but rather to say that it is important to achieving economic efficiency that the available tools are aligned rather than in conflict.

II. Willingness to Pay for Service Quality

Energy Probe considers that any system of incentives and other tools should strive to achieve, for each utility, the level of service quality that its ratepayers would be willing to pay for. The Staff Discussion Paper notes (at p.37):

"In particular, there was discussion at the meeting on the importance of focusing standards on things that customers will value and that, to ensure this, customer importance surveys, similar to that carried out by the Board in relation to distribution system reliability and, where appropriate, willingness-to-pay surveys should be conducted as part of the work to establish a standard. ..."

It is a consequence of willingness-to-pay thinking that the level of service quality that a regulated utility should provide should be determined by its customers' preferences. In a competitive market, firms adjust their quality of service in such a way as to maximize their profits. Hence, if the goal of regulation is to simulate the competitive market, then not all quality improvements should be made. Rather, to the extent that customers prefer lower quality at a lower price, efficiency dictates that the "right" level of service quality is determined by their willingness to pay.

Thus, incentives for quality improvement should be determined and applied in the same manner. If incentives stimulate a utility to provide a higher quality of service than its customers are willing to pay for, then that higher service level is inefficient.

III. Peer-based versus absolute performance

The Staff Discussion Paper discusses the appropriate approach to performance measurement at p.49 and seeks comment on how it might assess utility performance. The above discussion should inform the choice between peer-based (or relative) performance and absolute performance.

In competitive consumer markets, firms offer service quality consistent with customer willingness to pay. The service levels provided by a firm may be higher or lower than that provided by its competitors. The rise of low-cost air carriers that offer fewer amenities than full-service airlines provides an example. In this case, low-cost carriers find they can operate profitably by providing lower service quality at lower cost, hence meeting the willingness to pay of an identifiable group of consumers.

Therefore, it may be inconsistent to judge the adequacy of a utility's quality of service by reference to its peers. Setting aside the cost-differences among utilities that lead to different levels of service, as say between urban and rural utilities, there may also be differences in willingness to pay.

The question is which type of performance review is the more efficient. Without going into a detailed argument, Energy Probe has concerns about an incentive system that may, in conjunction with peer-based review, lead utilities to increase service quality simply in reaction to its peers are doing. The greater risk is increased quality for its own sake with the consequent bill impact, unrelated to willingness to pay.

IV. Standards versus financial incentives

Energy Probe recognizes that the current Board approach is to set minimum standards for electricity distributors, the exception being the standard for productivity (Staff Discussion Paper at p.33). It is of the view that setting common quality standards for all distributors and for all transmitters would be inefficient.

Energy Probe's presumption is that economic incentives based on willing to pay for service quality work best. However, uncertainty about the costs of quality improvement and/or about willingness to pay circumstances in which recourse to standards may be necessary. As has been suggested in the debate between taxation and standards in controlling environmental pollution, the differences in compliance costs are crucial.

Thus, the more certain the regulator is about costs and willingness to pay, the more it should rely on incentives than on standards.

V. Specific observations

Energy Probe supports the use of penalties for inadequate or failed service by the utility. For example, power outages should incur penalties and should vary with the severity and length of the outage. Most importantly, the penalty should compensate the customers for their losses due to the outage. In Energy Probe's view, the prospect of compensatory penalties would focus the minds of utility managements on avoiding outages.

However, Energy Probe does not support symmetry in the design of all incentives (Staff Discussion Paper, Table 6 at p.46). It might be appropriate to reward a utility for efforts to prevent outages if those efforts are successful, but the reward should be smaller than the penalty for failure.

The distinction between financial and reputational incentives is important. The financial penalty could, in certain circumstances, be treated simply as a “cost of doing business”, whereas adverse public criticism by the regulator may have greater impact on management. Ultimately, however, a financial penalty may be needed after successive failures. In this regard, the Board should make it clear that such costs are not recoverable in rates.

The Staff Discussion Paper refers to “marginal” incentives but provides no explanation; similarly, the Concept Paper does not discuss. In light of Energy Probe’s concern with efficiency, the way revenue rewards/penalties change as performance changes is clearly a matter of concern. However, one can easily observe the inefficiency of the “feed-in tariff” structure on renewable energy that is paid for at a mandated fixed rate. This type of incentive structure may have the effect of starting an industry but it does not adjust automatically as the industry grows. Yet if incentives are removed too quickly, the industry may not start up at all.

