ONTARIO ENERGY ASSOCIATION

# Coalition of Large Distributors Submission regarding Ontario Energy Board Advancing Performance Based Regulation Consultation

**EB-2024-0129**

January 8, 2025

To shape our energy future for a stronger Ontario.

Ontario Energy Association

# ABOUT

The Ontario Energy Association (OEA) is the credible and trusted voice of the energy sector. We earn our reputation by being an integral and influential part of energy policy development and decision making in Ontario. We represent Ontario's energy leaders that span the full diversity of the energy industry.

OEA takes a grassroots approach to policy development by combining thorough evidence based research with executive interviews and member polling. This unique approach ensures our policies are not only grounded in rigorous research, but represent the views of the majority of our members. This sound policy foundation allows us to advocate directly with government decision makers to tackle issues of strategic importance to our members.

## Together, we are working to build a stronger energy future for Ontario.

# Contents

# 1. Introduction

**Background**

On October 9, 2024 the Ontario Energy Board (OEB) initiated the Advancing Performance Based Regulation (PBR) consultation (EB-2024-0129) to advance its performance-based approach to rate regulation. The stated objective of this initiative is to more closely link electricity distributor earnings with the achievement of outcomes that customers value, such as cost-effectiveness, reliability, and customer service. While the OEB's initial focus will be on electricity distributors in Ontario, it intends to consider the inclusion of all rate-regulated utilities at a later stage.

The OEB has articulated that this initiative stems from the Minister of Energy's (now the Minister of Energy and Electrification) November 29, 2023, Letter of Direction to the OEB (LINK). In that letter, the Minister asked the OEB to consider whether traditional capital-based utility remuneration remains the most cost-effective model, and to assess what changes may be needed to ensure timely investments that support the "right" outcomes for customers and the province. The Minister also requested that the OEB's work include a review of remuneration models deployed in other jurisdictions.

To inform this work, the OEB retained Christensen Associates, whose jurisdictional scan report examines both Ontario's current utility remuneration model and various international approaches to performance-based regulation— including the use of Performance Incentive Mechanisms (PIMs). This report was provided to the Minister and was shared with stakeholders as part of this consultation process.

On November 19, 2024, the OEB hosted a virtual stakeholder meeting to discuss the Christensen Associates jurisdictional scan, the approach the OEB will take in evolving performance-based rate regulation, and the potential for a more fundamental, long-term review of the existing regulatory framework. Stakeholders were invited to provide written comments by January 8, 2025, and were provided a list of questions to answer within their submissions. Per the materials shared November 19, 2024, it is understood that the OEB's intention is to issue a Discussion Paper in the Spring of 2025, followed by additional consultation informing a final PIMs framework in the Fall of 2025.

**Public Interest Guiding PBR Policy**

These submissions are made by the Coalition of Large Distributors (CLD),[1] represented by the Ontario Energy Association (OEA), which appreciates the opportunity to comment on this important initiative.

The CLD recognizes that Ontario's energy landscape is rapidly changing. Distributors are under growing pressure to facilitate economic growth, integrate new technologies, and enhance system reliability and resilience, while maintaining energy affordability. The current regulatory framework, anchored in the Renewed Regulatory Framework (RRF), has historically emphasized cost control and has successfully guided core utility operations and outcomes. As external factors and stakeholder expectations of regulated utilities evolve, the CLD recognizes the potential value of targeted enhancements—such as PIMs, as further discussed below—to address specific policy objectives beyond business-as-usual.

The Minister's more recent Letter of Direction, issued December 19, 2024 (LINK), underscores the Government's priority for the OEB, "to ensure planning and approvals can best serve high-growth areas and to support Ontario's journey to a clean energy economy and its ability to attract future investment", including by giving "regulated entities and other stakeholders greater certainty and predictability." PBR plays a critical role in ensuring that those approvals are timely, that the approval processes provides the funding and flexibility for utilities to meet the supply, transmission, and distribution needs of the energy sector.

In that same letter, the Minister emphasized that "Ontario's economy and the day-to-day lives of its 15 million residents depend on a reliable energy system that delivers power on demand. As a result of the government's work over the past six years, demand on that system is growing quickly." While the Government and Independent Electricity System Operator (IESO) have been hard at work addressing competitively sourced supply procured in amounts and at a pace that prudently grows just ahead of customer demand, the OEB is doing its part by steadily scrutinizing and approving electricity generation, transmission, and distribution rate applications, as well as natural gas applications. The regulatory framework must continue to be oriented in accordance with the "North Star" of the public interest: an electricity grid and natural gas system that is sufficiently and predictably funded, such that customers have confidence in their energy supplies now and looking to the future.

[1] Alectra Utilities Corporation, Elexicon Energy Inc., Hydro One Networks Inc., Hydro Ottawa Limited, and Toronto Hydro-Electric System Limited

**Submission Outline**

The following sections set out the CLD perspective on how Advanced PBR and PIMs can be introduced effectively and fairly:

- **Principles of Advanced PBR** – Key principles that should guide the development and implementation of PIMs, ensuring they address clearly defined regulatory and implementation challenges and support government policy objectives.
- **PBR & PIMs for Government Priorities and Policies** – A proposed approach to PIM implementation which ensures performance incentives address discrete areas, and facilitate appropriate cost recovery of the investments required to achieve targeted outcomes.
- **Responses to OEB Questions** – Direct responses to OEB staff questions, reflecting the CLD's views on the near-term introduction of PIMs and considerations of any longer-term, fundamental changes to the regulatory model in Ontario.

