



**BY EMAIL and RESS**

**Jay Shepherd**  
jay@shepherdrubenstein.com  
Direct: 416-804-2767

October 19, 2019  
Our File No. 20180287

Ontario Energy Board  
2300 Yonge Street  
27<sup>th</sup> Floor  
Toronto, Ontario  
M4P 1E4

**Attn: Christine Long, Registrar and Board Secretary**

Dear Ms. Long;

**Re: EB-2018-0287/8 – UR/DER – SEC Phase 1 Submission**

We are counsel for the School Energy Coalition. Pursuant to the Board's letter dated September 26, 2019, these are the SEC submissions with respect to objectives, issues, and guiding principles.

**Introduction**

***The Stakeholder Sessions.*** The stakeholder sessions September 17-19<sup>th</sup> were very instructive, and a good way to start this process. The reason, however, was not that the presentations collectively gave clarity, or provided a lot of answers. The opposite was in fact true. The stakeholder sessions demonstrated the breadth and complexity of the issues implicit in the areas of discussion, and perhaps even more dramatically the diversity of views between stakeholders.

In short, the input in those sessions was all over the place, much more so than we normally see. It was not just that stakeholders disagreed – which they did – but also the range of subjects about which they were not on the same page. What was important to some was less or even unimportant to others. What was obvious to some was simply

wrong to others. At fundamental levels, parties saw the future, and the roles of utilities, regulators and customers in that future, in completely different ways.

To give just one example, some stakeholders believe that the shift to a more DER-prevalent future is a normal course of business market shift that can be taken in stride. They believe limited changes to the status quo are justified. Just a few tweaks.

Other stakeholders, including SEC, believe that this shift is likely to fundamentally transform the regulated energy sector, perhaps the biggest change in the last two decades. The Board's role could be crucial in protecting customers and utilities and the DER industry from the worst of the negative impacts of this change.

**Structure of the Process Going Forward.** In our view, the key role of OEB Staff at the outset of this process is to bring structure and coherence to what will otherwise be a very unfocussed (and therefore less helpful) dialogue between stakeholders and regulator. To do that, OEB Staff will have to identify the categories of issues and sub-issues that need to be addressed, and how they fit together. This was, of course, largely the purpose of the stakeholder sessions. However, given the high level of diversity we saw from the stakeholder input, this conceptualization of the process takes on a much higher importance.

SEC will suggest, below, a framework for this discussion in which the questions and issues are divided into two broad areas: a) issues of regulatory concepts and philosophy, in which evidence is valuable but the focus is on analysis and preferences, and b) issues that are more immediate, and/or rest almost entirely on factual evidence. These two general categories are discussed below.

**The Board's New Leadership.** One other introductory comment is important. The issues that will likely be raised in this process could go to the heart of the regulatory compact, and have the potential to affect the regulated energy sector – positively or negatively – for a very long time. As this is happening, the OEB is awaiting a new leadership team, which will be appointed by the government in the coming months.

From the point of view of OEB Staff, it is appropriate to gather information, prepare analytical documents, engage stakeholders in public discussions, etc., on the higher level issues in category one. However, decisions on those issues - decisions that are fundamentally about regulatory philosophy - should await the new Board leadership.

Conversely, the issues in category two are more technical and immediate. In our view, it is appropriate for the Board to continue dealing with these and similar issues, in the normal course, just as they have in the last few months while awaiting the new leadership team.

In our view, it will be important for the Board in the next several months to be very precise in distinguishing between the “vision” issues, and the business as usual issues.

While these submissions are limited to the first category of issues, that is not an indirect statement on their relative importance. Rather, SEC believes that other stakeholders will make many submissions with respect to category two issues. We believe we can add more value by focusing on the higher level issues that many parties may ignore.

### **Conceptual or Philosophical Issues**

There are four types of conceptual issues that the Board should address early in the process, and continue to address going forward. Those four are largely sequential, but also interrelated and to some extent iterative.

