

## ONTARIO ENERGY BOARD

### Stakeholder Forum

### Report of the Advisory Committee on Innovation

### Comments of Industrial Gas Users Association (IGUA)

#### IGUA's General Views on Utility Innovation

1. IGUA's members, Ontario's largest natural gas consumers, are well acquainted with the imperatives to innovate, including, as energy intensive industrials, in respect of energy services. Trade exposed industrials either innovate, or fail. They understand the risks and rewards associated with innovation, and with failing to innovate and adapt.
2. IGUA supports distribution utility innovation. Common wisdom is that the utility business is changing, and that these changes will continue and hasten. Utilities will need to develop new business models to retain their relevance and avoid risks of stranded costs, which risks concern large and dependent utility customers as much as they concern utilities.<sup>1</sup>
3. Pursuit of new sources of utility revenue through innovation in the delivery of regulated distribution services is an important initiative. In considering innovation by regulated utilities, IGUA has defined some basic principles:

(a) ***Utility innovation should be focused in areas of utility service.***

There is ample opportunity for regulated distribution utilities to advance "innovation" within the scope of their regulated operations, in order to both optimize those operations through investment in infrastructure and to facilitate, and respond to, customer innovation through development of new, intelligent and customer responsive utility services and rate structures.

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<sup>1</sup> Concerns regarding stranded costs also apply in particular to lower income gas and power consumers, whose alternative energy services choices are more limited than are those of higher income consumers.

It is in distribution system investment and operation that utilities are expert. Energy consumers, particularly large volume consumers, well understand their own operations and investment opportunities, and are best placed to evaluate the risks and rewards of innovation in their own approaches to energy procurement and consumption.

In respect of technologies and energy systems beyond the utility meter, the focus of regulated utilities should be on facilitating the innovation opportunities of customers, rather than pursuing those opportunities with ratepayer funding. IGUA appreciates that the boundary between energy distribution assets and consumer assets may be increasingly blurring, as smaller volume energy consumers become "prosumers" (as many energy intensive industrial energy consumers have been for some time). This blurring makes it particularly important that the Board and its staff be very careful to avoid giving regulated utilities an unfair advantage over competitive energy services innovators.

(b) ***Those who benefit from utility innovations should bear associated costs.***

The costs of utility innovation initiatives should not be allocated in such a manner as to subsidize certain classes of ratepayers or otherwise effect social objectives or wealth redistribution. Those are matters for government policy and funding, and should not be subsidized through energy regulation or allowed to distort energy prices. As in other areas of utility rate making, those who benefit from investments in utility innovation should bear the associated costs.

(c) ***Investments by utilities in innovation should be governed by the same basic principles of regulation that govern other utility investments.***

Utility innovation investments should be subject to:

- (i) The basic principles of economic regulation which govern the appropriate scope of regulated utility activities.
- (ii) Rigorous cost and benefit analysis.
- (iii) The risk/reward balance inherent in the "regulatory compact" under which utilities are protected from the risk of recovery of the costs of providing regulated utility services, providing that those costs were prudently incurred and reasonably necessary to the provision of such regulated services.
- (iv) Utility innovation initiatives should not allow utility shareholders or affiliates to reap rewards or gain undue competitive advantage while transferring risk to utility ratepayers.

4. It is in the context of these principles that the November 2018 *Advisory Committee on Innovation Report to the Chair of the Ontario Energy Board* (ACI Report) should be considered.

## General Comments on ACI Report and Next Steps

5. IGUA appreciates that the ACI Report is the product of a fair amount of work by a number of interested people. As a starting point, the ACI Report must be considered in the context of what it is, and what it is not.
6. The ACI Report is primarily about the future of distribution utilities as seen through the lense of the management of those utilities. It reflects what distribution utility management foresees as challenges facing their businesses, and what they want to see in response from their regulator.
7. The ACI Report also presents the views and “wants” of distributed energy resources (DERs) proponents (in particular in the “3” series of recommendations which are presented under the rubric; *Encourage Market-Based Solutions and Customer Choice*). These views are also coloured by the distribution utility lense in their emphasis on “[s]upportive regulatory guidance...to increase utilities’ confidence to propose these enabling investments”<sup>2</sup>.
8. What the ACI Report does not present, at all, is the view of customers. While the utilities and DERs advocates consistently frame their “wants” in reference to the “interests of consumers”, there is no direct consumer voice in the ACI Report. While IGUA appreciates that the utilities and DERs advocates are considering the interests of customers, they are doing so through their own lenses. Only customers themselves can properly represent and present customer’s interests.
9. School Energy Coalition (SEC) has concluded<sup>3</sup> that “*the input of the customers on these important issues will not be considered in formulating Board Policy. ...only the input of the utilities is thought by the Board to be of value*”. The Association of Major Power Producers of Ontario (AMPCO) has expressed similar concerns<sup>4</sup>, as did others at the January 16, 2019 Stakeholder Forum. IGUA shares these concerns.