# 2. Principles of Advanced PBR

The CLD submits Advanced PBR should be grounded in a clear set of principles that guide when and how PIMs are introduced and administered. By applying these principles, the OEB, utilities, and stakeholders can ensure that any regulatory changes are purposeful, transparent, and responsive to well-defined policy or performance gaps—avoiding the potential for ineffective or unnecessary complexity. Adhering to these core principles fosters a stable environment which builds upon regulatory successes to date, supports innovation, aligns with government priorities, and continuously improves outcomes for consumers.

### 2.1. PIMs Should be Responsive to Clearly Established Regulatory Problems

The CLD submits that PIMs should only be introduced in circumstances where the OEB has identified a specific, evidence-based regulatory gap or inefficiency that cannot be effectively addressed through existing regulatory mechanisms, such as Cost of Service, Incentive Rate-setting frameworks, or deferral and variance accounts. Before proposing or approving any new PIM, the CLD expects a clearly defined problem statement must articulate the nature of the shortcoming, explain why current regulatory tools are insufficient, and demonstrate the manner in which the proposed PIM effectively rectifies the shortcoming, and does so more effectively or efficiently than existing mechanisms. By ensuring PIMs are anchored to well-documented customer or system needs which are not adequately addressed within the current regulatory construct, the OEB and stakeholders can avoid unnecessary complexity, regulatory burden, and unintended consequences—ultimately delivering effective regulatory outcomes.

### 2.2. Targeted PIMs Addressing Ontario Government Policy Objectives

In advancing PBR, it is important to differentiate between the core business operations already governed by the Renewed Regulatory Framework (RRF) and new, policy-driven initiatives that require utilities to go beyond the status quo. In the CLD's view, PIMs should not intrude upon or replicate the objectives already encapsulated within the RRF. The RRF, through Cost of Service applications and related mechanisms, effectively governs the utility's core business activities—ensuring efficiency, reliability, and prudent cost control.

Introducing PIMs into areas already well-covered by the RRF could lead to regulatory overlap, cause confusion, and potentially dilute the RRF's effectiveness. Instead, PIMs should be deployed as a supplemental tool that incentivizes utilities to undertake activities that extend beyond conventional utility mandates and respond directly to government-led initiatives.

The Government of Ontario is directing the energy sector to achieve ambitious new objectives that transcend standard expectations and capabilities of utilities. These evolving priorities include:

- **Facilitating accelerated growth:** Connecting 1.5 million new homes, supporting new commercial developments, and enabling emerging sectors such as electric vehicle manufacturing.
- **Expanding system capacity:** Responding to forecasts that project a two- to three-fold increase in overall system capacity requirements, thereby ensuring the grid can handle future demand growth.
- **Driving innovation and modernization:** Encouraging the integration of Distributed Energy Resources (DERs), smart grid technologies, and digital solutions to manage the need for upstream capacity, improve system operations, and enhance customers' relationship with the grid.
- **Enhancing resiliency:** Strengthening infrastructure against extreme weather events, cyber threats, and other evolving risks to ensure reliable, secure service for consumers.

These directives from the Ontario Government go beyond the traditional scope of the RRF, representing new or expanded objectives that utilities would not normally be expected to achieve under the existing regulatory requirements. They invite innovative approaches, strategic investments, and concerted efforts that exceed the standard regulatory approvals for funding and flexibility. Under these circumstances, the CLD sees a potential role for PIMs to augment existing regulatory constructs.

### 2.3. No Generic, Sector-Wide PIMs

PIMs must be developed with a clear recognition that there is significant diversity amongst Ontario's electricity distributors, with wide variances in size of the customer base, customer load

profiles, local preferences, geographic and climatic conditions, and the technical attributes of distribution systems. A one-size-fits-all, sector-wide approach risks imposing incentives that are poorly aligned with local realities, with the likely outcome of misaligned incentives, wherein utilities may unintentionally be rewarded or penalized for outcomes that do not reflect genuine improvements in service quality or policy advancement, or for outcomes which are outside of their control.

The CLD submits that each PIM should be developed by an applying distributor, and be crafted as part of a voluntary, responsive proposal to address the specific government objectives.

As noted above, the CLD recommends that the government's identified policy priorities serve as the starting point for determining where PIMs should be applied, as different parts of Ontario face different policy-driven challenges. For example, while reliability is universally important, the question of how much reliability improvement is enough can differ by service territory. Requiring all utilities to chase ever-higher reliability levels regardless of local conditions and funding levels could lead to inefficient spending that yields minimal additional customer value. Moreover, the ability for utilities to meet PIMs tied to existing reliability metrics is inextricably linked to many exogenous factors, such as where utilities are in their rate cycle, or regionally-oriented economic growth expectations. These meaningfully impacts utilities' ability to respond to PIMs incentives through modifications to investment plans, further rendering as inappropriate the application of PIMs to sector-wide benchmarks**.** By contrast, a voluntary, purpose-built approach in which utilities develop customized proposals that would accelerate or enhance performance to achieve government objectives – with a built-in PIM – would be a significant step forward for PBR in Ontario.

The OEB can play a critical role in setting the stage for targeted PIMs by identifying government policy objectives and indicating the types of initiatives for which it would welcome proposals, and then ultimately reviewing and approving those proposals and the associated PIMs.

Utilities are best positioned to determine how these policy objectives intersect with their local conditions and devise PIMs commensurate to the effort and risk. Utilities can identify which policy-driven activities are most relevant to their customers and systems, propose technical and operational solutions tailored to these activities, and design proposals with PIMs for OEB review. This bottom-up approach not only ensures that PIMs remain grounded in performance aligned with local needs and capabilities, but also encourages innovative, utility-specific strategies that deliver meaningful improvements aligned with provincial goals.