The four categories are:

- a) The OEB’s stance in the changing energy sector.
- b) Questions related to major changes in energy principles, such as the Fair Return Standard, asset ownership and responsibility, competition for monopoly rights, and the boundaries of the monopoly.
- c) Questions related to regulatory tools and approaches, such as the use of price signals, the role of the utility as gatekeeper (if any), the amount of competitive freedom that should be available to utilities, etc.
- d) With respect to each of the energy principles and approaches in play, to what extent is that principle energy policy vs. regulatory policy (or something else).

### **The OEB’s Stance**

We chose the word “stance” quite deliberately, because it is not the Board’s “role” that needs to be addressed at the very beginning of the process. Rather, it is the Board’s point of view. The changes that are happening in the energy sector are happening all over the world, and are being dealt with by numerous regulators, legislators, academics, utilities, customers, and others. Where does the Board want to fit into that evolution?

Simply put, the Board can take one of three positions with respect to the major changes that are happening in the energy sector: lead, follow, or keep up.

**Lead.** If the Board opts to take a leadership role relative to others around the world (whether on the overall evolution, or specific industry changes), that has consequences. It will be much more expensive, of course. Like early adopters anywhere, the Board will likely have some of the worst solutions (clunky, even primitive), and make lots of mistakes. Utilities, customers and government may well object to solutions that are “ahead of their time”.

On the other hand, leaders have the advantage that they are less likely to be caught without a response to a problem. Leadership could also mean DERs in Ontario, for example, become a significant industry because we create an environment in which they flourish locally. There is the pride factor, of course, but there is also the tangible expression of that: easier recruitment of top people to the OEB. Leadership could also mean that Ontario, and Canada, move at a faster pace towards GHG reduction goals.

Somebody has to lead, and despite the higher costs and risks of leadership, people do it. In our view, if the OEB as regulator decides to be a leader in this area of transformative sectoral change, it should do so consciously and with a plan to control those costs and risks.

**Follow.** The other extreme the Board could adopt is to let other jurisdictions tackle the problems of the changing sector, implement solutions, have successes and failures, etc. Once other jurisdictions have brought those solutions to the point of being “best practices”, then the OEB can adopt them in Ontario.

This is the most risk-averse approach, from a regulatory perspective, and probably the most common among regulators in other jurisdictions. Regulatory costs are likely lower, and solutions when implemented will in all probability work well.

It is also inherently suitable for the utility sector. The regulator expects utilities to be risk-averse, and to ensure that they are always adopting best practices. It is not unreasonable to think that the regulator should have a similar stance to regulation as it expects utilities to take with respect to managing distribution infrastructure. It would also be consistent with many other parts of the Ontario economy that are owned or overseen by governments.

The disadvantages of a pure follow-the-leader approach are largely the inverse of the advantages of leadership. The DER industry in Ontario could be stifled, and certainly the industry would not see Ontario as a base of operations to serve other jurisdictions. Climate change objectives could be harder to meet. Perhaps most important, with solutions lagging behind the market realities, the OEB as regulator, and the utilities as system managers, are likely to have to deal with many issues on a reactive basis. There is the likelihood that regulatory responses will not be available when they are needed, and that customers and DER businesses will be unhappy with the regulator and/or the government as a result.

**Keep Up.** Between leading and following is the pack in the middle, regulators who ensure that they are up to date on what others are doing, or testing, or piloting, and are doing a limited amount of experimentation themselves.

This middle-of-the-road approach still has to aim for a particular spot on the “leading edge” curve. Some will want to be near the front, not early adopters of the Motorola car

phone, but still eager to have the early Blackberry even though it isn't perfect. Others just don't want to be last, that person still searching for a pay phone when everyone else has an iPhone.

"Keep up" has generally been the Board's stance in the past on regulatory concepts and changes as they evolve. While the Board has often been near the front of the pack (PBR/IRM, for example), and is almost never a laggard on important issues, it is also rarely the first regulator to roll out a new solution.

Stepping back from leadership avoids the largest costs and risks of that approach. It also ensures that reasonable solutions are available as sectoral issues mature, while avoiding radical changes that generate utility or customer resistance.