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<sup>2</sup> ACI Report, page 17

<sup>3</sup> SEC Letter of January 24, 2019

<sup>4</sup> AMPCO Submission, January 24, 2019

10. ***IGUA suggests, with respect, that the Board should be very concerned that key customer interests so obviously feel disenfranchised with regard to the innovation initiative.***
11. At the same time, IGUA recognizes that work has gone into the ACI Report, and that it does offer considered observations, albeit limited to the perspectives from which it has been written. IGUA has approached the ACI Report as reflecting the “pulse” of the distribution utility sector, and to some extent the DERs promoter community, in respect of “innovation”. In this respect, IGUA believes that the ACI Report can be helpful to the Board and other stakeholders.
12. The issue now is what the Board does with the report. ***The Board must now consider and determine its own appropriate role in responding to the trends considered by, and associated concerns of, the utilities and the DERs proponents as reflected in the ACI Report. In doing so, the Board must add consideration of the interests, perspectives and concerns of, among others, customers.***
13. We understand that the next step in this process for the Board’s consideration of energy sector “innovation” is for Board Staff to author a “scoping paper”. That paper should critically consider the views and recommendations presented in the ACI Report from the perspective of the Board’s role as the province’s economic energy regulator. ***In the paper to be drafted OEB Staff should reiterate the appropriate scope and principles of economic regulation, and in particular provide Staff’s views on the appropriate role of the distribution utilities in energy services “innovation”.***
14. For example, OEB Staff should consider such regulatory principles as:
  - (a) The risk/reward balance appropriate in the regulated context in which regulated utilities assert entitlement to a reasonable opportunity to recover all of their prudently incurred costs and to earn a return of and on their prudently incurred investments, such recovery and earning determined not by the value placed on their services by customers, but rather by the quantum of their costs.
  - (b) The fundamental role of economic regulation in addressing “market failures”, by considering what “market failures” are apparent when considering energy sector innovation and how these “market failures” are best addressed and by whom.

15. None of these principles are identified in the ACI Report, yet they are critical in considering application of the observations in the report to the Board's role and, in turn, to potential "innovation" in how Ontario's energy distribution sector is to be regulated going forward.
16. In their upcoming paper, OEB Staff should expressly articulate what they consider to be the relevant principles of economic regulation to apply to consideration of where distribution utilities themselves should be innovators (in smart grid advancement, for example), and where they should be responding to innovation by others (through innovative service offerings or rate structures, for example). OEB Staff should also consider what areas of energy services innovation should be left to the market and the disciplines of competition and customer mobility (for example, development and deployment of behind-the-meter technology).
17. In properly considering how innovation will impact the future of regulation, the Board also needs to understand customer driven "innovation". It was observed at the January 16<sup>th</sup> Stakeholder Forum that the utilities are as much responding to innovators as innovating themselves. ***IGUA respectfully suggests that the Board, the utilities, and other stakeholders can learn something about energy innovation and the appropriate role for distribution utilities therein by listening to an important group of "innovators"; energy customers.***
18. To their credit, the ACI Report authors themselves recommend broader engagement of stakeholders in consideration of the recommendations offered.<sup>5</sup> The Board should heed this recommendation.
19. IGUA also shares the concerns expressed on behalf of SEC, AMPCO, the Vulnerable Energy Consumers Council (VECC) and others that the Board has adopted the "regulatory sandbox" concept seemingly abruptly, and with no input from customers.
20. IGUA does understand the plea for timely response to innovation, and the notion that perfection is the enemy of the good. At the same time, as IGUA has emphasized in previous processes, ***transparency, acceptability and ultimately quality of regulatory decision making is achieved only when the regulator brings its key stakeholders -***

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<sup>5</sup> ACI Report, page 3, column 2, paragraph 2

***customers undeniably being central among these - along with it up the relevant “learning curve”, and seeks their informed input.***

21. IGUA assumes that in the design and launch of its own version of this “sandbox” mechanism, the Board has considered in some detail the structures of the analogous mechanisms adopted in the U.K., Singapore, and any other relevant jurisdictions. ***Board Staff should take the opportunity in its upcoming scoping paper to share with other interested and affected stakeholders the basis upon which the Board adopted the “sandbox” design that it did, and what it learned from the successes and challenges faced by other regulators in implementing such mechanisms.***
22. One issue that has not been addressed, which should be, is the ownership, protection and management of intellectual property resulting from rate payer funded innovation. Staff should address this issue in their upcoming scoping paper.

#### **Comments on Particular ACI Report Recommendations**

23. There are several recommendations offered in the ACI Report which IGUA supports, or has no particular concerns about. These include recommendations for [recommendation numbers are in square parentheses]:
  - (a) Consideration of new forms of distribution utility services. [1D, in part]
  - (b) Removal of any rate making barriers to the most efficient energy services solutions (whether entailing capital investment, operating cost incurrence or contracting for services from third parties). [2A.]
  - (c) Standardization of processes for contracting for and connecting DERs resources. [1A., 1B., 1C., 2B., 2C.]
  - (d) Provision by the distribution utilities of information to the market regarding required resources. [3A.]
  - (e) Encouraging investment by utilities in monitoring and control capabilities for management of a more dynamic distribution system. [3B.]
24. There are other recommendations in the ACI Report, however, that IGUA has concerns about:



- (a) Recommendation 1D.: *Re-examine regulatory restrictions on utility business activities and review the separation of regulated and competitive services in light of new technologies and service expectations.*

This description is of concern to IGUA. It seems to belie the notion that distribution utilities should expand beyond the distribution business. (In the discussion of this recommendation, however, the authors discuss the notion of the development of different services for different customers, and this is an area that IGUA agrees merits further consideration, subject to the basic principle that the role of a regulated utility is to provide distribution services, not broader energy services.)

