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Our File: EB20240129

Attn: Ritchie Murray, Acting Registrar

Dear Mr. Murray,

Re: EB-2024-0129 – Performance Incentive Mechanisms – SEC Comments

We are counsel to the School Energy Coalition ("SEC"). These are SEC's comments on the Discussion Paper on Proposed PIMs for Electricity Distributors ("Discussion Paper").[1]

General Comments

Broadly speaking, SEC is supportive of the OEB Staff's overall approach to performance incentive mechanisms ("PIM") as set out in the Discussion Paper. The OEB Staff proposes a limited number of PIMs (4), which attempt to balance high-level outcomes (such as broad-based reliability metrics) with two more granular metrics aimed, at least in part, at achieving policy outcomes.

However, SEC is both surprised and disappointed that the OEB Staff has chosen not to include a single explicit cost-effectiveness or customer service PIM, even though the OEB Staff's own stated overall objective of the PIM work says they reflect two of the three outcomes customer's value.[2]

With respect to the PIMs that were proposed, SEC's primary concern is that the OEB Staff have not yet established the actual reward and penalty framework, the level of incentive, or, in some cases, even the performance targets. These key elements have been left for the implementation stage. While SEC acknowledges the 'chicken-and-egg' challenge involved, it is difficult to evaluate the appropriateness of the proposed metrics without a clear understanding of the potential magnitude, structure, and scope of the reward and penalty system, as well as the final targets. For example, SEC might be more inclined to support a policy-oriented PIM if the associated penalties or rewards are relatively modest when compared to other performance metrics within the rate-setting framework.

It is also critical to understand the design of the reward/penalty regime, as it directly drives utility incentives. Depending on how the OEB ultimately structures this aspect, there is a risk that some PIMs

[1] OEB Discussion Paper: Performance Incentive Mechanisms (May 2025) ["Discussion Paper"]
[2] "Strengthen the link between what electricity distributors earn and the achievement of outcomes consumers value, such as cost effectiveness, reliability and customer service, while ensuring alignment with government policy." [emphasis added] See Discussion Paper, p.5

may inadvertently create perverse incentives that undermine the intended policy goals from the customer's perspective.

We urge the OEB Staff to consider this carefully as it moves forward. It may be prudent for the OEB to tentatively set the metrics and how they would be measured, but leave open the possibility of revisiting them during the implementation phase. If so, the metrics should be renamed to reflect their provisional nature.

The undersigned, on behalf of SEC, participated as a member of the Reliability & Power Quality Review Working Group ("RPQR WG"), which was tasked, in part, with setting distributor reliability performance expectations (i.e., targets). SEC can state unequivocally that this process proved to be far more complex than originally anticipated by the OEB and working group participants. The final design of the reliability performance expectations methodology looked nothing like the initial proposals from OEB Staff and their consultants. It required lengthy discussions among working group members.

A key element that facilitated progress was OEB Staff's willingness to undertake and share analyses showing how conceptual targets would have performed in practice. This allowed subsequent discussions to refine the proposals and address emerging concerns. Similarly, SEC anticipates that for the other proposed metrics, comparable challenges will arise. The current lack of data is particularly problematic from SEC's perspective, as it hinders a full understanding of the pros and cons of each metric's real-world application. After reviewing relevant data and better understanding the intricacies of each metric and its potential targets, it may be necessary to adjust, revise, or even abandon certain PIMs.

SEC Comments on Specifcic Questions

PIM Definition and Design Criteria

At its core, the PIM definition is close but not perfect. PIMs are not about meeting pre-defined targets, but about achieving a pre-defined level of performance, which is reflected in the setting of performance targets. This is a subtle but important distinction and better reflects the overall objective of the PIM work, as set out in the Discussion Paper.

