Advancing Performance-based Rate Regulation

EB-2024-0129

Introduction:

In the November29, 2023 Letter of Direction to the Minister of Energy asked the Ontario Energy Board (OEB) to consider whether utilities' remuneration based on traditional capital infrastructure deployment remains the most cost-effective model. Th Minister asked the OEB to take steps to consider what changes may be required 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.

The OEB initiated this consultation process to advance its performance based approach to regulation with the objective of strengthening the link between what electricity distributors earn and the achievement of outcomes consumers value such as cost-effectiveness, reliability and customer service.[1] The OEB intends to consider changes to the current remuneration model for electricity distributors in Ontario before including all of the utilities it regulates.

The OEB retained Christensen Associates (the Report) to undertake a jurisdictional review of utility remuneration models, including the use of performance incentive mechanisms in five jurisdictions. That report was provided to the Minister of Energy and Electrification on September 17, 2024.

On November 19, 1024, OEB Staff held a stakeholder meeting to discuss the Report, the approach the OEB will be taking to evolve performance-based rate regulation and the potential for a more fundamental, longer term review of the OEB rate regulation regime.

The OEB is seeking stakeholder comments on the issues discussed at the November meeting. These are the Submissions of the Consumers Council of Canada (CCC).

Submissions:

In its report to the Minister the OEB set out its conclusions based on the Christensen Associates Report:

> The report finds 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. They do so by recognizing that traditional rate base rate-of-return remuneration will not incent utilities to leverage non-wires solutions that do not generate, and may in fact reduce, returns to utility

[1] OEB Letter dated October 9, 2024, Advancing Performance-based Regulation, p. 1

> shareholders. To offset this misalignment of incentives, each of the jurisdictions has, after considering their unique circumstances, undertaken some mix of performance incentives, mandated activities, or mechanisms to reward shareholders for non-capital-related expenditures. The report shows that while some successes have been achieved, none of these regulatory changes have, at this point, proven wholly effective. Further, it shows that there is no clear path or consensus on how to create the right incentives to ensure utilities optimally undertake non-traditional activities that are in the best interests of their customers and energy systems.[2]

The OEB set out three conclusions regarding opportunity for changes to utility remuneration:

1. As there is no clear successful way to create the right incentives for utilities to optimally engage in non-traditional and innovative activities, a made-in Ontario solution is needed, one that considers the nature of Ontario's energy sector and builds on the current approach to rate regulation as the starting point;

2. The current framework provides the OEB with the opportunity to, at a minimum and on a short timeline, introduce performance incentives an initial evolutionary measure to encourage non-traditional activities. The OEB has already began work on incentives through the Framework for Energy Innovation and now needs to work with stakeholders to enhance the effectiveness and breadth of these incentives:

3. Given performance incentives elsewhere have had limited success in obtaining optimal non-traditional utility activities, there is no assurance evolutionary performance incentives will optimize the potential benefits of non-wires solutions, it is possible a more revolutionary approach will be required. The OEB will consult with stakeholders on whether to undertake, as a longer term goal, a parallel path to develop a rate-setting model that is no longer primarily premised on rate base rate-of-return. [3]

CCC supports the OEB's path to move forward. In light of the fact that energy transition is happening, we need to look at alternative approaches to regulation. In Ontario this is required as traditional rate base rate of return regulation can incent inefficient capital spending. Incentives are required to ensure that utilities are deploying the right and most cost-effective solutions for their customers.

Performance Incentive Mechanisms:

CCC is of the view that developing performance incentive mechanisms (PIMs) is an appropriate approach for the OEB going forward. The Christensen Associates' Report does not suggest that the OEB make broad changes to its existing framework at this time, but that PIMs could be

[2] Ontario Energy Board, Report Back to the Minister dated September 27, 2024, p. 2
[3] Ibid, pp. 2-3

designed to complement that framework to achieve specific goals[4]. CCC believes that it would be premature, at this time for the OEB to establish the structure and designs for PIMs. This should be undertaken through further stakeholdering, and potentially the establishment of a working group comprised of industry stakeholders including ratepayers and utilities (This approach was employed in Hawaii).[5] This process could be supported by consultants that have experience in developing alternative regulatory frameworks. In the development of PIMs, however, the OEB should initially establish principles and objectives which should include:

- PIMs should be focussed on outcomes for customers. Customers care about costs/rates, reliability and customer service. Incentives should not be focussed on enhancing returns for utilities without corresponding tangible benefits for customers;

- PIMs should be uncomplicated and transparent in their design. The OEB, utilities and customers should be clear as how they operate and the potential outcomes, including potential financial outcomes and the impacts on rates;

- PIMs should be focussed on affordability. Metrics should be designed in a way that encourages utilities to pursue cost-effective and efficient results for their customers;

- PIMs should not always be asymmetrical. If utilities are given the potential to earn rewards for performance there should be penalties for underperformance;

- The OEB should first pursue pilots and not mandate any PIMs for all utilities in Ontario.

Fundamental Rate-Regulation Changes:

In its report to the Minster the OEB the OEB stated its intent that if after the winter of 2025 consultation the OEB determines that a more fundamental change to utility remuneration should be considered, the OEB will set a path forward, including whether more research and analysis is required before engaging on the design of a new framework.[6]

CCC supports a review of the current framework. The Renewed Regulatory Framework for Electricity (RRFE) has been in place for many years. As a part of this review the OEB should look at how the RRFE has impacted rates and how it has impacted customer satisfaction. A review of the current framework is critical to assessing the appropriate path forward.

[4] Christensen Associates' Report, September 2024, p. 85
[5] Ibid, p. 2
[6] OEB, Report Back to the Minster dated September 27, 2024, p. 5