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June 9, 2025
Our File: EB20250083

Attn: Ritchie Murray, Acting Registrar

Dear Mr. Murray:

Re: EB-2025-0083 – Margin on Payments DSC Amendments – SEC Interrogatories

We are counsel to the School Energy Coalition ("SEC"). These are SEC's comments on the OEB's Notice of Proposal to amend the Distribution System Code ("DSC") to implement a Margin on Payments ("MoP") incentive for the use of third-party distributed energy resources ("DERs") as non-wires solutions ("NWS") to meet a distribution system need.[1]

General Comments

SEC is a strong supporter of the use of NWSs to meet distribution system needs, as they can be a cost-effective alternative to expensive traditional electricity distribution infrastructure. SEC also accepts that providing electricity distributors with a financial incentive can be an appropriate mechanism to promote the use of third-party DER solutions, addressing a distributor bias against NWSs, particularly those that defer or eliminate the need for capital assets that earn a return on equity.

While SEC supports the general intent underlying the proposed DSC amendments, it has significant concerns with the approach and specific provisions outlined in the Notice of Proposal, as discussed in greater detail in these comments. SEC does not believe it is appropriate to remove the discretion of individual OEB hearing panels to assess the appropriateness of an MoP incentive for a specific third-party NWS project. This discretion is especially important given that "the application of DERs to meet distribution system needs is a practice still in its infancy, and not a mature application.[2] The OEB has

[1] Notice of Proposal To Amend A Code (EB-2025-0083), May 16, 2025
[2] Guidehouse, Incentives for Electricity Distributors Using Third-Party Distributed Energy Resources as Non-Wires Alternatives: Margin on Payments: Consultant Report on Options for Alternative Margin on Payments Incentive Mechanisms, p.7

never received an application for a MoP, nor has a panel of Commissioners applied the Benefit-Cost Analysis Framework ("BCA Framework") for Addressing Electricity System Needs.[3]

SEC was also surprised by the release of the Notice of Proposal in the absence of any underlying consultation to assist in its development, which is the OEB's usual approach. If it had done so, it would have resulted in a more fulsome understanding of the underlying approach the OEB has chosen to take, and potentially interested stakeholders would have been able to provide input to assist the consultant Guidehouse, and to better understand the peer jurisdiction it had reviewed.

Detailed Comments

Use of Code to Set Rates

SEC accepts that there are benefits to establishing a default MoP value and uniform eligibility criteria. This promotes predictability for distributors when making procurement decisions regarding third-party NWSs to meet distribution system needs. Setting default values for rate-setting parameters can also improve regulatory efficiency and provide consistent expectations. However, SEC's concern is the method of OEB implementation.

SEC does not believe it is appropriate for the default value and criteria to be established through an amendment to the DSC. To SEC's knowledge, this would be the first time the OEB has used its code-making authority to constrain its own adjudicative discretion in rate-setting matters, and the legal authority to do so is, at best, unclear. The purpose of codes is to bind licensees, not OEB hearing panels. Removing that discretion does not support sound regulatory decision-making in the public interest. This is particularly concerning given that the OEB has no experience assessing actual applications seeking a MoP, nor has it reviewed a single project under the BCA Framework.[4]

SEC believes a more appropriate course of action would be for the OEB to establish a default MoP value and eligibility criteria through more conventional regulatory guidance, such as guideline or filing requirements. This would be similar to how the OEB sets a distributor's default Working Capital Allowance through the Filing Requirements for Electricity Distributors.[5] This approach would still offer guidance and regulatory certainty, while preserving the OEB's ability to exercise discretion in individual cases where the evidence shows that application of the default would not result in just and reasonable rates. A request to depart from the default MoP value or criteria could be brought by either the distributor, intervenors or OEB Staff, and may be justified in the context of a particular application or NWS proposal (e.g., a higher or lower MoP or modified eligibility criteria).