The main difficulty with the "keep up" approach is that it can be haphazard, and therefore inefficient. OEB Staff members are constantly getting input on the activities in other jurisdictions, either directly as part of their professional development (conferences, papers, direct interactions), or indirectly through information/advocacy from utilities and other stakeholders. In the area of DERs, for example, this has been accelerating in recent periods.

There is usually no organized structure to keeping up to date. (It just happens naturally, as they say.) What this means is that OEB Staff, government, utilities, environmental groups, government and customers are often not on the same page, and many initiatives are challenged to be efficient. It also means that, when faced with major sectoral change, the Board does not have an overall methodology in place for implementing a "keeping up" strategy.

**SEC Recommendation.** It will be apparent from the above analysis that SEC believes keeping up is a good stance for the OEB, and that staying near the front of the pack, as the Board has often done in the past, is also a reasonable trajectory. While Ontario probably gives up some economic and environmental benefits by not being leaders, the ongoing cost control is a worthwhile goal. It is a balance, but skewed in favour of the slightly higher cost to be near the front of the pack.

SEC does believe, however, that the changes coming to the regulated energy sector from DERs, conservation, and climate change policy are a bigger challenge than the Board has usually had to face in the past. This challenge is at least as big as bringing the newly-corporatized electricity distributors under a regulatory regime, and maybe greater than gas unbundling. Given that perspective, SEC believes that it may be worthwhile for the Board to consider a more formalized structure for maintaining information about what is happening elsewhere, and determining how and when issues raised in that data should be brought to Ontario stakeholders for discussion and potential action.

One way to do that (this is an example, not a specific proposal from SEC) might be called the “curatorial” approach. In this approach, OEB Staff establishes and maintains a comprehensive public database of information on DERs and regulatory responses to DERs around the world. One or two staff members would be dedicated to ensuring that at all times this resource contains everything that is happening related to this issue. Utilities, customer and environmental groups, and others, would be encouraged to feed information into that database that is less readily available.

This database would go beyond a commission decision in California on socializing DER connection costs, or a decision in Germany on rate basing conservation investments by a utility. It should also include expert evidence filed in those proceedings, and academic work published in journals, etc. The goal would be to have available for the Ontario industry in real time a comprehensive compilation of work being done, and decisions being made, with respect to the transition from traditional energy infrastructure to a more distributed energy services system driven by new technologies.

Information is of limited use if it just lies there, un-analyzed. In this potential scenario, the Board would establish today an ongoing stakeholder working group, charged to work with OEB Staff to keep up to date on the information available, and identify DER issues that are ripe to be considered in Ontario. That identification would be based in part on the status of the particular problem in Ontario (areas not available for DERs due to system constraints, for example), and in part on the maturity of the information from other jurisdictions or academia. It would also be conscious that “ripeness” might be different when considering whether to have a full-blown policy review or generic hearing on an issue, vs. designing a pilot to test aspects of the issue in the real world.

SEC understands, of course, that OEB Staff engages in this sort of analysis and review already, for all issues related to regulatory policy. That is not new, and it should certainly continue. What is different in this potential approach is the addition of a stakeholder working group to provide a more multi-dimensional perspective to enhance OEB Staff’s analysis. This is suggested in part because this set of issues is likely part of a fundamental transformation of the sector. Whether it takes two years or ten years, it will certainly happen, and in our view a more robust approach to keeping ahead of the curve is justified.

Whether it is this curatorial approach, or any other approach, in our view “keeping up” requires the Board to formalize a structure for considering the issues, both as they arise in Ontario and as potential solutions are considered or implemented in other jurisdictions or forums.

In summary, therefore, SEC submits that the Board should first determine what stance it wants to adopt relative to this transitioning of the industry. If, as we recommend, it adopts a “keeping up” stance, aiming to be relatively near the front of the pack, the

Board should also set in place a mechanism to implement that, such as the example we have outlined above.

### **Fundamental Regulatory Principles**

During the stakeholder session, when SEC suggested that concepts such as the Fair Return Standard and utility ownership of ratepayer-funded assets and postage stamp rates be re-examined, there were (almost inaudible) intakes of breath from some of the stakeholders in the room. The written submissions will certainly express resistance to changing those and other fundamental principles. None of this is surprising.