Energy Probe Research Foundation appreciates the opportunity to comment on these most important issues brought forward in the Board’s letter of April 5, 2012.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

April 20, 2012

Energy Probe Research Foundation

Energy Probe Comments on Board Staff Paper

Distribution Network Investment Planning

(EB-2010-0377)

1. **Are there elements of the Code, the GEA Filing Requirements and the Benefits Framework that require further alignment to promote, for example, the consistent categorization of investments for all regulatory purposes related to network planning?**
2. **Are there elements of the *CoS Filing Requirements* and the *GEA Filing Requirements* that could be further harmonized, having regard to the fact that both address facets of a distributor's overall network plan?**

Energy Probe suggests that the first priority is that Code and all related requirements be aligned to promote economic efficiency in the sector. Saving resources that are currently devoted to the production of information may be an important part of this goal as long as those savings do not detract from the Board's ability to meet its statutory obligations.

However, in Energy Probe's view, the more important contribution to efficiency lies in aligning the Code and related requirements to put the cost responsibilities on all of the parties whose plans affect the utility's costs. If the Code assigns cost responsibility to the distributor for connecting renewable energy generation, then those generators do not take such costs into consideration in evaluating the profitability of their investments. Recognizing the Board's statutory requirement to promote renewable energy, it nevertheless ought to arrange that cost responsibilities be shared.

3. **What are the merits and key challenges of pre-establishing network investment assessment processes and corresponding filing requirements based on criteria involving the characteristics of the proposed investments?**
4. **Should the Board consider mechanisms, such as an incentive-based approach to information filings, to promote network planning filings that achieve a requisite degree of quality?**

Energy Probe notes that OFGEM sees information quality incentives as means of encouraging utilities to demonstrate that certain costs have been incurred efficiently and are valued by customers.

It is not clear to Energy Probe why incentives are needed to induce the utility to provide this information. It would seem to Energy Probe that the Board should be requiring this information in the normal course. Indeed, Energy Probe assumes that if such information is not provided to the Board's satisfaction, then the Board should deny the approvals.

- 5. Are there elements of the *GEA Filing Requirements* related to qualitative investment planning information that can be usefully adapted for *CoS Filing Requirements* purposes?**
- 6. What are the best ways *qualitative* information can be used by a distributor to demonstrate the economic efficiency and cost effectiveness of their proposed network investments and should such methods differ depending on investment category or purpose?**

Energy Probe would have expected that such information was already being provided for the specific purpose of demonstrating efficiency and cost-effectiveness. It would seem that such information would be provided voluntarily as it is in the applicant's interest.

- 7. Are there quantitative analyses that should be required in respect of planned network investments and therefore included in the *CoS Filing Requirements*?**

Energy Probe's concern in this regard is that utilities may have an incentive to propose investments with lower requirements for quantitative analysis over those with higher requirements.

- 8. In general and/or specifically in relation to the PA Model: what are the merits and potential weaknesses of using information on the potential direct and indirect bill impacts of proposed network investments for regulatory assessment purposes?**
- 9. What are the merits and potential weaknesses of using estimates of direct and indirect bill impacts for network investment planning purposes (e.g. project selection; program configuration; scenario analysis)?**
- 10. What are the key issues to consider when determining whether and if so in what form information on estimated direct and indirect bill impacts should be included in filing requirements?**

Energy Probe's common response to the above questions is that direct and indirect bill impacts will lead utilities to structure their investments in ways that make it difficult for the Board to ensure the desired pacing of investments. To the extent that a utility can recover costs from all Ontario ratepayers, it has an incentive to

propose investments that permit it to do so. Hence, if renewable energy connection investments can be treated in this way, while investments in aging network assets cannot, it should not be surprising that a utility will set investment priorities around the former and not the latter.

Moreover, since all utilities have these incentives, it should not be surprising that they choose to make these preferred investments at the same time.

Even if it is the case that the Board cannot control or influence all of the elements of the customer's bill, it should use the tools at its disposal. Energy Probe cannot ascertain the extent to which changes in these incentive arrangements would ameliorate the Board's concern for pacing and bill impacts. However, these matters are within the control of the Board and should be considered.

11. Should the Board consider mechanisms that would help ensure the network planning policy framework is regularly informed of network investment outcomes and planning process developments?

(no comment)

Energy Probe Comments on Board Staff Paper

Approaches to Mitigation for Electricity Transformers and Distributors (EB-2010-0378)

1. **Is it appropriate for the Board to consider the total bill impact even if the applicant does not control or have the ability to influence all elements of the bill?**

Energy Probe regards it as appropriate for the Board to “consider” the total bill impact. It can do so in the ways discussed in the Staff Discussion Paper and, perhaps more importantly, by examining the impact of its own regulations.

Energy Probe supports efficient investment in the sector, and urges that subsidies be avoided. In this regard, Energy Probe notes that the rules for cost responsibility are established by the Board, and it is open to the Board to re-visit those rules when considering the total bill impact.

For example, where the Distribution Service Code assigns full cost responsibility for connecting renewable generators, it may be desirable in light of the total bill impact, to put at least some cost responsibility on the generator in order to avoid or at least minimize the subsidy.