SEC disagrees with the OEB Staff's approach to the PIM criteria. From SEC's perspective, the OEB is conflating two distinct types of criteria that should be evaluated separately. First, those that relate to the overarching purpose and benefits of a specific PIM. Second, those that address more practical considerations. These are fundamentally different and should not be combined, especially if they are to be given equal weight.

SEC believes a more appropriate approach is to evaluate PIMs in two stages. In the first stage, the OEB should assess whether the PIM targets the right area of performance. This would involve evaluating criteria such as outcomes, ratepayer benefits, policy alignment, consistency, and elements of proportionality. Once potential PIMs have been selected, the second stage should then consider more practical criteria, such as distributor control, availability of existing data, regulatory burden, and simplicity. An additional benefit of this two-stage approach is that during the second stage, the OEB Staff would be able to adjust or refine a proposed PIM to address any identified shortcomings.

Proposed PIMs - General

SEC is supportive of the proposal to apply a standard set of PIMs to all electricity distributors. If the purpose of the selected PIMs is to represent metrics that the OEB Staff believes reflect the overall objective of the initiative, "to strengthen the link between what electricity distributors earn and the

achievement of outcomes consumers value"[3], then we see no reason why these should apply only to certain distributors and not others.

Allowing distributors to pick and choose their specific PIMs, or to opt out except in the most compelling circumstances, would unnecessarily add complexity to rate cases. Time would be spent by intervenors and the OEB assessing such requests to determine whether they are genuinely justified, or merely an attempt to avoid application of a PIM the distributor believes it cannot meet.

The SEC further agrees with the proposal in the Discussion Paper that a distributor should be allowed to propose additional custom PIMs as part of a cost of service application (and presumably also under a Custom IR application).[4] SEC assumes this also means the OEB would permit custom PIMs to be developed, even if not initially proposed by the distributor in their application, whether through a settlement proposal or as part of an OEB decision.

PIM 1 – System Utilization

SEC supports a PIM designed to encourage greater system utilization. While the Discussion Paper frames this PIM as supporting the secondary objective of system capacity and electrification, SEC believes it should also be viewed as a tool to promote cost control and efficiency. By encouraging greater and more efficient use of a distributor's existing system, the PIM has the potential to reduce costs. SEC was pleased to see the OEB recognize this issue and attempt to address it through the design of a new PIM.

However, at this stage, SEC is not able to reach a firm conclusion on whether the proposed load factor metric is the appropriate way to achieve the stated objective. There is simply not enough information available to determine if the metric is suitable.

A review of the Discussion Paper raises a number of initial questions that SEC seeks to explore further. For example, SEC would like to examine historical load factor data for distributors in order to better understand annual variations and the factors that drive changes from year to year. This information is important in assessing the level of variability that can be expected, even when distributors take proactive steps to improve their load factor.

While more efficient use of the distribution system is an important way to reduce the need for incremental capacity, such improvements often emerge in Distribution System Plans at the feeder or station level, rather than across the entire system. This raises a question about whether a system-wide metric can effectively capture the improvements the PIM is intended to measure.

The Discussion Paper also notes that the PIM is intended to encourage the use of DER solutions to reduce peak load. While SEC agrees that this is a valid goal, it is not clear whether the metric could unintentionally conflict with other government initiatives aimed at conservation of energy (and not just peak demand savings). In general, lower total energy consumption results in a lower load factor, which could work against the intended outcomes of this PIM.

In summary, SEC sees value in a PIM focused on system utilization, but several key questions remain. Further data, analysis, and discussion will be required before a final assessment can be made.

PIM 2 and 3- SAIDI and SAIFI

SEC strongly supports the recommended PIMs. Aside from costs (i.e., rates), reliability is consistently the top priority for customers. This is understandable, as the role of electricity distributors and the OEB

[3] Discussion Paper, p.38
[4] Discussion Paper, p. 15

often involves balancing these two, sometimes competing, objectives. PIMs that address reliability are essential.