- (b) Recommendation 2D.: *Consider timely funding mechanisms to encourage utility innovation that provides near term customer benefits.*

While we find nothing objectionable about this recommendation, *per se*, IGUA has concerns related to the discussion of;

- (i) allowing utilities to act as “launch pads” for innovative products and agents of product commercialization; and
- (ii) existing rate setting processes being inimical to assumption of “*higher than normal risks*”.

The discussion of this recommendation suggests that “*allowing utilities a relatively small amount of funding, collected through rates but separate from normal business operation and deployed with an efficient level of oversight may be an effective means of encouraging breakthrough approaches*”, and goes on to assert that “[u]tilities often have the scale, reputation or markets to provide a launch pad for introducing innovative products”. This discussion sounds a lot like relaxing regulatory parameters for distribution operations and oversight on how ratepayer funds are deployed, and these notions are of concern to IGUA. Critical consideration of such proposals, and of appropriate spending parameters for distribution utilities in this respect, is warranted.

- (c) The “4 series” of recommendations are, as a group, presented under the rubric of “*Embrace Simplified Regulation*”. These series of recommendations, read together, could be taken to be advocating significant weakening (as distinct from appropriate streamlining) of regulatory oversight. There is a huge difference.

For example;

- (i) Recommendation 4B. suggests; “*Review the information the OEB collects to ensure it is used to evaluate performance in the sector – specifically whether utilities, other service providers and regulation itself are benefitting customers.*” While IGUA has no concerns with this formulation *per se*, there is discussion under this recommendation which asserts the need for “*a commitment by hearing panels to ensure that hearings do not simply replicate cost of service reviews and that decisions are focussed on the evaluation of performance against objective performance standards*”. IGUA appreciates the plea for expedition in regulatory adaptation to fast moving innovation. IGUA has supported, and continues to support, thoughtful

approaches to streamlined and “proportional” regulatory mechanisms. However, IGUA is concerned that “simplified regulation” not be interpreted to mean exclusionary regulation.

- (ii) Recommendation 4C. states: *Explore the use of self-executing processes that use transparent, pre-approved criteria to allow streamlined regulatory review.* The discussion under this recommendation suggests that “[u]sing this approach, proposals selected and planned in accordance with prescribed criteria would require no further regulatory approval to proceed. ...Any after-the-fact review of utility performance would focus on learning from experience in the interests of continuous improvement rather than hindsight critique of what a utility could have done differently”. It is important that standards of prudence and utility management responsibility for spending of ratepayer funds not be diminished in the quest for regulatory efficiency, and in particular that innovative approaches to regulation not exclude the very interests for whom regulation was created; customers. In fact, this is recognized in the very next recommendation; “Further examine OEB decision timelines to determine whether they can be shortened without compromising the effectiveness of stakeholder participation.”

- 25. Proper and lawful economic regulation requires meaningful engagement by those directly affected and retention of the independent discretion of hearing panels exercised in accord with the basic principles of economic regulation and guided by the particular circumstances of the application before it.


#### **Comments on the “OEB Innovation Sandbox”**

- 26. IGUA endorses the formalization by the Board of a process for access by interested parties to Board Staff and guidance from Staff on their informed views regarding regulatory implications for proposed initiatives. To the extent that the *OEB Innovation Sandbox* furthers such access, it is a positive initiative.
- 27. However, IGUA is concerned with the lack of clarity on the boundaries of Staff’s authority to make decisions exempting proponents from regulatory (including legislated) requirements.
- 28. IGUA is also concerned at the lack of transparency regarding utility activity that the adopted sandbox framework appears to foster. In particular if rate regulated innovation proponents have good ideas which they intend to pursue in the interests of, and funded by, utility customers, IGUA sees no reason why those ideas should not be made public.



29. As already noted, IGUA appreciates the plea for expedition in regulatory adaptation to fast moving innovation. IGUA has supported, and continues to support, thoughtful approaches to streamlined and “proportional” regulatory mechanisms. However, regulatory mechanisms premised on exclusion of the very stakeholders which regulated utilities are created to serve – customers – is not appropriate streamlining, it is inappropriate compromise of regulatory procedure.
30. ***IGUA urges the Board to immediately and publically confirm that:***
- (a) ***Board Staff does not have the authority through the OEB Innovation Sandbox to provide rate approvals. The cost consequences for ratepayers of innovation initiatives are only properly determined in open Board processes in which those paying the bills are able to fully and meaningfully engage.***
  - (b) ***Any innovation initiative which could have a material impact on utility costs or finances must be subject to an open hearing in which utility customers have a meaningful voice.***

ALL OF WHICH IS RESPECTFULLY SUBMITTED by:



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