The Staff Discussion Paper cites (at p.25) the Government’s Long Term Energy Plan of 2010 which attributes 56% of the 7.9% annual increase in the price of electricity to residential consumers over the next 5 years (beginning 2010) to investment in renewable generation.

Energy Probe recognizes the Board’s statutory obligation regarding renewable energy, but urges the Board to consider how its own rules may be contributing to higher customer bills.

2. **Are these guiding concepts appropriate? If not, how might these concepts be changed? Are there additional concepts that should be considered?**

The Staff Discussion Report cites several instances where economic efficiency is considered in the Board’s approach, e.g. in incentive regulation. However, in the context of this consultation, the Staff Discussion Paper sees efficiency as something to be balanced by “gradualism” (at p.30).

Energy Probe feels that efficiency should be viewed as a guiding concept, indeed the most important such concept.

- 3. What are the implications, if any, of defining mitigation as considerations that are brought to bear only after a cost has been determined by the Board to be reasonable, prudent and/or eligible for recovery?**

Energy Probe accepts the view in the Staff Discussion Paper that mitigation as currently defined by the Board does not contemplate the *ex ante* control of costs through the appropriate pacing and prioritization of investments. It agrees that the proper focus for such measures is in the initiative on distribution network investment planning (EB-20210-0377).

- 4. Should the Board's mitigation framework continue to have a threshold? If so, why? If not, what other tool(s) might utilities and the Board use to identify circumstances under which mitigation should be considered?**
- 5. Are the above noted criteria for establishing a threshold appropriate? Why or why not? What other criteria might be appropriate, why, and what are the implications for the setting of a threshold of these criteria?**
- 6. Staff invites comments from stakeholders as to the merits of, and considerations for, the approaches identified in section 3.3.2 above. Are there other approaches that the Board could consider for deriving a threshold?**

Energy Probe is concerned that changes in the current approach to mitigation may be, or may be seen to be, motivated by hardship concerns. In Energy Probe's view, the Board is not well-suited to make hardship determinations, and that such concerns belong more properly with the Ontario Government.

- 7. In light of the cost pressures facing electric utilities, the Board's approach to rate-setting, and the considerations noted in the Navigant Report, what is the appropriate role, if any, of the conventional and alternative mechanisms identified in this chapter for the purpose of mitigation? What criteria might utilities and the Board use to guide consideration of the use of these mechanisms?**
- 8. What conditions need to be in place in order to ensure the appropriate and effective use of the mechanisms identified in this chapter?**

Energy Probe is concerned that, as a general matter, the adoption of "alternative funding mechanisms" will make both individual utilities' practices and the regulatory system itself much less transparent and much more difficult to predict.

Also, the need for such mechanisms arises only because of the complexity of the regulatory system and the opportunities for avoidance of regulatory requirements. This was clearly seen in the recent financial crisis in the United States in connection with mortgage securitization, which had become popular because of regulatory limits on the mortgage holding of banks.

Energy Probe is not overly concerned about the introduction of International Financial Reporting Standards. Ultimately, investors and regulators are concerned about a utility's cash flow. Thus, the fact that IFRS does not recognize deferral and variance accounts as legitimate assets to be included in the body of published financial statements is completely irrelevant to knowledgeable parties such as lenders, financial analysts, utility management and regulators.

The suggestion of including CWIP in the rate base is of interest because it would impact the utility's cash flow. Before endorsing it as a mitigation method, Energy Probe would like to understand the implications if the utility assets under construction do not, in fact, come into service.

Finally, in Energy Probe's view, the Staff Discussion Paper's focus on the regulatory aspects of mitigation (i.e., what to allow the utility to do) is somewhat narrow. There may be other ways to encourage "levelization" of the customer's bill. As suggested elsewhere in the RRFE consultation, it ought to be possible for customers to purchase insurance, in which the insurer accepts the risk of unexpected cost increases in return for a regular level premium. This exchange is the essence of insurance and, while only limited insurance programs are currently available (i.e. through marketers of fixed-rate contracts), there is no obvious reason why conventional insurers would not be interested in providing "total bill" insurance.

Energy Probe Comments on Board Staff Paper

Defining and Measuring Performance of Electricity Transformers and Distributors (EB-2010-0379)

- 1. What should the Board consider when setting new or refining existing standards and measuring standards for service and/or cost performance for distributors and transmitters?**
- 2. What should the Board consider when developing appropriate incentives to transmitters and distributors for cost-effective and efficient performance, including appropriate rewards for exceeding the standards?**
- 3. What should the Board consider in relation to when and how it might assess utility performance?**

In the Board's letter to stakeholders of April 5, 2012, it stated that the RRFE consultation process will lead to the formulation of Board policies in relation to a renewed regulatory framework for electricity that would, inter alia, "establish performance outcomes that reflect consumers' expectations and encourage enhanced utility productivity". Energy Probe approaches public utility regulation from the perspective of economic efficiency and believes that the Board accords efficiency a basic consideration in all of its decisions.