### 2.4. Incentive-Based Structures are More Effective than Penalties

The CLD expects that performance-based proposals to address targeted, incremental, government objectives will include PIMs that reward utilities for achieving or surpassing targets, rather than penalizing them for failing to meet newly established benchmarks. Ontario's

electricity distributors already operate under multiple regulatory safeguards—such as service quality indicators, stretch factors, earnings sharing mechanisms, and OEB enforcement—that effectively penalize poor performance and ensure cost discipline. Introducing further punitive measures would add unnecessary complexity, and deter utilities from taking on new, policy-driven initiatives that require innovation and investment due to increased risk. The introduction of net new activities or priorities accompanied by PIMs should have the explicit objective of leaving both customers and utilities better off than they otherwise would have been under a status quo investment scenario.

Successful PIMs will positively encourage and provide flexibility for utilities to deliver outcomes that go beyond the standard provision of safe, reliable, and affordable electricity service. As the provincial energy landscape evolves, utilities will need to facilitate new growth objectives, support electrification, integrate emerging technologies, and bolster system resiliency. In such circumstances, the most effective regulatory tools are those that reward utilities for surpassing conventional expectations and achieving policy-aligned targets. Positive incentives create a constructive environment and a culture of growth that motivates utilities to invest in the resources, processes, and projects needed to attain these higher-level objectives without undue financial risk. In many cases these initiatives will likely involve customers and other stakeholders, which will add to the importance of PIMs that create a spirit of opportunity and achievement amongst all participating partners. In sharp contrast, penalties and disincentives would need to be incorporated into arrangements with customers and stakeholders, leading to a spirit of negativity, reducing project participation rates, and impeding progress or performance.

### 2.5. Incremental PIMs Require Incremental Cost Recovery

The CLD submits that any PIMs introduced into Ontario's regulatory framework must be supported by incremental funding mechanisms, which can appropriately sit outside of a distributor's existing base rates. Incremental funding is essential to ensure that utilities can pursue new, policy-driven goals without diverting necessary resources away from the fundamental provision of safe, reliable, and affordable electricity service. As noted above, the outcomes of a utility's Cost of Service application under the RRF is just and reasonable rates to deliver its core services.

By securing separate, transparent cost recovery for PIM-related initiatives, utilities gain the financial stability and clarity needed to invest in advanced measures that exceed the usual scope of distribution operations.

As previously noted, the RRF has successfully guided core utility operations under normal business conditions, placing a strong emphasis on cost control, efficiency, and baseline service quality. However, in the Minister's November 29, 2023 Letter of Direction, the Minister's calls upon the OEB to focus on a variety of government priorities, and notes "The government's vision

for a clean energy grid that attracts investment and creates jobs while continually enhancing reliability, resiliency and customer choice **will require utilities to make new investments**."[emphasis added].

The CLD agrees with the Minister: achieving the government's priorities for the energy sector will require greater investment from utilities. Current utility budgets and rates have been established under the RRF, and do not contemplate these incremental investments necessary to achieve expanded priorities. Without dedicated funding for incremental policy-driven initiatives, utilities face a situation where advancing new provincial objectives compromises their ability to maintain existing services. Requirements to enable expanded investments with existing funding, particularly paired with any PIM inclusive of a penalty component, are likely to preclude utilities from the opportunity to recover their prudently incurred costs or earn the deemed return on equity, thus violating the Fair Return Standard.

To address this challenge, the CLD proposes creating a separate, discrete PBR approach, including a funding stream (with PIM) for approved investments relating to government priorities. This approach isolates the incremental costs, revenues and incentives associated with pursuing government-specified priorities, ensuring that these endeavors are not funded at the expense of the utility's foundational work. By doing so, the OEB can foster a regulatory environment that enables utilities to invest in transformative projects and practices that align with the Minister's directives as they arise, even where such opportunities are not proximate to a rebasing application, while still preserving the integrity of their core distribution operations.

Section 3 of this submission outlines one potential regulatory construct to this end, and illustrates how this innovative PBR mechanism can be applied. This construct will help ensure that incremental PIMs deliver tangible value, promote continuous improvement, and remain responsive to evolving government priorities; ultimately benefiting Ontario's customers and the provincial energy system.

# 3. PBR & PIMs for Government Priorities and Policies

Introducing PIMs that address government priorities and policies requires a regulatory mechanism to ensure that utilities can implement these new expectations without eroding their existing budgets and customer outcomes for core services. The OEB PBR framework has addressed this in the past through the use of deferral and variance accounts, such as for smart metering and locates. For modest initiatives or utility-specific needs addressed in rate applications or other policy proceedings, this mechanism may continue to be sufficient. However, the CLD submits that in light of the magnitude of growth and innovation that the Ontario

Government expects from the sector, these standard approaches to PBR may prove insufficient to enable the level of performance required.

The CLD suggests the OEB consider innovative ways to facilitate the cost recovery of incremental costs which are directly responsive to the Government's expanded expectations of electricity distributors. By way of example, in regulating Enbridge Gas Inc. the OEB has historically used a Y-Factor approach to separate incremental initiatives—including those like Demand Side Management which are driven by policy imperatives, or extraordinary capital requirements such as gas transmission expansion—from the utility's standard rates. By leveraging this or a similar cost recovery construct, the regulatory framework can provide both the funding and the performance incentives needed to realize ambitious government goals, without forcing utilities to compromise on their baseline obligations to deliver safe, reliable, and cost-effective electricity. Further, ensuring that each incremental goal is supported by corresponding incremental funding provides a stable, predictable means for utilities to invest in the transformational activities that Ontario's energy future requires.

