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Our File No. 2018-0287

Ontario Energy Board
2300 Yonge Street
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Toronto, Ontario
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Attn: Christine Long, Registrar and Board Secretary

Dear Ms. Long:

Re: EB-2018-0287/8 – Utility Remuneration and DERs

We are counsel for the School Energy Coalition. Pursuant to the Board's letter dated January 21, 2020, and the stakeholder consultation on February 20. 2020, these are SEC's submissions on the preliminary proposals of OEB Staff on these initiatives.

SEC was active in providing input during the stakeholder consultation, and will not repeat every point in these written submissions. Rather, these submissions focus on the major items, and also add some additional input that arises out of further reflection, as well as review of the transcript.

These submissions are organized under the same headings as the OEB Staff proposals.

<u>Guiding Principles</u> *<u>(slides 13 and 14)</u>*

SEC generally agrees with the direction of the proposed Guiding Principles, but believes that wording can matter a lot in this situation. We therefore have the following comments:

1. ***"Consumer".*** It is not clear to us why "consumer" is more appropriate than "customer". It implies that those who supply to the system, as opposed to those who draw from it, are not part of the Board's focus, which is probably not intended. Consumer has, in the past, also been used as a reference to residential customers, and so has the potential to be misunderstood in this context.

2. ***"Cost containment".*** There was a debate in the stakeholder meeting with respect to "cost containment" (which implies increasing costs) vs. "cost reduction" (which implies declining costs). SEC believes that both can be relevant, depending on the circumstances, and suggests that "cost minimization" could capture both.

3. ***Fair Return.*** The reference to "fair return" implies the continuation of the existing cost of service, rate base model, which has an inherent bias in favour of capital spending. Since all agree this is likely to be part of the problem with DERs, SEC believes that this reference should be removed. If it is essential to include a guiding principle ensuring fair utility remuneration, it may be better just to say so, i.e. *"It includes a remuneration framework that provides utilities the opportunity to earn fair compensation."*

4. ***Optimal Use of Existing Assets.*** A key issue in the current evolution of the sector is the potential for stranded assets, and the risks and costs associated with those assets. This includes issues relating to existing assets that will become less useful, and to new assets that may, before their lives are complete, become obsolete. Rather than making "optimal use of existing assets" a guiding principle, which in our view creates a bias in favour of keeping what you've got (i.e. status quo), it may be better to say *"It encourages improvements in asset management and infrastructure planning as new technologies and approaches to providing energy services become available."*

<u>OEB's Role and Approach</u> *<u>(slides 21 and 22)</u>*

This was a focus of SEC's earlier submissions, and in general SEC agrees with the proposals put forth by OEB staff. This leads to the following limited comments:

5. ***Where on the Curve?*** While SEC agrees that the OEB should aim to keep up with the rest of the world in adapting to this evolution of the sector, it is in our view important that the Board decide where on that curve it wants to be. In short, does the OEB want to keep right up to date, and so be early to adopt solutions that it sees

to be working, or does it want to be closer to the back of the pack? SEC believes that, as it has with other types of change (PBR/IRM is a good example), the Board should not be inventing all of the new solutions, but it's goal should be to keep to the front, i.e. closer to the proactive end than the reactive end. That may have been implied by OEB Staff's proposal. If so, we believe it should be made clearer.

6. ***Formalized Approach.*** The OEB Staff proposal on approach appears to treat this sector evolution as similar to other changes in the energy marketplace. SEC believes that this could be much more of a game-changer than that, and has therefore proposed that OEB Staff initiate a formal operational structure to both keep on top of changes in other jurisdictions, and maintain an ongoing dialogue with stakeholders. We were disappointed that the OEB Staff proposals did not include such a proposal.

7. ***Keeping in Your Lane.*** Some stakeholders want the OEB to take full charge of this evolution, and in effect identify market objectives and cause them to be achieved. Other stakeholders want the OEB to let customers and the market do their thing, and just ensure that the regulatory process remains neutral and fair, allowing efficient decision-making by all involved. SEC agrees with the latter, and also emphasizes that the Board should always be conscious of the line between its mandate as regulator, and the role of the government in establishing and driving overall energy policy.