Another drawback of this approach is that it eliminates the OEB's discretion to determine, in a given application, that a different incentive mechanism may be more appropriate (e.g., a Shared Savings Mechanism or a performance or scorecard-based incentive[6]). For example, as the FEI Utility Incentive Sub-Group previously recognized in its report, a major drawback of a MoP is that it "is not tied to results" and that "[e]ffectiveness of the spending is not measured."[7]

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[3] Benefit-Cost Analysis (BCA) Framework for Addressing Electricity System Needs, May 16, 2024
[4] Benefit-Cost Analysis (BCA) Framework for Addressing Electricity System Needs, May 16, 2024
[5] See Filing Requirements for Electricity Distribution Rate Applications - 2025 Edition for 2026 Rate Applications, Chapter 2 Cost of Service, p.21
[6] Framework For Energy Innovation: Setting A Path Forward For DER Integration (January 2023), p.30
[7] FEI Working Group (EB-2021-0118), Appendix B, Framework for Energy Innovation, Report of the Utility Incentives Subgroup, p.20

If the OEB proceeds with implementing a default MoP incentive through a DSC amendment, SEC strongly urges the inclusion of a provision that permits deviation from the default value and criteria where it would be unreasonable to apply them in the circumstances. This would set a threshold for departure (unreasonableness), but allow the OEB to respond to evidence demonstrating that strict application would not be appropriate.

Default Value and Eligibility Criteria

The OEB has proposed a 25% MoP value, in combination with eligibility criteria, based on the recommendation of its consultant, Guidehouse. This recommendation was not the result of a comprehensive assessment of the specific incentive level required to influence distributor behavior in Ontario, but rather Guidehouse's judgment of what is reasonable after reviewing three jurisdictions (California, Michigan, and Australia) that have MoP incentive programs and assessing which programs have and have not worked.

SEC believes the 25% default value is likely too high, especially given that the incentive payments may capture up to 50% of the net present value of the expected benefits of the NWS. This is particularly important because the underlying costs and benefits will be forecast using assumptions that are often imperfect. As Guidehouse correctly notes, it is "imprudent and unrealistic to assume that forecast error will be symmetrical," and it "expects that NWS will underperform forecast net benefits more frequently than they over perform them."[8]

On that basis, SEC submits that the OEB should adjust the eligibility criteria to reflect this asymmetrical risk, and apply a discount to the current requirement that the net present value of the MoP incentive cannot exceed 50% of the NWS benefit. SEC believes a more appropriate maximum would be 30% of the net present value of the NWS benefit.

Code Amendments Do Not Require Showing of Prudence of Underlying NWS

The proposed DSC amendments state that if the OEB is satisfied that the requirements in sections 11.5 to 11.7 are met, it must include a 25% MoP (unless the utility requests a reduced amount) in rates.

Section 11.5 requires that, under the OEB's BCA Framework methodology, the project must yield a positive net benefit, and that MoP incentive amounts not exceed 50% of the net present value of those benefits. Section 11.6 outlines various filing requirements in the application for a MoP. Section 11.7 allows a distributor to apply, and the OEB to approve an incentive, even if some requirements are not met. However, none of these provisions require a finding that the underlying NWS project or the payment to a third-party DER provider is prudent, either individually or in the context of the distributor's overall spending.

The proposed amendment does not address how the underlying NWS project costs, particularly payments to third-party DER providers, will be assessed for inclusion in rates. That question would remain for the OEB panel to determine. SEC submits that this is appropriate as there are several reasons why demonstrating a net benefit under the OEB's BCA Framework is not, on its own, sufficient to conclude that payments to third parties are prudent.