In short, there is ample room within the OEB's existing rate-making frameworks for separating out government-specified initiatives from revenue requirement, rate base, and rates calculations. What should first be addressed however, the CLD respectfully submits, is the Advanced Performance Mechanism (APM) through which utilities can voluntarily submit proposals to pursue government-specified initiatives.

### 3.1. Advanced Performance Mechanism Standalone Applications

The CLD proposes the OEB introduce an Advanced Performance Mechanism (APM) through which regulated utilities can develop and submit proposals that include a PIM and that are directed at attaining government policy objectives. These proposals could be included in rebasing applications, or could be prepared and filed as dedicated, standalone applications rather than being embedded within a standard Cost of Service or IRM proceeding. By evaluating PIM proposals independently, the OEB and stakeholders can maintain a clear focus on the incremental activities and outcomes associated with government-driven priorities. This approach prevents the dilution of regulatory scrutiny and avoids unintended consequences that might arise from mixing these new initiatives with ongoing, business-as-usual distribution ratemaking.

The CLD notes that the OEB's Innovation Sandbox, operating in conjunction with the IESO Grid Innovation Fund, offers a "pilot" reference point to what a much larger APM could do. Whereas the Sandbox-GIF is for a small number of projects with very limited scale – and to be clear the CLD supports its ongoing operation with that narrow purpose – the APM would allow the OEB to receive similar applications for targeted projects that are responsive to government-specified and OEB-authorized initiatives. Another analogous regulatory approach was used by the OEB for

conservation and demand management (CDM) plans, including rewarding attainment of government-specified performance objectives with incentive payments.

The following are examples of what APMs could look like within Ontario's electricity distribution sector:

- One example might be a government objective of accelerating greenfield housing connections by 50% for a period of time to temporarily boost housing construction. The OEB would put out an open call for proposals; on a voluntary basis utilities would respond with proposals inclusive of the costs of meeting that performance objective, incorporating a PIM; and the OEB would approve applications which clearly demonstrate positive outcomes for customers and the achievement of government policy.

- Another example might be a government objective for a specific section of the grid to be expanded or enhanced within a set time period, perhaps to support a major industrial customer looking to develop a site in Ontario. The OEB would invite a proposal from the utility serving that area; the utility would respond with a proposal inclusive of the costs of meeting that performance objective, incorporating a PIM; and the OEB would provide approval so long as the proposal was reasonable.

The CLD expects the following would be required, at a minimum, as part of a standalone APM application:

1. **Clear Government Policy Alignment**: The application should explicitly connect the proposed PIM activities to a stated government priority or directive. By grounding the PIM in a recognized policy objective—such as accelerating housing connections, enhancing system resiliency in response to climate risks, or supporting the integration of DERs—the utility demonstrates that the initiative serves the public interest beyond routine operations. To improve uptake, the OEB could go further and provide an "open call" or a "targeted call" based on where the government objective needs to be addressed. In doing so, the OEB will have determined that responding to the government-specified need is in the public interest and that utilities that file proposals responsive to it have a reasonable opportunity to be approved. Further, by proactively delineating what the OEB wants to see in proposals, the OEB will de-risk and expedite the application process, and allow responsive projects to proceed more quickly.

2. **Technical and Operational Evidence**: Utilities would provide evidence in support of the application, in keeping with the requirements set out by the OEB in a call for proposals or elsewhere. This might include technical studies, operational plans, or pilot results. The proposal and the PIM should be supported by credible evidence, ensuring measures are effective and responsive to the stated priority. Importantly, in order to achieve the Government's broad objective of greater performance within the sector, and its specific

objectives that will drive individual calls for proposals, the OEB's application and evidentiary requirements (i.e. filing requirements) will need to be proportionate to the call; where the regulatory burden to prepare and receive approval for a proposal is too great, no foreseeable PIM may be large enough to overcome the regulatory risk.

3. **Capital and OM&A Budgets for Incremental Activities**: The application should detail the incremental capital investments and OM&A expenditures required to achieve the policy-driven outcomes; including articulating where and how OM&A expenditures may have been chosen over capital expenditures, and how this choice delivers greater value for customers. Transparent budgeting enables the OEB to assess the prudence of these costs and ensures that customers, the OEB, and government have a clear line of sight to the financial implications of pursuing these objectives.

4. **Scorecard-Based Metrics and Targets**: To measure progress and hold utilities accountable, each PIM should be associated with a clear scorecard of metrics and targets. These performance measures must be directly linked to the stated policy goals, allowing for objective assessment of results. By establishing targets grounded in evidence, the OEB can confirm that incentives are earned only when meaningful advancements toward government policy objectives are achieved.

5. **Incentive Structures for Success**: The application must propose an incentive mechanism that aligns with the value and difficulty of the outcomes sought. By defining clear financial rewards for meeting or exceeding performance targets, the PIM encourages proactive utility behavior. Incentives should be commensurate with the benefits delivered to customers and the broader Ontario economy, ensuring that utilities have a genuine stake in achieving the intended policy outcomes.

Through this standalone APM-PBR approach, policy-driven PIMs responsive to government priorities that address the public interest will be better integrated into Ontario's regulatory framework; empowering utilities to innovate and invest in areas of strategic importance at magnitudes and according to timelines that exceed standard performance.

### 3.2. Cost Recovery Mechanisms

As described above, the CLD proposes APMs could be approved by way of a standalone application, which could be effected in rates via a Y-Factor or similar approach. Amounts approved for cost recovery need not complicate existing rate-setting approaches, as their nature as separate and distinct envelopes allows for their inclusion into rates in Cost of Service or IRM / Annual Update applications. Similarly, rate riders and variance accounts present themselves as additional tools to ensure that an approved APM can be implemented in a timely fashion; without being hindered by a particular utility's cost-based rate-setting cycle. The use of a new construct for approval of APMs would also better facilitate the equal treatment of capital and operational

expenditure solutions in a manner not currently provided for in Ontario outside of rebasing applications.