In relation to establishing standards for service and/or cost performance, Energy Probe notes that economic efficiency does not always dictate that quality should be improved. Rather, the "right" level of service quality is that which is determined by customers' willingness to pay" (WTP)". Hence, when a standard for distributors or transmitters is introduced or refined, it should be done with reference to WTP.

The Board recognizes this most clearly in discussing service reliability. Although 100% reliability may be a goal, it clearly cannot be a standard because no customer is willing to pay the very high cost that would be required (assuming it was even realistic goal to begin with).

As this example shows, a standard developed without reference to WTP will be incorrect in the sense that it will lead to an inefficiently high or low level of service quality. If the standard is set with reference to WTP, then it will be unnecessary (indeed, inefficient) for regulators to provide “rewards for exceeding the standard”.

A similar efficiency concern arises with determining the incentives. The “appropriate incentive” is one that incents the utility to provide the level of service quality for which its customers are willing to pay.

Hence, regulators should attempt to understand WTP when setting or refining standards of service. In this connection, Energy Probe notes that the Staff Discussion Paper (at p.37) mentions willingness-to-pay surveys and endorses their use in standard-setting.

In competitive markets, firms are rewarded for offering quality consistent with their customers’ preferences, which may differ from the levels offered by their competitors. This also implies that inferring or measuring the appropriate service quality for a utility should **not** be based on what other (peer) utilities’ service levels are. Indeed, what other utilities’ service levels are should be of no, or of much less, concern than the WTP of a particular utility.

- 4. In light of the objectives for a renewed regulatory framework for electricity, do the Board’s existing “standards”, described in section 4.2.1, continue to effectively capture a holistic view of utility performance (e.g., financial, operating, etc.)? If not, what standard(s) for service and/or cost performance might be appropriate, how/when would the standard(s) be determined, and what are the implications, advantages and disadvantages of such standard(s)?**

The current standards for performance in Ontario (s.3.2.1 at p.32) are, as noted, minimum standards that establish “core” performance standards for transmission and distribution businesses. These standards address quality of service to customers, transmitter or distributor efficacy in delivery of service to customers, and cycle-times. (An exception to “minimum standards” is the standard for productivity for electricity distributors.)

If it is the case that transmitters and distributors are performing above those minimum standards, then these actions may be taken as a response to their customers’ WTP.

Energy Probe agrees with the Staff Discussion Paper (at p.34) that an individual transmitter or distributor should be able to make business decisions and accommodate conditions unique to its service area. It also agrees with the Staff Discussion Paper that to the extent possible, standards should endeavor to replicate the outcome of markets and should be related to aspects of service that customers value, and encourage efficient long-run cost performance (at p.35).

The reference to “long-run cost performance” may indicate a diversion from basing standards on WTP in order to accommodate objectives other than efficiency. To this extent, Energy Probe disagrees with the Staff Discussion Paper.

- 5. In its review and approval of costs associated with investment plans, what methodologies and approaches might the Board use to develop an empirical approach to help it determine appropriate cost levels? Can the Board’s utility cost comparison and benchmarking work be used to help size cost envelopes?**
- 6. In addition to the CDM targets, are there any other “core performance standards” that should be encouraged through the use of specific incentives? If so, what incentive(s) might be appropriate, how/when would it be determined, and what are the implications, advantages and disadvantages of such an incentive?**

Energy Probe supports negative incentives when a utility does not meet the standard. It is less supportive of incentives that reward the utility for exceeding the standard. With exception of incentive regulation and similar standards that are premised on constant productivity improvement, if the standard is set correctly, there should be no reward for exceeding it.

Energy Probe supports the use of financial penalties that compensate customers for well-defined service failures such as outages. Fines that do not compensate for customer losses are likely to be viewed as simply a “cost of doing business”.

However, Energy Probe sees value in reputational incentives. Indeed, providing easily available information to the public on services failures by utilities may be an effective way to change the behaviour of utility management. (Whether positive reputational incentives work is less clear.)

Another question to be considered is the effectiveness of revenue incentives. In Energy Probe’s view, such incentives, when they are small, may not induce the desired change in behaviour. This is an issue that deserves greater research.

- 7. How might the standards for performance discussed in section 4.2 and the various empirical tools discussed throughout the paper further inform (a) utility planning processes, (b) utility applications to the Board, and/or (c) the Board's review processes?**
- 8. What conditions would have to be met to "fast-track" an application?**

No comment.