SEC also agrees with the OEB Staff that the proposed metrics and targets should align with those recently announced. As noted earlier, SEC participated in the RPQR WG, which spent considerable time developing these reliability targets. That work included ensuring the targets were both reasonable and achievable for distributors, while also promoting continuous improvement, which is what customers expect. If anything, the proposed targets are extremely modest.

SEC acknowledges that distributors may object to making these two PIMs penalty-only. SEC would not necessarily oppose a symmetrical design, since superior reliability performance deserves a reward. The issue is that the targets were developed conservatively, "with modest performance improvements in mind to ensure expectations are both reasonable and achievable."[5] If stakeholders had known the targets would underpin a symmetrical penalty/reward framework, the OEB would likely have set more ambitious performance expectations (i.e. reduced SAIDI and SAIFI targets).

One question that arises from using the previously announced reliability performance targets as the basis for the PIM targets relates to flexibility. In the OEB's letter announcing the initiative, it stated that distributors may propose alternative targets aligned with their proposed investment plans, which would be assessed based on planned capital and operating expenditures.[6] It is unclear whether this approach will carry over to the PIM framework, and whether it would depend solely on a distributor's request.

SEC believes it is important that the OEB have the ability, either through an approved settlement or an adjudicated decision, to increase reliability targets where appropriate. This would help ensure the targets reflect the level of proposed expenditures. If a distributor's customers are being asked to fund significantly higher investments to improve reliability, then the performance expectations, along with any associated penalties or rewards, should reflect that level of investment.

The one additional area where SEC wishes to comment is the proposal to base the associated penalty on a Value of Lost Load ("VOLL") calculation. While SEC believes this issue should be addressed during the implementation phase or the next stage of consultation, we want to raise a note of caution. As part of the OEB's VASH consultation, there has been discussion about using the U.S. Department of Energy's ICE calculator to determine a province-wide value.[7] This tool uses data from U.S. states and has been considered as an alternative to developing an Ontario-specific VOLL, which could be costly.

Stakeholders, including SEC, were generally open to this approach in the context of the OEB's new Vulnerability Assessment Toolkit, where the use of VOLL was limited to a default input value. However, applying VOLL in the context of a penalty mechanism appears to be significantly different with direct financial impact. In this case, SEC has increasing concerns about relying on the ICE calculator to determine such a value.

PIM 4 – DER Connections

SEC understands OEB Staff's proposal to include this metric, which has been a significant focus of government policy, as reflected in the recent Integrated Energy Plan implementation directive.[8] What

[5] OEB Letter, Setting Reliability Performance Targets (Reliability and Power Quality Review (EB-2021-0307), January 28, 2025, p.7
[6] OEB Letter, Setting Reliability Performance Targets (Reliability and Power Quality Review (EB-2021-0307), January 28, 2025, p.6-7
[7] See EB-2024-0199, OEB Electricity Distribution Vulnerability Assessment and System Hardening - Proposed Component 3 & 4 Methodology Presentation (April 11, 2025), slide 11-12
[8] Integrated Energy Plan Implementation Directive to OEB, section 15

makes the proposed metric somewhat unusual is that the OEB has already established specific expectations regarding maximum connection times through the adoption of the DER Connection Procedures ("DERCP"), which are incorporated into the Distribution System Code ("DSC"). Non-compliance with the DERCP timelines constitutes a breach of an enforceable provision. Therefore, for any new target to serve as a fair baseline for assessing performance, whether for penalties or rewards, it would need to be more stringent than the timelines already set out in the DERCP.

Other PIMs

OEB Staff asks if there should be further consideration given to PIMs referenced in Table 10 of the Discussion Paper, but not ultimately proposed. SEC believes OEB Staff should assess all of the potential metrics against the criteria it developed (and is asking for comment on), otherwise what is the point of developing detailed criteria?

With respect to the specific metrics, SEC would have liked greater consideration of the reductions from baseline weather normalized coincident system peak in MW, as a potential alternative to the proposed system capacity metric.