SEC believes that taking consideration of any of the fundamental principles off the table should only be done by a carefully analyzed decision of the Board, and with acceptance of the natural consequences that flow from setting that principle in stone.

Three examples of key principles can make this clearer.

***Fair Return/Cost Recovery.*** The tried and true principle that utilities are entitled to a fair return on their investment, and the related principle that they are entitled to recover their prudently incurred costs to provide the regulated service, are sacrosanct to many in the industry.

There are two problems with these principles in the current context.

First, utilities and others are already talking about adding new sources of utility remuneration, over and above the fair return standard, for additional activities by utilities. This menu-driven approach to utility remuneration is asymmetrical, and unfair to customers. This is further exacerbated by the fact that some utilities want to be able to enter competitive businesses, but put the assets of those competitive businesses in rate base and reap the benefits of the fair return standard.

Underlying this is the idea that the Fair Return Standard does not work properly or completely in an environment where there are an increasing number of non-wires alternatives. However, the proposals being suggested look at fixing this problem only by adding more methods of remuneration (i.e. additional costs to be borne by customers), with resistance to the idea that the problem can be fixed by changing the paradigm (potentially lowering costs to customers).

Second, the notions of fair return and cost recovery are at their root inimical to the “outcomes” driven goals of the regulator. Outcomes implies that utilities should recover costs, and make a profit, based on producing outcomes that customers want, and are willing to buy. The price should, in theory, be the value of the outcomes, which is not necessarily tied to cost or ROI.

In the traditional regulated energy sector, it is difficult to value outcomes independently, because there is no empirical reference point except for cost (including cost of capital). Cost of service regulation and the fair return standard didn't arise out of intellectual laziness. They arose because the nature of the services being provided were almost impossible to value any other way.

That is no longer true in a world of increasingly prevalent DERs. Customers, and particularly larger customers, have other choices to produce the same energy results as provided by monopoly utilities in the past. Those choices provide a reference price that effectively "judges" the utility service as competitive, or as too expensive. Grid defection rarely happens today, but it is inevitable in a world in which utility costs and prices are increasing, while the alternatives are experiencing declining prices and improving availability.

Thus, the market conditions may be right for the Board to explore different versions of utility remuneration that are more outcomes-driven. It may be that it is still premature, or it may be that new approaches can only be applied to some aspects of utility businesses. We can't know those things until we review the options in a disciplined manner.

The alternative is to retain cost of service and the fair return standard. However, in that future three things are also true:

- **No Add-ons.** Add-ons to existing remuneration should also not be considered. An asymmetrical review of utility remuneration is unfair to the customers.
- **Mandating Non-Wires Alternatives.** Utilities will still have to be motivated to consider solutions that are not capital intensive, but without a remuneration system that does this, the motivation must come from regulatory rules and requirements. Instead of incenting utilities to consider non-wires alternatives, the Board would have to simply require it.
- **Grid Defection, or, DER Resistance.** Since DERs and other competitive methods of providing energy services will likely continue to decline in cost and price, one of two results will ensue. Either utilities will be unable to compete because of their locked-in price structure (thus accelerating grid defection), or the Board or government will have to stifle DER expansion, protecting the utilities but in the process denying the customers better and cheaper energy options.

SEC therefore believes that reconsidering these principles is essential to having a robust transformation of the energy sector.



**Ownership of Utility Assets.** A recurring theme in discussion of DERs is stranded assets. This is because of another asymmetry at work, asset ownership.

In the current rate system, customers pay all of the costs associated with assets used to provide regulated services. The assets are owned by the utility, which keeps any profit associated with the sale of the asset. This is most commonly seen in MAADs transactions, where the shareholders keep the premium over the book value of the assets. The customers get none of that.

On the other side, however, if assets are stranded the utilities expect the customers to pick up the tab. The theory is that, since the sole purpose of the assets is to serve the customers, their stranding is simply another cost that should be borne by those customers.

