Advancing Performance-based Rate Regulation (EB-2024-0129)

AMPCO's Comments
January 8, 2025

The Ontario Energy Board (OEB) initiated a consultation to advance its performance-based approach to rate regulation. The 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.[1]

Background

The consultation is in response to the then Minister of Energy Todd Smith's Letter of Direction dated November 29, 2023 where the Minister asked the OEB to consider whether utilities' remuneration based on traditional capital infrastructure deployment remains the most cost-effective model. The 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 retained Christensen Associates to undertake a jurisdictional scan to assist the OEB in understanding the opportunities in Ontario related to utilities' remuneration. Christensen Associates' delivered a report in September 2024 that provides an overview of Ontario's current utility remuneration model and reviews utility remuneration (UR) models, including the use of performance incentive mechanisms (PIMs), in five jurisdictions: Australia, California, Hawaii, New York, and Great Britain. Christensen Associates derived conclusions from this review and developed proposed approaches for a PIMs[2] regime and a fundamental review of the OEB rate-setting framework.

On September 27, 2024, the OEB delivered its report back to the now Minister of Energy and Electrification on proposed approaches to the development of PIMs and UR.

On November 19, 2024, AMPCO attended the OEB's Stakeholder Consultation to discuss: the findings of the jurisdictional scan of utility remuneration; the OEB's planned approach to advancing performance based rate regulation for electricity distributors in the short term; and. the need for a more fundamental, longer-term review of rate regulation for electricity distributors.

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[1] OEB Invitation to Stakeholder Meeting October 9, 2024 p.1

[2] A PIM is a mechanism consisting of one or more metrics, targets, and financial incentives (rewards and/or penalties) that is designed to strengthen performance incentives in a targeted area such as reliability or energy efficiency

AMPCO 's Comments

AMPCO concurs rate base rate-of-return regulation can incentivize inefficient capital expenditure and new approaches to utility remuneration that support good outcomes for customers are a positive step forward, particularly in the context of the sector changes being driven by energy transition. AMPCO supports the above stated objectives of 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."

Currently Ontario does not have PIMs in place. In the near term, the OEB plans to advance performance-based regulation by incorporating PIMs into the current framework.

AMPCO's provides the following response to the discussion questions posed at the November 19, 2024 Stakeholder Consultation:

Important Considerations in Developing PIMs

- Simplicity should be a governing principle in developing PIMs. An overly complex PIMs process with too many metrics should be avoided. Simpler is better.

- All metrics should be outcome focused. AMPCO recommends the OEB consider the initial development of a short-list of metrics to align with its above stated objectives and the outcomes customers value, for example a cost-effectiveness metric, a reliability metric and a customer service metric.

  The outcomes AMPCO members value most continue to be affordability and reliability as documented in many recent Electricity Distribution Customer Surveys.[3] Most other customer classes consistently rank affordability and reliability as their top two concerns. AMPCO believes the initial PIM should at a minimum be tied to these two outcomes.

- AMPCO supports a phased approach, allowing for additional metrics to be considered and added over time to respond to a changing grid.

  The Hawaii PUC began with a set of specific goals at the outset of its PBR design process, and then crafted the UR framework around those goals.[4] A portion of utility revenue is set by eight PIMs, which provide financial incentives for the achievement of certain policy objectives and the provision of enhanced customer service. Consistent with this approach, AMPCO believes the OEB's initial PIMs framework should consist of a small number of discrete metrics that respond to the OEB's key regulatory goals/objectives.

[3] EB-2023-0195 THESL Customer Summary p.3
[4] Presentation Slide #21

- The PIM system should consider prioritization and weighting of each metric based on the importance of the policy objectives to be addressed and outcomes to be achieved. However, the PIMs will need to work in conjunction with one another to balance cost outcomes and ensure efforts to reduce operational and capital expenditures don't compromise reliability.

- With respect to measurability, AMPCO recommends the PIM regime consider the SMART process and five critical criteria: Specific, Measurable, Achievable, Relevant, and Time-bound. The OEB needs to be able to measure PIMs progress and accurately determine if the PIM targets have been achieved.

- Maintaining current performance should not be an option. Targets should ensure utilities strive for continuous improvement. At the same time, unrealistic goals and metrics should be avoided as they will not be achievable, doable or practical, and are often set to higher standards than can be achieved. Unrealistic PIMs should be avoided as they can be expensive and time-consuming. Cost impact and time to implement the PIM system will be key considerations for the OEB.

- All metrics should be transparent to customers. This requires disclosure of all relevant information so that the metrics are clear and easily understood by all.

- AMPCO believes the PIMs system should incorporate both rewards and penalties related to performance in order to promote the right incentives and outcomes. The PIMs system should be symmetrical.

- At the outset AMPCO sees the PIMs applied uniformly to all utilities, allowing for additional utility specific custom PIMs at rebasing.

- In its most recent electricity rate application, Toronto Hydro, inspired by similar mechanisms being used in other leading jurisdictions such as New York and the U.K, proposed to link its 2025-2029 Custom Scorecard to an innovative PIM that holds the utility financially accountable for delivering results across 12 PIMs in four key areas of focus: (1) System Reliability and Resilience; (2) Customer Service and Experience; (3) Environment, Safety and Governance; and (4) Efficiency and Productivity.[5]

  The OEB's Reliability and Power Quality Review (RPQR) Working Group is developing reliability benchmarking and performance targets.

  The OEB's Activity and Program-based Benchmarking (APB) assess and benchmarks utilities' costs at a targeted level of a specific activity or program.

  AMPCO recommends the OEB take this work into consideration in designing the PIM system

[5] EB-2023-0195 THESL Executive Summary and Investment Plan Overview p.33-34

and further consult with these and other relevant stakeholders on the development and detailed design of the PIM metrics and targets. Many questions posed at the Stakeholder Consultation such as: "What PIM structure/design is likely to be most effective and most suited to Ontario considering the existing rate-regulation framework?; How should baseline performance levels be established, and how frequently should targets be reviewed?; and How should PIMs account for factors outside utility control (e.g., weather events)?"[6] require further discussion and would be best reviewed through further consultation.

Four of the jurisdictions (all but California) have implemented PIMs. California previously had PIMs in place but currently California does not utilize PIMs.[7] In developing a PIM system in Ontario, an understanding of why PIMs is no longer used in California should be taken into consideration.

AMPCO believes there are advantages to implementing PIMs as it offers utilities opportunities to advance emerging priorities in response to outside incentives versus internal forces. AMPCO believes a well-developed PIM program increases accountability and will enhance regulatory effectiveness.

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.

AMPCO agrees with the age-old concern in the sector that regulated returns on rate base incentivize utilities to over-invest in capital assets. Often seen as "gold plating", the resulting costs are then passed on to consumers in the form of higher bills. In order to facilitate the energy transition to net zero, prospective periods of extraordinary and unprecedented capital expansion are expected which will significantly contribute to higher costs.

Against the backdrop of energy transition, AMPCO agrees a fundamental review and potential change to the rate-regulation framework in Ontario is required, including how earnings are tied to the achievement of certain performance goals that address challenges arising from a changing grid, moving away from returns based solely on rate base.

[6] Presentation Slide #39-40

[7] Christensen Associates Report September 2024 P. 81