By employing flexible and transparent cost recovery pathways, the OEB and stakeholders can maintain a clear delineation between standard utility costs and incremental, policy-driven investments. This ensures that utilities receive the cost recovery necessary to advance the government's energy policy objectives, that existing funding for business-as-usual activity remains intact, and would provide customers visibility into the drivers behind incremental changes in their electricity rates.

### 3.3. PIM Design

Effective PIM design involves creating incentive structures that are transparent, proportionate, and aligned with clearly defined outcomes. By using a scorecard approach to measure performance, the OEB and stakeholders can ensure that utilities understand exactly what targets they must meet, and how their achievements will be rewarded. Scorecards are a flexible means to translate broad policy objectives into concrete, measurable metrics, allowing for straightforward assessments of utility performance over time.

Incentives should be calibrated to be large enough to encourage meaningfully utility action, without overcompensating outcomes. The design of incentives must also consider the relative attractiveness of policy-driven activities versus traditional approaches. In some cases, utilities might achieve a targeted outcome using more conventional capital expenditures. However, if a PIM encourages alternative strategies—such as using incremental OM&A to implement a novel solution—then the incentive must be set to ensure that pursuing this less traditional path is not discouraged. By recognizing these outcomes, incentives can steer utilities toward innovative, policy-aligned solutions that deliver better long-term value for customers.

To maintain accountability and simplicity in administration, the approvals associated with APMs, including the PIM components, should be tracked, reviewed, and disposed of through a dedicated Group 2 Advanced Performance Mechanism Deferral Account (APMDA). This ensures transparent bookkeeping and enables clear reporting and verification of results. At the time of a future rebasing or scheduled review, the OEB would evaluate the utility's performance against the established scorecard metrics and determine the final disposition of the APMDA. In this way, the entire incentive process—from goal setting through performance evaluation and incentive payout—is structured to promote responsible, results-driven utility actions that align with both customer interests and government policy objectives.

### 3.4. APM & PIM Summary and Illustration

Consolidating the proposal outlined above, the following table presents a summary of the proposed framework for an APM and PIM regulatory construct to facilitate the achievement of discrete government priorities:

**Table 1: APM and PIM Framework Summary for Standalone Applications[2]**

| | Capital Investment | OM&A Expenditure |
|---|---|---|
| **Application** | Standalone APM application seeking approval of funding and PIM(s) relating to a specific Government priority | |
| **Funding Mechanism** | Derivation of capital-related revenue requirement (CRRR) for capital investments required to support achievement of specific priority and performance. Approved CRRR recovered in rates via riders in next year's IRM, Annual Update or Cost of Service application (as applicable) | Approved operational investment required to support achievement of specific priority and performance becomes approved funding to derive rate riders for incorporation into next year's IRM, Annual Update or Cost of Service application (as applicable) |
| **Incentive** | Primary reliance on standard rate-of-return on rate base. PIMs may be requested for outcomes which are not direct result of CAPEX but are influenced by CAPEX (e.g. new customers connected faster than minimum requirement)<br><br>PIM financial incentives are tracked in an Advanced Performance Mechanism Deferral Account (APMDA) | A scorecard is developed, including metrics and targets directly linked to identified Government priority. A pre-determined financial incentive (expressed as aggregate incentive dollars, or on $/unit basis) is established for performance against target<br><br>PIM financial incentives are tracked in an PIM Advanced Performance Mechanism Deferral Account (APMDA) |
| **Close-Out** | Results against scorecard brought forward in Rebasing. Net assets and depreciation are rolled into rate base. Disposition of 1508 sub-accounts sought. Disposition of PIMDA is sought on basis of results. APM assets could be rolled into general rate base or held separate in perpetuity, at the discretion of the OEB in establishing the policy | Results against scorecard brought forward in Rebasing. Disposition of revenue/cost variance account sought. Disposition of APMDA is sought on basis of results |

[2] The CLD expects APM and PIM proposals could also be included in rebasing applications

To further articulate the proposal outlined in this submission, the table below provides an illustrative example of an APM funding and PIM proposal responding to an identified government priority:

**Table 2: APM and PIM Illustration**

| | Capital Investment | OM&A Expenditure |
|---|---|---|
| **Initiative** | Government of Ontario (or other relevant authority) identifies a priority new residential development which requires rapid construction and provision of electricity service | |
| **Investments** | Standard assets required to connect new development, including expansion of capacity if needed. Some incremental capital costs required to expedite material delivery and to secure labour | Incremental staffing and/or contractors to liaise with municipality, expedite planning and construction, and purchase incremental cloud computing solution to streamline processes |
| **Funding & Rates** | Incremental capital related revenue requirement is approved for funding via rate riders. Gross PP&E, Accumulated Depreciation, and Depreciation Expense are tracked in 1508 sub-accounts. Actual rate rider revenue and actual revenue requirement are tracked in 1508 sub-accounts, or subject to a rolling true-up through IRM model revisions | Forecast incremental OM&A expenditure is recovered via rate riders. Actual rate rider revenue and actual expenditures are tracked in 1508 sub-accounts, or subject to a rolling true-up through IRM model revisions |
| **PIM Target** | # of New Customers Connected Faster than Service Quality Requirement (within specified new residential development) | |
| **Incentive** | Standard rate-of-return on rate base. Incremental expenditures required to expedite customer connections are deemed prudent and attract the same rate of return | An incentive is established providing the utility a set $/New Customer Connected Faster than the minimum requirement |
| **Incentive Mechanics** | Net PP&E incorporated into rate base at next rebasing. Revenue requirement prior to rebasing is recovered via rate riders (including ROE) | An APMDA records annual entries for incentives owed to the utility based on achievement of the PIM target (i.e. a dollar amount for APMDA entry is calculated based on New Customers Connected Faster than minimum requirement). Disposition is sought at next rebasing |

# 4. CLD Responses to OEB Staff Questions for Stakeholders

The following are the CLD's answers to OEB Staff's questions regarding Advancing PBR.

