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Ms. Nancy Marconi
Registrar
Ontario Energy Board
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2300 Yonge Street
Toronto, ON M4P 1E4

January 7, 2025

EB-2024-0129 – Consultation on Advancing Performance-based Regulation
Pollution Probe Comments

Dear Ms. Marconi:

The Ontario Energy Board (OEB) initiated a consultation to advance its performance-based approach to rate regulation. The stated objective of this initiative is to strengthen the link between what electricity distributors earn and the achievement of outcomes consumers value, such as cost-effectiveness, reliability and customer service. The OEB held a virtual stakeholder meeting on November 19, 2024 and published related materials for review and comment including the jurisdictional scan completed by Christensen Associates. In accordance with the OEB request, please find Pollution Probe's comments below.

There are a lot of ways for the OEB to strengthen the link between what electricity distributors earn and the achievement of outcomes consumers value, such as cost-effectiveness, reliability and customer service. The more targeted the approach, the more likely it will achieve the intended outcomes. Utilities are driven by certain incentives that include carrots, sticks and specific regulatory requirements (with consequences if they are not followed). These kinds of approaches are highlighted in the report by Christensen Associates.

There have been many successful OEB initiatives(e.g. outcomes from the DER Connections work, just to name one), but there are also clear examples of where the OEB put in place requirements that have not achieved the intended outcome and lessons can be learned from those examples. It is also important to understand why one utility delivers desired outcomes under a framework while another does not. Learning from what has not worked is as valuable (or perhaps even more valuable) than using the learnings from the successful initiatives. One example from the parallel natural gas side is the Integrated Resource Planning (IRP) requirements under the EB-2020-0091 IRP Decision and related IRP Framework. This was intended to ensure a thorough analysis of non-pipeline alternatives and result in more cost-effective alternatives to optimize the energy system, reduce long-term costs, provide ratepayer

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benefits and mitigate Capital projects that have a high potential of become stranded assets. Although the requirements have been in place since 2021, there has been no tangible results (i.e. IRP projects implemented) and no specific projects added to the utility asset management plan. On the electricity side, a similar risk could occur with the OEB's BCA Framework. Phase 1 was implemented in Spring 2024 and Phase 2 development is expected to be launched in 2025 by the OEB. It has been a relatively short period of time (i.e. less than a year), but no projects using the BCA Framework have been identified to-date. Pollution Probe flagged several of these risks in its previous submissions and there are opportunities to mitigate the residual risks in Phase 2. Overall, an initiative can be 95% right, but the last 5% can mean the difference between success and failure. In other words, a chain is only as strong as its weakest link. Using the two examples noted above, if a framework does not produce the expected outcomes, swift analysis action must be taken by the OEB to fix it in a timely manner. Active, transparent monitoring and remedial action should be done on an annual basis, since these are not a 'one and done' checkbox exercises. Talk and activity around initiatives that are not performing as hoped should not be mistaken for tangible outcomes that can be measured (perhaps via scorecard). Without tangible outcomes, success will be illusive.

In the OEB's letter dated October 29, 2024, the OEB referenced the November 29, 2023 Letter of Direction from the the Minister of Energy (now Minister of Energy and Electrification) which asked the OEB to consider whether utilities' remuneration based on traditional capital infrastructure deployment remains the most cost-effective model. A focus of potential changes is to ensure "timely investment is made to support the right outcome" and that a report back on this work incorporate a review of models deployed in other jurisdictions. This is a more narrow focus than the OEB stated objective to "strengthen the link between what electricity distributors earn and the achievement of outcomes consumers value, such as cost-effectiveness, reliability and customer service". Pollution Probe has attempted to provide a balance of comments that the OEB can consider in relation to achieving both these goals. More detailed discussion could be of value once the OEB has digested feedback from this round of stakeholder input.

There is a large number of OEB initiatives/proceedings currently underway and several of these have the potential to impact (directly or indirectly) this PBR initiative. Lack of clarity or overlap between initiatives has the potential to create confusion between initiatives and it is recommended that the OEB create a table that identifies which initiatives link to "strengthening the link between what electricity distributors earn and the achievement of outcomes consumers value, such as cost-effectiveness, reliability and customer service", indicate the distinct purpose of each and how they fit together as a whole. This would help avoid

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unintended consequences between initiatives. One example is the interaction of this initiative with the OEB's Cost of Capital review currently underway[1]. Putting in place the wrong set of incentives and requirements can have unintended consequences. This can occur by fixing a problem in one OEB initiative and then causing an unintended problem (directly or indirectly) through another initiative. Short-term isolated thinking can have significant negative consequences. For example, research shows that where there is excess returns for utility Capital expenditures, it promotes excess Capital spending in an inefficient manner which actually creates barriers to achieving the intended system outcomes (e.g. enabling system development in alignment with the Energy Transition)[2]. Some of these issues are being considered by the OEB in the current Cost of Capital proceeding, but like all desired outcomes they must be considered in each relevant OEB initiative since a single initiative is unlikely to drive results on its own.

Incentives already exist for Ontario utilities to spend Capital, but ensuring that the investments are the more efficient to support Ontario's growth are not guaranteed by providing a return on Capital invested. Setting returns and incentives too high for utility Capital expenditures is a direct barrier to more cost-effective alternatives including DERs. It is also interesting to see how some utilities chase excess returns while others take a more balanced approach. Some of this is due to utility ownership and management incentive structure.