This is inconsistent with the competitive sector, where stranded (“redundant”) assets are virtually always for account of the shareholders, and management is expected to manage risk to protect the shareholders from this cost. Customers never eat the cost of stranded assets, because asset stranding is the result of either a management mistake (shareholder risk), or a change in the market (shareholder risk).

The increases in DERs could eventually amount to a substantial change in the market, leading to billions of dollars of assets that are no longer useful. SEC believes that there are only two fair choices:

- Assets are held by the utility for the benefit of the customers. In that case, customers would be on the hook for stranded assets (subject to prudence), but on the other side any premium value for the assets, including a complete distribution system, should belong to the customers. Further, it should be possible for the regulator, on behalf of the customers, to change which utility is entitled to serve any area, and the assets should transfer at book value to the new utility.
- Assets are held by the utility for the benefit of the shareholders. In that case, the shareholders get the premium on the sale of assets, but the shareholders are also responsible for all remaining costs of assets no longer useful in supplying energy services to customers. Stranded assets would be specifically for account of the shareholders.

Currently, Ontario has neither of those paradigms, but until recently (and with the advent of IFRS), that has not been a significant problem (or, if it was, it was not visible). DERs could make it a significant problem, and a symmetrical, fair ownership approach should be selected.

SEC therefore submits that the principle that the utility owns ratepayer funded assets should be reconsidered as part of the Board's response to DERs.

**Postage Stamp Rates.** Currently Ontario has postage stamp rates for the commodity and transmission across the province, and postage stamp rates for distribution in anomalous, historical areas of the province. For example, Smith's Falls, Brockville and Ancaster have the same rates, because they are all served by Hydro One.

The unfortunate result is that DERs that reduce wires costs for customers will be more cost-effective in Ancaster than a few hundred meters away, in Hamilton. If one goal is to enable cost-effective DERs, this kind of anomaly is not efficient. On the other side, if a DER solution is more technically effective in Niagara than Toronto (due to weather, system configuration, or other factors), the higher wires costs in Toronto will incent the market to deliver the solution there rather than Niagara. Again, not efficient.

If the reason for postage stamp rates is social policy (the same electricity costs for everyone), then distribution rates could be normalized around the province, either by rebates or by socializing some aspects of costs. This would then level the playing field for DERs, and motivate DER providers to offer and promote their solutions first where the technical benefit is the highest.

There may be other reasons why customers should pay different distribution rates in different parts of the province. However, if that is the case, the Board should address that directly, and should then consider what other means are available to ensure that DER providers go where the benefit is the highest, not where the rates are the highest.

**Principles.** Most regulatory principles are there for good reason, and SEC would be the last to suggest that they just be thrown aside without fanfare. What we are suggesting is not that they are wrong, but that as the regulated energy sector transforms, the fundamental principles should adapt to keep pace.

And, most important, SEC is proposing that the Board consider the various principles consciously and formally, to ensure that there are no unintended consequences because we stick to a principle that, in its current form, is past its best before date.

### **Regulatory Tools and Approaches**

There are a long list of other, high level decisions that the Board has to make, either at the outset of this transformation process, or along the way. They include things like:

- **Price Signals.** To what extent, if any, should the Board mandate or allow the use of price signals, either to enable or limit DERs? The Board has in the past generally avoided the use of price signals (except TOU rates, which are mandated by the government), preferring to interpret just and reasonable in the

traditional way to mean cost-based. However, it is not unreasonable to think that, in some cases, rates could be set to achieve a given result (disincenting grid defection, promoting behind the meter storage systems, etc.).

- **Limits of the Monopoly.** Utilities will, in this period of time, suggest that some activities that are thought of as competitive should be included in their monopoly business. This has already happened in a few cases, and will continue. On the other side, competitive businesses have already proposed to compete with utilities in areas that might be thought of as natural monopolies (e.g. suite metering). In other sectors that underwent major changes, one of the things that happened is that the monopoly was redefined, partly by changes in technology, and partly by regulatory decisions. The Board may want to consider whether the boundaries of the utility monopoly should be allowed to change, and if so in what ways.
- **Utility as Gatekeeper and Player.** There was much talk in the stakeholder sessions of whether utilities with some form of system operator (i.e. gatekeeper) role, should also be allowed as players on the playing field they referee. The Board will have to grapple with either cutting back the gatekeeper role, or limiting utilities' participation in the market, or some other method of separating the two roles.
- **Utility Innovation.** Utilities want the Board to make it easier for them to innovate, but some customers believe that utilities are not naturally suited to the task of innovation. The Board may need to assess whether innovation should be left to the private sector (including utility affiliates), with the normal market incentives that drive competitive companies, rather than allowing risk-averse utilities into areas that are almost entirely about taking risks.