### 4.1. Questions – Performance Incentive Mechanisms

***In the near term, the OEB plans to advance performance-based regulation by incorporating PIMs into the current framework. Informed by your review of the jurisdictional scan:***

***a. What do you see as the advantages and disadvantages (or opportunities and risks) of incorporating PIMs?***

**Advantages include:**

1. **Advancing Government Policy:** Incorporating PIMs allows the OEB to advance government policies that are not otherwise incentivized through the existing regulatory framework. This alignment ensures that utilities are actively contributing to provincial priorities such as electrification, sustainability, and infrastructure modernization.

2. **Alignment with the OEB's Benefit-Cost Analysis (BCA) Framework:** Some PIMs are expected to be able to leverage the OEB's BCA framework, enabling Local Distribution Companies (LDCs) to propose PIMs that advance government policies in areas like non-wires solutions. Where applicable, this synergy will help ensure that investments made under PIMs deliver optimal public benefits and are economically justified.

**Disadvantages include:**

1. **Potential Impediments to the Fair Return Standard:** If PIMs are structured as penalty mechanisms, they could interfere with the OEB's implementation of the Fair Return Standard. Specifically:
   - **Penalties Preventing Fair Return:** Penalties would hinder the ability to earn a fair return on utility investments and activities, discouraging necessary capital expenditures.
   - **Co-mingling of Funds:** There is a risk that PIM-related funding could become blended with an LDC's annual revenue requirement established under the Price Cap or Custom IR frameworks, potentially diluting or reducing the utility's annual return on investment.

2. **Increased Regulatory Burden:** Introducing PIMs may lead to an unproductive regulatory burden, requiring additional administrative oversight and compliance efforts from utilities and the OEB.

3. **Unintended Consequences of Poorly Structured PIMs:** If not carefully designed, PIMs might inadvertently incentivize sub-optimal outcomes or reward ratepayers or shareholders for results that are beyond the control of utility management. This misalignment could undermine the effectiveness of PIMs and erode stakeholder trust.

***b. From your perspective, what are the most important considerations to keep in mind when developing PIMs? (e.g., measurability, simplicity, transparency)***

1. **Adherence to Established Principles:** The development of PIMs should align with the principles outlined in Section 2 of this submission, ensuring that they address clearly defined regulatory challenges and support government policy objectives.

2. **Utility Control Over Metrics:** To function effectively as incentives, any PIM metric must be under the clear and direct control of utility management. If the metrics are influenced by external factors outside the utility's control, the PIM risks becoming an undue penalty or reward, which could distort utility behavior and performance.

3. The CLD supports the example considerations listed above by OEB staff:
    a. **Measurability:** Metrics used in PIMs should be quantifiable and based on reliable data, enabling accurate assessment of utility performance.
    b. **Simplicity**: PIM structures should be straightforward to understand and implement, minimizing complexity and reducing the administrative burden on both utilities and the OEB.
    c. **Transparency**: The criteria for earning incentives should be clear and publicly accessible, ensuring that utilities and stakeholders understand how performance is measured and rewarded.

***c. In your opinion, what outcomes do consumers value? (e.g., cost-effectiveness, reliability, customer service, enabling electrification, EVs, and/or DERs/NWSs)***

1. **Advance Public Policy:** Investments and initiatives that align with public policies set by elected government are highly valued, as they ensure that utilities are contributing to the broader societal goals and objectives expressed by voters, who are in aggregate also the customers of utilities.

2. **Cost-Effective Use of Ratepayer Funds:** Consumers expect that their ratepayer dollars are used efficiently, delivering maximum value without unnecessary expenditure. Cost-

effectiveness ensures that utility investments translate into tangible benefits for customers.

3. **Maintain or Improve System Reliability and Resilience**: Ensuring a reliable and resilient electricity system is paramount. Consumers value investments that prevent outages, enhance the system's ability to recover from disruptions, and adapt to evolving challenges such as extreme weather events and cyber threats.

***d. To which outcomes or performance measures do you believe PIMs should be tied?***

1. **Alignment with Government Objectives:** PIMs should be directly tied to specific government objectives that the OEB has identified as not being adequately addressed by existing rate-making frameworks. This ensures that PIMs are targeted and relevant, addressing areas where additional regulatory incentives are necessary.

2. **Beyond Core Utility Functions:** PIMs should apply to activities and outcomes that extend beyond the core utility functions and expectations. Examples include the accelerated integration of Distributed Energy Resources (DERs), the rapid connection of new residential developments, and initiatives aimed at enhancing system resiliency in response to climate-related challenges.

***e. What PIM structure/design is likely to be most effective and most suited to Ontario, considering the existing rate-regulation framework? (e.g., $ value per participant/installation etc., awarded basis points if targets are met)***

1. **Incentive-Based PIMs Without Penalties:** The most effective PIM structures are those that provide positive incentives without imposing penalties. This approach encourages utilities to pursue ambitious policy-driven objectives.

2. **Scorecard-Based PIMs:** PIMs should be structured around a scorecard approach, where utilities are evaluated based on specific metrics and targets that are clearly aligned with desired policy outcomes. This method allows for objective assessment and transparent measurement of performance.