It is unclear whether the OEB's Cost of Capital review is considering the kinds of issues and options identified in the Christensen Associates' report. Pollution Probe assumes that the OEB review of Cost of Capital parameters is being done under a 'status quo' assumption. For example, it would be counterproductive and higher cost to ratepayers if the Return on Capital was set high and then adders were included under this initiative. Monopoly utilities are expected to provide certain outcomes and paying more than needed for those (i.e. excess returns) is not fair or required. If the model were to change (e.g. to a TOTEX approach), the Cost of Capital may need to be reviewed in relation to any model changes. Under a generic TOTEX approach the bias toward overspending Capital and underspending O&M would change to underspending both Capital and O&M, compared to approved budgets.

More is certainly required, including detailed reviews during utility rate cases which consider the specific local environment and demands. A recent snapshot of when this has worked well is the Toronto Hydro 2025-2029 rate case which has enabled system development (including DERs) in one of the heavily growing municipalities and in alignment with the most demanding

[1] EB-2024-0063
[2] EB-2024-0063 K5.5 - PollutionProbe_HearingCompendium2_20241001, Page 37.

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goals in Ontario, Net Zero by 2040[3]. There are other utilities at the back of the pack who despite having the same access to similar resources, have fallen behind on keeping their system current and able to meet future needs including DERs. Why is this, particularly if the regulatory framework is the same for these utilities? By doing a pair-wise comparison of utilities, it is easy to see who is leading and who is lagging. There are a lot of factors at play such as the focus and interests of their shareholder, but the variety of factors are likely too large to align through a generic approach. This is where the value of benchmarking and holding utilities accountable through their rate cases hold strong value. The rate case is the single most important regulatory event for each utility and leveraging that process to reward leaders and mitigate laggards aligns existing processes with expected outcomes.

As noted by the OEB, the Christensen Associates' report found that regulators in the jurisdictions reviewed are each considering how evolving approaches to rate regulation can help utilities meet the demands of the energy transition and facilitate new investments and innovative solutions, while maintaining a clean, reliable and affordable energy system. There is consensus that the Energy Transition is underway not just in Ontario, but across broader jurisdictions globally. Some jurisdictions are further along and have structured regulatory strictures and requirements that are more aligned with enabling innovation and modern approaches. A strong, transparent and integrated policy framework is supportive of these desired regulatory outcomes.

It should be no surprise that the report findings recognize that traditional rate base rate-of-return remuneration will not incent utilities to leverage non-wires solutions, and may in fact reduce, returns to utility shareholders. The corollary of this is also true, that excess Capital bias creates a barrier to an efficient and cost-effective Energy Transition. To offset this misalignment of incentives, each of the jurisdictions in the report has, after considering their own unique circumstances, undertaken some mix of performance incentives, mandated activities or mechanisms to reward shareholders for non-capital related expenditures. Considering what works elsewhere while focusing on modernizing Ontario's specific regulatory/policy framework makes logical sense and has been successful in other OEB initiatives. A symmetrical approach is important and represents best practice. In order to do this strong (results based, not activity based) performance management need to added to utility scorecards. Development of those outcomes could be strengthened over time on a continuous improvement basis with a strong feedback loop based on real annual results. The approach equally applies to electricity and natural gas.

[3] Summary of the details is available in EB-2023-0195 dec_order_Partial_THESL_20241112

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It should be noted that broad brush approaches seldom lead to the specific outcomes intended. Differentiating Capital or decoupling revenue by category is another consideration the OEB could consider to increase focus in specific areas and decrease excess incentives in other areas. If this tool is considered, it would be important to include the right safeguards that Capital is not deployed in areas that maximize utility revenue, but leave other areas underinvested and efficient. This has occurred in the Ontario gas sector where Growth Capital attracts excess returns above other Capital and is therefore prioritized over other Capital classes.

The Christensen Associates' report identifies a broad range of Utility Remuneration approaches and elements could be considered or piloted by the OEB. There is a challenge with a blanket remuneration that favours excess Capital spending and underspending O&M to maximize utility returns. In some cases this had led to some perverse results. Pollution Probe also previously highlighted some of the undesirable utility behaviours this model promotes[4]. Pollution Probe encourages the OEB to review which utilities are demonstrating the desired behaviours and outcomes now and which utilities are not. If there is significant variation in outcomes under a Utility Remuneration model, then it would suggest that more targeted tactical approaches are required. If the regulatory structure is correct, the OEB will be able to manage performance thought existing mechanisms such as the rate case and compliance toolset. However, if there are structural biases for certain utilities that are not delivering the outcomes expected, changing the broad regulatory structure may not fix those specific issues. Rate cases are an easier focus to target those mitigation efforts since the process already aligns with including specific issues as part of the issues list. Compliance is another tool that should be used, but this will be more challenging since it has been more of a special case use by the OEB rather than a tool to fix poor (and in some cases non-conforming) utility performance.

Finally, the Energy Transition has brought forward technology advancements that can reduce costs and emissions in alignment with the OEB intended outcomes. Some of these need to occur at the customer site rather the utility side of the meter. Continuing to incent old school pipes and wires solutions is a challenge when more cost-effective solutions exist. Distributed Energy Resources is one example which includes a large range of tools including energy efficiency. Pollution Probe has recommended that the OEB adopt the National Standard Practice Manual for DERs (NSPM)[5] which has been widely recognized as the best practice approach, common definitions and available toolset. Going it alone outside of best practice jurisdictions in North America will create unnecessary work and be inefficient. This is an

[4] See EB-2024-0063 PollutionProbe_ReplySUB_20241128 and PollutionProbe_SUB_20241107
[5] National Standard Practice Manual - NESP (nationalenergyscreeningproject.org)

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example of where a more unified and coherent approach could drive better outcomes over time.

Respectfully submitted on behalf of Pollution Probe.

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