We were also surprised to see no consideration of a PIM that accounts for program or project unit costs. SEC understands the OEB Staff's view that cost control, efficiency, and affordability objectives are addressed through other OEB regulatory and rate-making tools. However, we do not agree that this is sufficient. The OEB has devoted considerable effort to improving cost performance through the Activity and Program Benchmarking ("APB") initiative. While there are flaws in that specific methodology, more granular cost metrics like these are critically important to ensuring the cost-effectiveness of distributor spending. This becomes especially important if, as the Discussion Paper suggests, forecasts project a two to three-fold increase in overall system capacity requirements[9], and, presumably, corresponding increases in capital and operating costs.

Target Setting and Incentive Levels

SEC agrees with the Discussion Paper's proposed target-setting method, which includes using past performance, performance against peers, and targets set by policy, for each of the proposed metrics.

With respect to the methodology for determining the incentive level, SEC acknowledges that while the overarching concept (that the incentive should be set at an economically efficient level by assessing the cost of distributor compliance against the resulting benefits) has merit, what this looks like in practice, and whether it can be reasonably calculated and implemented, remains an open question.

OEB Staff propose that empirical work be conducted, which will be subject to future stakeholder engagement. Until that work has been completed, it is difficult for SEC to assess whether this approach is practical and whether it represents the best way to determine incentive levels. Moreover, as the Discussion Paper notes itself, the incentive level is inherently linked to the specific targets set by the OEB.

In this regard, SEC strongly supports OEB Staff's proposal to consider this matter through a working group process. In our experience, especially for matters that are complex, technical, and likely to evolve through multiple iterations, working group processes are the most effective means of gathering stakeholder input. For this reason, we urge the OEB to convene a single working group rather than multiple separate groups for each PIM. This is because PIMs cannot be developed in isolation and their interdependencies must be considered.

A key question the OEB will need to address is the overall level of incentive, as well as how to balance the various PIMs and the relationship between rewards and penalties. Depending on the targets,

[9] Discussion Paper, p.6

metrics, and associated risks, a given metric may involve both a reward and a penalty. However, as the Discussion Paper notes, this does not imply that they are valued equally. Furthermore, the potential size of the incentive may vary by metric. For example, SEC would expect that the incentive levels for the two reliability-related PIMs would be considerably higher than others, given the significant importance of their outcomes to customer value. All of this requires an integrated discussion, which a single working group is better positioned to provide.

Administration of PIMs

SEC agrees with OEB Staff's proposal on the administration of the PIMs, including that the incentives should be captured in a variance account and disposed of annually through the IRM process, with one caveat.

As this will be a new process, some of the metrics, while appearing purely mechanistic, may not be so in practice due to the way distributors implement them. For example, SEC understands from its work on the RPQR WG that a number of distributors calculate SAIDI and SAIFI using manual estimation, as many lack the ability to determine (or at least easily extract) outage information at the customer level. Some distributors, after an outage, manually estimate the impact based on the outage duration on a feeder and how many customers they know, or reasonably believe, were affected.

Because SAIDI and SAIFI metrics have not historically resulted in financial rewards or penalties, neither the OEB, nor distributors have had to ensure the absolute accuracy of these calculations. This stands in contrast to the financial data the OEB receives annually through the Reporting and Record-keeping Requirements, which is expected, after relevant adjustments, to align with audited financial statements at the aggregate level.

SEC submits that two things will be required from the OEB. First, the OEB will need to significantly enhance its audit function regarding the reporting of these new metrics to ensure they accurately reflect actual performance. Second, the OEB should allow the variance account balances to be cleared through the IRM process on an interim basis only, with final clearance deferred until a distributor's subsequent rebasing. This would ensure that the OEB retains the ability to make necessary corrections to any balances that were cleared in error.

Yours very truly,
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Mark Rubenstein

cc: Brian McKay, SEC (by email)