3. **Avoidance of ROE Intertie**: Linking PIM incentives directly to Return on Equity (ROE) within the rate base is unnecessary. PIMs should focus on policy-driven initiatives that are separate from traditional utility assets and operations to prevent conflicts of interest and ensure unbiased performance evaluations. A direct link to existing ROE is not required to accomplish this, and introduces unneeded complexity and regulatory burden.

4. **Standalone Framework:** Establishing PIMs within a standalone framework ensures that they are reviewed on their own merits. This separation allows for appropriate levels of cost recovery to be considered concurrently, without intertwining with other standard utility costs and rate-regulation processes.

***f. Should PIMs be applied uniformly to all utilities, or should they be utility specific? Elaborate.***

1. **PIMs should be utility-specific:** Given the extensive diversity among Ontario's electricity distributors—including variations in customer size, customer preferences, geographic location, weather conditions, system characteristics, and financial circumstances—PIMs must be tailored to the unique needs and challenges of each utility. A uniform, sector-wide approach fails to account for these differences and could lead to ineffective or unfair incentives.

2. **Guidelines for Customization:** While PIMs should be tailored, the OEB can provide overarching guidelines or criteria to ensure consistency in how utilities develop and justify their proposals. Similarly, the OEB may consider identifying priority areas of government policy which it views to be optimal for PIMs proposals. This balance between customization and standardization helps maintain regulatory coherence while respecting local diversity.

***g. What timeline would be appropriate for PIM implementation, and should there be a phased approach?***

1. **Implementation will Inherently be Phased:** Regardless of the policy specifics, PIM implementation must be phased. The CLD has provided a proposal for OEB consideration of APM and PIM proposals via standalone applications, which would naturally implement PIMs on a phased basis as applications are brought forward and approved. Even under an alternative approach, it is clear to the CLD that PIMs require a cost-based review to ensure utilities have the funding required to realistically achieve stated targets. Failing to do so is highly likely to violate the Fair Return Standard; requiring investments from utilities with no opportunity for recovery of new prudently incurred costs. Further, subjecting existing funding to competition with net new priorities and objectives will undermine utilities' ability to deliver on core outcomes of high value to customer; including objectives clearly valued by the Government of Ontario such as reliability and the timely connection of new customers. Given the staggered nature of utility rate cycles, a phased approach should occur naturally under all policy scenarios.

2. **Phased Implementation Benefits:** A phased approach allows for gradual integration of PIMs, providing utilities and the OEB time to adapt to new processes and frameworks. This reduces the risk of immediate, widespread disruption and allows for iterative improvements based on initial experiences and feedback.

***h. How should baseline performance levels be established, and how frequently should targets be reviewed?***

1. **Utility-Specific Baselines:** PIMs should establish performance levels and targets specific to each LDC in their standalone applications. These baselines should be based on historical performance data and/or realistic projections, tailored to the unique circumstances of each utility.

2. **Avoid Sector-Wide Benchmarks:** Due to the wide variety of distributors in Ontario, it is inappropriate to set PIM performance levels based on cross-distributor benchmarking. Such an approach fails to account for the inherent differences amongst LDCs and will likely result in unfair comparisons and incentives.

3. **Pre-Determined Target Review Intervals:** Performance targets should be reviewed and updated at pre-determined intervals to reflect changing conditions, technological advancements, and evolving government priorities. This ensures that PIMs remain relevant and continue to drive meaningful improvements over time, without "moving the goal posts" during utility implementation phases.

***i. How should PIMs account for factors outside utility control (e.g., weather events)?***

1. **Immediate Term Considerations:** In the short term, PIMs should focus on achieving government policy objectives and incentivizing performance under normal operating conditions. Exogenous factors such as extreme weather events should be factored into the performance outcomes. If an exogenous event significantly hampers a utility's ability to meet PIM targets, the achieved incentive should be proportionately reduced to reflect the unforeseen challenges. For clarity, this construct is only viable under an incentive-only construct, and is inappropriate where PIMs incorporate potential penalties.

2. **Long-Term Adjustments for Exogenous Factors:** As PIMs become a more entrenched part of Ontario's rate-regulation framework, future designs should incorporate mechanisms to ensure that utilities are neither penalized nor rewarded for outcomes that are beyond their control. This might involve:

a. **Adjustable Targets:** Setting dynamic targets that can be adjusted based on significant external events.
b. **Resilience Buffers:** Incorporating resilience buffers that account for variability and uncertainty in performance metrics.
c. **Exemption Clauses:** Establishing clear guidelines for exemptions or adjustments in cases of extreme and unpredictable external factors.

### 4.2. Questions – Fundamental Change

***In the long term, the OEB is considering developing an approach to rate regulation that is no longer premised on rate base rate-of-return.***

*a.* ***Is this fundamental change required? Why or why not?***

**No fundamental change to core rate-making or the RRF is required.**

1. **Problem Identification:** The Advancing PBR consultation needs to clearly identify the specific problem that PIMs are intended to solve, which has not presently been accomplished. Without a well-defined issue, there is no justification for altering the fundamental rate-making structure in Ontario.

2. **Significance and Justification:** Moving away from rate base rate-of-return regulation would be a substantial undertaking, likely requiring no less than a decade to implement across all regulated entities. Such a change should only be considered if the identified problem is of critical importance, and demonstrably cannot be addressed through targeted regulatory enhancements like PIMs.