There are many other examples. This is just the tip of the iceberg. The point is that, the earlier the Board can identify and scope these higher level questions, the sooner stakeholders will understand the parameters within which specific policies and solutions should be addressed.

### **Energy Policy vs. Regulatory Policy**

For each of the higher level issues raised above, it is important for the Board to make a clear determination on whether the issue engages energy policy (the purview of the government, unless delegated to an agency) or regulatory policy (the purview of the OEB, or in some cases other agencies such as IESO). Some will be obvious, but many will be less so.

Is changing the Fair Return Standard within the Board's mandate? In theory it should be, but it may be practical to engage the government to make any change, rather than

make the change as a matter of regulatory policy, and then spend years in the courts fighting challenges.

A different issue is raised by, for example, postage stamp rates. Some solutions to that issue involve legislation, while others do not. The same conclusion could be reached for the use of price signals.

Even if the Board is overseeing a significant change in the energy sector, the industry will still look to the regulator to be a steady hand, making measured changes while considering all aspects of the issues. Ensuring that any role of the government or other agencies is taken into account early in the process, including co-ordination with the government or other agency, is part of that requirement to be a “steady hand” at the tiller.

SEC notes that the issues of co-ordination and jurisdiction were raised again and again in the stakeholder sessions. We believe that, each time the Board considers one of the higher level issues, it should state expressly how it is dealing with those jurisdiction and co-ordination aspects. None of it should be assumed. It should all be expressed clearly.

### **Process**

This consultation, or series of related consultations, can quickly get unwieldy and scattered. SEC suggests that, at least for the higher level questions addressed in these submissions, the following process may be appropriate:

1. OEB Staff prepares a green paper setting out all of the important higher level issues, and providing commentary from OEB Staff’s point of view on the options available.
2. Stakeholders provide submissions on the OEB Staff green paper. This might also include stakeholder sessions to promote dialogue, and/or a second round to allow replies to the submissions of others.
3. If sought by some stakeholders, the opportunity to file expert evidence on one or more of the higher level issues, and the opportunity for other parties to ask questions of those experts.
4. This process should give new OEB senior management (Chair, CEO, Chief Adjudicator) time to get in place. Once OEB Staff has stakeholder input, it should go to OEB senior management with that information, and seek guidance from the Board on directions, priorities, and even issues that the Board wants to make immediately.

5. Out of that Board guidance should be an OEB staff white paper, and probably a roadmap for the Board to consider those higher level issues that the Board wants addressed.

### **Conclusion**

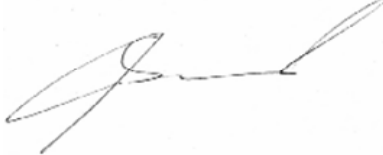
The transformation of the regulated energy sector will be a significant driver of the Board's work over the next few years, and could have profound impacts on customers and utilities alike.

Many issues were raised in the September stakeholder sessions. SEC has only touched on some of them, focussing on those higher level questions that are so often overlooked in the rush to get to the detailed policy and implementation debates.

Some of the commentary above will probably seem obvious. However, SEC believes that, by being tightly disciplined about the many conceptual issues, the Board can do a better (and likely faster) job attacking the technical, operational, competitive, rate, and reliability issues that need to be addressed as the industry transforms.

All of which is respectfully submitted.

Yours very truly,  
**SHEPHERD RUBENSTEIN  
PROFESSIONAL CORPORATION**



Jay Shepherd

cc: Wayne McNally, SEC (email)  
Interested Parties