[8] Guidehouse, Incentives for Electricity Distributors Using Third-Party Distributed Energy Resources as Non-Wires Alternatives: Margin on Payments: Consultant Report on Options for Alternative Margin on Payments Incentive Mechanisms, p.7

For example, when considering the distribution need in isolation, it may be that there exists a more cost-effective NWS solution than the one selected by the distributor. That alternative may offer greater benefits, whether qualitative or quantitative. In fact, under the proposed MoP structure, distributors may be incentivized to select more expensive solutions that nonetheless meet the baseline eligibility criteria, since the margin is calculated as a percentage of those payments. The higher the payment to third-party DERs, the greater the incentive it receives. Additionally, in a typical rebasing application, the OEB assesses not only whether individual expenditures are prudent, but also whether the distributor's overall spending level is reasonable. It may be that each cost item is defensible on its own, but taken together, they would result in unjust or unreasonable rates. The OEB routinely balances these considerations in approving a distributor's overall capital and operating budgets. A third-party DER project may pass the BCA Framework, but funding it at a particular point in time may not be the best use of limited ratepayer funds relative to other needs.

As currently proposed, an odd situation may arise where an application for a MoP incentive meets the requirements under the proposed amendments, but the underlying project is nevertheless found to be imprudent or unreasonable. Customers would be paying an incentive to shareholders for payments to a third-party that the OEB has determined to be unreasonable. This clearly cannot be what the OEB intended. SEC submits that an additional requirement must be included, a MoP incentive should only be paid if the underlying NWS cost (i.e. the payments to a third-party DER provider) are found to be prudent.

OEB Panel Must Approve BCA Framework Calculations

The MoP incentive criteria are based on the net benefit derived from the results of the Distribution System Test ("DST") set out in the OEB's BCA Framework.[9] SEC submits that the OEB should clarify that the panel hearing the MoP application must approve the inputs used in the BCA Framework. While the BCA Framework provides a general calculation methodology, many of the inputs require forecasts and assumptions[10], and must be critically assessed for reasonableness and accuracy. This includes not only the costs of the traditional and NWS solutions, but also other impacts that the BCA Framework allows distributors to quantify. Specifically, the BCA Framework permits distributors to "provide quantitative estimated values for impacts listed as qualitative, and include those in the DST, if they have the means to do so."[11] These impacts include benefits such as reliability, resilience, innovation and market transformation, and planning value. The OEB has little experience in assessing the monetary quantification of these benefits and cannot simply defer to what was provided by the distributor in its application.

Third-Party DERs Owned By Affiliates Should Be Excluded

The proposed definitions of both "Third-party DER" and "Third-party DER provider" would include those owned or operated by a distributor's affiliates. SEC submits that the OEB should exclude from the application of the proposed DSC amendments any payment of MoP incentives to a distributor's affiliate. Creating default or mandatory MoP incentive payments to distributor shareholders, could lead to the structuring NWS solution ownership that would be to the determinate of ratepayers.

For example, if a distributor is considering constructing a battery storage project to defer traditional investment, it may determine that it is more beneficial from the shareholders' perspective for the project

[9] Notice of Proposal To Amend A Code (EB-2025-0083), May 16, 2025, section 11.5
[10] Benefit-Cost Analysis (BCA) Framework for Addressing Electricity System Needs, May 16 2024, p.26-27
[11] Benefit-Cost Analysis (BCA) Framework for Addressing Electricity System Needs, May 16 2024, p.19, ft 18

to be undertaken by its affiliate and paid for through a procurement contract with the distributor. The underlying cost to customers may be the same over the life of the asset, comparing the revenue requirement of a distributor-owned asset versus payments to the affiliate, but under the affiliate ownership scenario, ratepayers would be required to pay to the common shareholder an additional MoP incentive. This is clearly not appropriate.

SEC is not suggesting that MoP incentives should never be paid to affiliates. There are many scenarios where it may be entirely appropriate and in the interest of ratepayers. However, this is an area that requires heightened scrutiny due to the potential for gaming. The determination regarding the appropriateness of a MoP incentive, including its value, for payments made to affiliates should be left entirely up to an OEB hearing panel that can review the specific details of the proposal and ensure it is reasonable.

Summary

Although SEC supports the overarching objectives of the proposed DSC amendments, it has serious concerns regarding the proposed approach and several specific provisions, as outlined in more detail in these comments.

Yours very truly,
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Mark Rubenstein

cc: Brian McKay, SEC (by email)