

ONTARIO ENERGY BOARD

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# Filing Guidelines for Incentives for Electricity Distributors to Use Third-Party DERs as Non-Wires Alternatives

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Ontario  
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## 1. Background

On January 30, 2023, the Ontario Energy Board (OEB) released its Report *Framework for Energy Innovation: Setting a Path Forward for DER Integration* (the FEI Report) which, among other things, invited distributors to apply for an incentive mechanism to encourage the use of third-party DERs<sup>1</sup> as non-wires alternatives.

The OEB's goal in inviting distributors to propose and implement incentive mechanisms is to evolve the current rate-setting framework to facilitate near-term progress on the use of third-party owned DERs as non-wires alternatives, in a manner that can inform a broader reconsideration of utility remuneration and the development of an incentive policy applicable to all distributors.

This Filing Guidance identifies the information distributors should include in their applications for incentive mechanisms, to assist distributors in developing their incentive proposals and to facilitate effective and timely regulatory review.

As set out in the FEI Report, distributors may choose one of the following three incentive mechanisms and may file proposals as part of a rebasing application or as a stand-alone application:

Incentive Mechanism	Description
1. Shared Savings Mechanism	Calculates the savings for customers from DER solutions and allocates a formula-based portion of savings to the distributor's shareholders.
2. Performance Target or Scorecard-Based Incentive	Allows a distributor to earn a fixed incentive payment, based on its performance against an established target or scorecard metrics.
3. Margin on Payments	Allows a distributor to add a margin on payments to DER providers (customers or third parties) for providing services to the distribution system, such as capacity, reliability, etc.

<sup>1</sup> "Third-party DERs" refers to any non-distributor owned DERs. For further clarity, any distributor-owned DER solutions are not eligible for an incentive mechanism because the purpose of incentives is to drive better outcomes for customers by levelling the playing field for market-based non-wires alternatives solutions. In addition, where distributor-owned DER solutions involve rate-based DER assets, the distributor is already earning a rate of return on those solutions and earning an additional incentive would be inappropriate.

## 2. General Information for Incentive Applications

Any application for a DER incentive mechanism, regardless of which mechanism is proposed, should discuss the specific OEB approvals sought, the market-based DER solutions the applicant intends to deploy, and the details of the proposed incentive mechanism.

### 2.1 Approvals & Rate Funding Sought

The application should clearly state the approvals being sought.

Generally, incentive applications will describe the incentive mechanism and related DER activities the applicant is proposing and the anticipated benefits to customers. The OEB will determine whether an incentive will be implemented and the elements and parameters of any approved incentive mechanism.

Approved incentive mechanisms will usually require establishing a deferral account to record amounts to fund earned incentives. Separate OEB approval to award the incentive, and dispose the account balance would occur later, based on an assessment of factors applicable to the type of incentive implemented (e.g., in the case of a performance target-based incentive, OEB approval to allow recovery of the incentive would be contingent on an assessment of the distributor's actual performance against pre-established metrics or targets).

When an incentive proposal is included in a **rebasings application**, it is expected that rate funding for DER activities related to the incentive would be integrated with the applicant's overall spending proposals.

If an incentive proposal is filed as a **stand-alone application**, the applicant should discuss if rate funding for the planned non-wires alternatives has been obtained through another application or whether the non-wires alternatives are displacing previously planned capital projects (i.e., wires solutions) and will be funded through budget reallocations within the applicant's current rate envelope.

If incremental rate funding for market-based non-wires alternatives is being sought, along with the approval of the incentive mechanism, the application should follow the approach contemplated in the CDM Guidelines.<sup>2</sup> To support requests for rate funding,

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<sup>2</sup> [2021 Conservation and Demand Management Guidelines for Electricity Distributors](#), December 20, 2021:

"The option to file a request for funding for CDM activities outside of rebasing is available to distributors using any rate-setting methodology (Price Cap IR, Custom IR, Annual IR Index). Distributors using the Price Cap IR or Annual IR Index rate-setting methodologies may choose to file a request for funding for CDM activities outside of rebasing either as part of an incentive rate-setting mechanism (IRM) application, or as a stand-alone application, while distributors using the Custom IR rate-setting methodology may file a request for funding for CDM activities outside of rebasing either as part of a Custom IR update application, or as a stand-alone application." p 11