3. **Existing Framework Efficacy:** The Renewed Regulatory Framework (RRF) already provides LDCs, the OEB, and the Government with the tools necessary to implement public policies and achieve provincial goals effectively. While the RRF is tailored to business-as-usual utility operations, the government has ample tools to drive outcomes which are above and beyond the status quo. By way of example:

    a. **Smart Meter Implementation:** Government Regulation provided the framework for Ontario's transition to electricity smart meters, streamlining decision-making and process for implementation and cost recovery.
    b. **Additional Transmission Capacity:** The Government of Ontario has recently relied upon Regulation to specify particular priority transmission investments, streamlining regulatory approvals and construction.

c. **Affordable Energy Delivery to Rural Communities:** The Natural Gas Expansion Program relies on Regulation to establish and allocate funding for the expansion of natural gas to rural communities.

4. **Supplementing Existing Frameworks:**

Targeted PIMs or other regulatory constructs that focus on advancing government policies can be effectively achieved within the existing RRF, supplemented by the Benefit-Cost Analysis (BCA) framework. This approach avoids the need for wholesale changes to the rate-regulation model while still addressing evolving policy needs.

***b. What are the advantages and disadvantages of pursuing this approach?***

**Advantages:**

1. **None, at this Time:** Lacking a clearly defined regulatory problem which cannot be solved by any other less disruptive means, there is no advantage to a wholesale change to the regulatory construct at this time. In the future, evolutions in technology, consumer usage patterns, and government policy may bring about a circumstance where substantial change is required. The CLD does not see evidence of those conditions today.

**Disadvantages:**

1. **Significant Long-Term Disruption:** Transitioning away from the established rate-of-return model would entail profound changes to OEB regulatory practices, utility accounting, and regulatory accounting, causing some level of confusion and inefficiency.

2. **Utility and Regulatory Burden:** A fundamental shift would impose a substantial training burden on utilities, intervenors, OEB Staff and supporting professionals, compounded by the need to ensure consistent implementation across the industry. The likelihood of errors and inconsistencies on implementation is high.

3. **Accounting Inconsistencies:** Diverging regulatory accounting from International Financial Reporting Standards (IFRS) used for tax and financial reporting purposes could create discrepancies and complicate financial management for utilities, shareholders, and lenders.

4. **Uncertain Outcomes:** There is no guarantee that the proposed fundamental changes would effectively address the identified objectives, leading to potential waste of resources.

***c. How would this fundamental long-term change impact stakeholders in the sector, both throughout its development and upon implementation?***

1. **Prolonged Uncertainty:** Fundamental changes to the rate-regulation model would introduce significant uncertainty for all stakeholders, including utilities, customers, investors, lenders, and regulatory bodies. This uncertainty can hinder long-term planning and investment decisions. Of particular note, there is a reasonable probability the energy transition will require substantial investment and borrowing to support electricity infrastructure. A prolonged increase in the level of uncertainty should be expected to drive higher borrowing costs, and should logically drive a higher ROE.

2. **Increased Regulatory Burden:** Stakeholders would face increased administrative and compliance burdens as they adapt to new regulatory requirements, potentially diverting resources away from core business activities.

3. **Financial Implications:** Utilities might encounter financial instability during the transition period, as existing revenue models are disrupted, and new cost recovery mechanisms are put in place.

4. **Stakeholder Dissatisfaction:** Without clear benefits and efficient implementation, fundamental changes could lead to dissatisfaction among stakeholders, undermining trust in the regulatory process and the OEB's decision-making capabilities.

***d. What transition measures could be put in place to provide stability during a period of change?***

1. **Phased Implementation:** Any comprehensive overhaul of the rate-regulation model should be executed in stages, allowing utilities and the OEB to adapt incrementally. This approach minimizes immediate disruptions and provides time for feedback and adjustments. Implementing changes utility-by-utility via Rebasing applications ensures that each transition is tailored to the specific needs and conditions of individual utilities, promoting fairness and efficiency.

2. **Pilot Programs:** Implementing pilot programs for new regulatory approaches can help identify potential issues and refine mechanisms before full-scale deployment. Pilot initiatives offer practical insights and allow for evidence-based adjustments.

3. **Stakeholder Engagement and Training:** Comprehensive training programs and continuous stakeholder engagement are essential to ensure that all parties understand

and are prepared for the changes. Providing resources and support can facilitate smoother transitions and foster cooperation.

4. **Financial Safeguards:** Establishing financial safeguards, such as temporary buffers or contingency funds, can help utilities manage unexpected costs or revenue shortfalls during the transition period.

***e. <u>Are there quick wins that the OEB can advance in the short term?</u>***

1. **Targeted Performance Incentive Mechanisms:** The OEB can identify specific, non-core areas where objectives are desired but not currently being met. By introducing targeted PIMs in these areas, the OEB can achieve immediate improvements without necessitating broad regulatory changes.

2. **Clear Objective Setting and Design:** Quick wins are achievable when PIMs are designed around clear, well-defined objectives that align with government priorities. Thoughtfully designed PIMs, grounded in the principles outlined in this submission, can deliver measurable benefits promptly.

3. **Leveraging Existing Frameworks:** Utilizing existing regulatory frameworks, such as the RRF and BCA, to integrate PIMs can streamline the implementation process, allowing for swift advancements without extensive procedural overhauls.

4. **Initial PIM Implementations:** Starting with a few high-impact PIMs can demonstrate the effectiveness of performance-based incentives, building confidence among stakeholders and paving the way for broader adoption in the future.

5. **Facilitating Collaboration:** Encouraging collaboration among utilities, the OEB, and other stakeholders can help identify and implement PIMs that deliver quick, tangible benefits. Cooperative efforts enhance the probability that successful cases will be replicated and bring about comparable benefits to a broader set of ratepayers in Ontario.