"The default treatment of costs and the approach to utility remuneration is the same for CDM activities as for other

the applicant should provide evidence of materiality, need, and prudence. Discussion of the need and options considered should be consistent with section 5.4.1.1 of the *Chapter 5 Filing Requirements for Electricity Distributor Rate Applications*.<sup>3</sup> Consistent with the CDM Guidelines, applications filed outside of rebasing should "propose an approach for cost recovery (including issues of cost allocation and rate design) and identify whether any funding to address the identified system need is already included in existing rates. This will assist the OEB in determining, on a case-by-case basis, whether the proposed spending is incremental and should be eligible for cost recovery."<sup>4</sup>

## 2.2 Description of Market-Based DER Activities (Non-Wires Alternatives)

To provide context for consideration and approval of an incentive mechanism, the application must describe the procurement programs or other means that the distributor intends to use to obtain services from third-party owned DERs. This must include information about:

- the system needs being addressed;
- the wires solutions being deferred or displaced; and
- the corresponding benefits to customers.

When an incentive proposal is filed as part of a **rebasing application**, this context may be provided by way of references to the parts of the application discussing the relevant DER activities.

## 2.3 Proposed Incentive Mechanism

The application must describe the proposed incentive mechanism in detail, as well as discuss why the approach was selected out of the three available incentive options. The description of the proposed incentive mechanism must include the elements discussed below, as well as information pertinent to the specific type of incentive selected, discussed in sections 3 to 5.

### 2.3.1 Incentive Amount

The application should forecast the total amount of the proposed incentive the distributor may earn. The amount should be presented as a total for the term of the incentive, as well as broken down on an annualized basis, where applicable.

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distribution system expenditures. Distributors should assign costs for CDM activities to capital expenditures or to operating expenses in accordance with their capitalization policy." p 13

<sup>3</sup> [Filing Requirements for Electricity Distribution Rate Applications - 2023 Edition for 2024 Rate Applications Chapter 5 Distribution System Plan](#), December 15, 2022

<sup>4</sup> [2021 Conservation and Demand Management Guidelines for Electricity Distributors](#), December 20, 2021, p 14

### 2.3.2 Methodologies

Applicants must provide the proposed methodology, including underlying inputs and assumptions, for calculating the incentive. The proposed methodology for measuring performance and the achievement of targets, as applicable, depending on the mechanism proposed, should also be provided.

### 2.3.3 Incentive Term

Applicants must propose an effective date and duration for the incentive mechanism.

When an incentive proposal is filed as part of a **rebasing application**, the term of the incentive is generally expected to be the length of the rate-term (5 years), unless a different term is specifically approved (e.g., an incentive term related to the life of the contract with third-party DER owners to provide services to the distribution system).

When an incentive proposal is filed as a **stand-alone application**, the term of the incentive is generally expected to be the remainder of the current rate term (from the effective date sought in the application), unless a different term is specifically approved.

## 2.4 Incentive Implementation

Applicants must discuss the proposed approach to implementing and awarding the incentive.

As discussed in section 1.1, this will usually involve establishing a deferral account to record incentive amounts that may be earned, and obtaining separate OEB approval to award the incentive and dispose of the amounts in the account, once the incentive term has ended.

- The applicant should file a draft accounting order along with a description of the proposed account.
- The application should also discuss the mechanics of the proposed account and the anticipated timing of the disposition request.
- When an incentive term ends at the same time as the rate-term, it is generally expected that an OEB decision on whether to award the incentive, and to dispose the deferral account balance would occur in the subsequent rebasing application.
- If a different incentive term is sought, the applicant should identify when and how it will seek OEB approval to award the incentive and dispose the deferral account balance.

As noted in section 1.1, the OEB's decision about whether to award an incentive will be based on an assessment of factors applicable to the type of incentive implemented. For example, in the case of a performance target-based incentive, OEB approval to award the incentive would be contingent on an assessment of the distributor's actual performance against pre-established metrics. In the context of a shared savings mechanism or margin on DER spending, if the approved incentive structure includes

bandwidths around the incentive that may be earned, the OEB may consider the forecast spending on market-based non-wires alternatives and the forecast incentive amount against actuals, to inform its decision on any incentive amount to be awarded. In all cases, distributors should plan to provide sufficiently granular information to facilitate the OEB's decision to award the incentive amount, as applicable given the elements and parameters of the approved incentive mechanism.

### 3. Information for Shared Saving Mechanisms

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Applicants may propose to retain, for their shareholders, a portion of the savings to customers associated with implementing third-party owned DER solution.

To fulfill the information requirements established in section 1.4 applicants must:

- Identify and provide a rationale for the portion of savings the applicant proposes to allocate to shareholders (i.e., the proposed dollar amount of the incentive). This should include the estimated savings to customers and the proposed share to be retained by shareholders over the life of the incentive term and on an annualized basis.
- Provide a detailed benefit-cost calculation for both the third-party owned DER solutions and the wires alternatives to reveal the net savings associated with the DER solutions.
  - Once the OEB's Benefit-Cost Analysis Framework for DERs is implemented, the OEB expects any subsequent proposals for a shared savings mechanism to rely on the OEB's methodology for calculating costs and benefits.
  - Until then, distributors may instead choose to use a conventional discounted cash flow analysis or another appropriate approach. Distributors should clarify whether net savings are based only on the costs and benefits associated with providing distribution service, or whether other costs and benefits are also included.



## 4. Information for Performance Target Shared Saving Mechanisms

Applicants may propose an incentive mechanism that provides the opportunity to earn a fixed incentive payment for achieving a single performance target or a set of targets, which may be underpinned by multiple metrics contained in a scorecard. A range of fixed payments tied to degrees of target achievement may also be proposed.

To fulfill the information requirements established in section 1.4 applicants must:

- Identify and provide a rationale for the fixed incentive payment (or range of possible payments) to be earned upon achievement of the proposed targets.
- Identify proposed performance targets and the method for measuring achievement.
- Provide, as applicable, scorecard metrics and the associated methodology for evaluating each item in the scorecard, to support the proposed performance targets.
- Propose a process for evaluating and verifying the achievement of targets.

The OEB does not wish to limit distributors' creativity in proposing targets or scorecard metrics that may best reflect how third-party owned DER solutions can provide value to customers (including giving due consideration to which targets and metrics can be measured with reasonable confidence). However, in the interest of assisting distributors in the development of their proposals, here are some examples of performance targets and/or scorecard metrics that could be included in an application:

- The dollar value of capital projects deferred or displaced by third-party owned DER solutions over the incentive term, including the anticipated length of time capital projects may be deferred by third-party owned DER solutions and the corresponding benefit to customers.
- The amount of system capacity provided by third-party owned DER solutions that would otherwise have to be provided by a wires solution.
- The reliability improvement experienced by distribution customers (or a subset of customers within a distributor's service area) as a result of a third-party owned DER solution.
- The number of customers or third-party DERs participating in a distributor program or procurement for non-wires alternatives.

Targets for which incentive payments are earned may be annual or for the duration of the incentive term. Progress against targets and scorecard metrics should be tracked on an annual basis for the duration of the incentive. This information should be included in an application to seek OEB approval to award the incentive at the end of the term and dispose the amounts in the deferral account (discussed in sections 1.1 and 1.4).

As noted above, the application should include a proposed approach for evaluating and verifying achievement of targets.

## 5. Information for Margin on Payments

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Applicants may propose to add a margin on payments to DERs owned by customers or third-parties for providing services (e.g., capacity, reliability, etc.) to the distribution system as part of a non-wires solution.

To fulfill the information requirements established in section 1.4 applicants must:

- Identify and provide a rationale for the margin on payments to DERs for services to the distribution system to be retained by the distributor. This should include an estimate of the total dollar value generated by that margin during the proposed incentive term and on an annualized basis.
- Provide a forecast of payments for DER services to the distribution system for the proposed incentive term, including details about underlying assumptions and inputs to allow assessment of the reasonableness of the forecast.

## 6. Assessing Implications and Outcomes of Incentives

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The FEI Report stated:

*Once some incentives have been in place for sufficient time to assess implications and outcomes, the OEB will use that information, as well as lessons learned from adjudicating the proposals, to inform its broader review of utility remuneration and determine if any future incentives policy applicable to all electricity distributors is warranted. To facilitate this, the OEB may seek to undertake interim assessments of incentive impacts within the first 24-36 months of their implementation, in addition to considering the outcomes of incentives during review of the implementing distributors' next rebasing application.*

Distributors who receive approval to implement an incentive mechanism should be prepared to provide information to the OEB, both during the term of the incentive and at its conclusion, to help the OEB assess the outcomes and implications of the incentive.

This may include, but is not limited to:

- completing a survey;
- providing data and information related to activities to obtain services from third-party owned DERs; and
- responding to questions from OEB staff.

Distributors should also plan to provide evidence in their next rebasing applications about the progress or results of implemented incentive mechanisms. For further clarity, the OEB does not generally expect information or updates about incentive mechanisms to be filed with IRM applications or Custom IR annual updates, unless such a requirement is established in the OEB's approval of the incentive mechanism.



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