Needs Statements *(slides 25 and 27)*

OEB Staff is placed in a difficult position in identifying Needs before the establishment of working groups and the detailed study of the issues. As a result, the Needs Statements are necessarily high level. With that caveat, SEC has the following comments on the OEB Staff preliminary proposals:

8. ***Remuneration.*** SEC believes that the time has come for the Board to consider fundamental changes to how utilities are remunerated for their basic provision of the monopoly service. While the Needs Statement appears to imply an inquiry this broad, it is not stated explicitly. SEC would like to consider concepts like variable ROE, competitive bidding for service territories, fixed margin arrangements, and many other approaches that are not strictly driven by the Fair Return Standard. To avoid resistance during the process, we believe that the Board should make clear it is time to take a broad look at utility remuneration.

9. ***DERs.*** While SEC agrees with the Needs Statement, we are concerned that it misses one important element. There is, in our view, a need to deal with the inherent conflict between the utility as gatekeeper of DER installations within their service territory, and the utility as competitor to those DER companies. Independent

power was held back for years because Ontario Hydro was both competitor and gatekeeper. That is equally a challenge in the rollout of DERs.

Objectives *(slide 32)*

The OEB Staff proposal on Objectives appears to SEC to be inadvertently signalling protection of the status quo. There are several areas in which we believe it could be improved:

10. ***Winners and Losers.*** The proposal explicitly states that customer choice cannot be allowed to "negatively impact others". SEC strongly disagrees. Any new technology will have winners and losers. The market will allow customers to make choices that improve their positions, and the result will be that other customers will be left to bear more of the costs of the system. There are many situations in which the Board should step in and ensure fairness between those customers. However, to make "no negative impacts" an overall objective is unrealistic. For example, some of what is likely to happen will involve price signals. Those who respond to those price signals will see their situation improve. Those who don't will see their situation deteriorate. The market can only work if there is the potential for winners and losers. Protecting customers is a good objective. Prohibiting all negative impacts of customer choice is not a good objective.

11. ***"Utility Incentives".*** Consistent with the goal of reviewing utility remuneration "holistically", it is better not to focus solely on utility incentives. That is only one view (a utility-centric view) of adapting to DERs: provide additional sources of remuneration for utilities to incent new activities. Another view (a customer-centric view) is that the entire structure of utility remuneration must be driven by outcomes valued by customers. We would reword this to say *"The structure of utility remuneration should encourage greater efficiencies, cost-effectiveness, and outcomes valued by customers."*

12. ***Appropriate Scope of Regulatory Activities.*** Some parties will ask the Board to allow utilities to expand their activities in competitive markets. In our view, the objectives of this process should not be expanded to include utilities implementing non-monopoly solutions. Where there is a functioning market for a solution, the Board's objective should be to ensure that there are no barriers to that market, and that utilities are not able to inhibit that market, either through unfair competition within the regulated entity, or other means.

13. ***Options.*** The last bullet appears to imply that utilities should be in the DER business. This is an issue that needs to be addressed, and is not appropriate as an objective. SEC believes this bullet could be replaced with *"Any barriers to DERs should be removed from utility remuneration structures"* , or something similar.

Issues List (slide 49)

The issues list has the potential to drive the consultation from a practical perspective, so in our view it is critical that it capture all of the salient elements of the problem. It is also highly interrelated, which is going to become a concern when different working groups, for example, approach a common issue from different perspectives.

Against that background, we have the following comments on the Issues List proposed by OEB Staff:

14. ***Incentives.*** The entire first issue is, we believe, much too narrow. It assumes a particular view of remuneration, and is inconsistent with the holistic review of the structure of utility remuneration. We would rephrase the issue as follows: *"Structure: What is the appropriate framework to compensate utilities for the operation of their monopoly franchises, in a manner that aligns the interests of the utility shareholders with those of the customers?"*

15. ***Risk.*** In the end, utility remuneration is going to be driven by the allocation of risks between customers and shareholders. The biggest risk for customers is going to be the risk of stranded assets, which has two components. First, the existing assets of the utilities can become stranded. Right now, increases in the value of those assets accrue to the benefit of the shareholders, but declines in value can in some cases be a cost for customers. One of the key questions to be addressed is how to align these risks and benefits. Second, utilities continue to be driven to add capital, as that is how they increase profits. The Board's regulatory processes need to look at the risk that these new assets will become stranded, and expressly allocate risk and benefits as part of approvals. Both of these parts of the stranded asset risk issue should be added in the "Key Questions" column.

16. ***Value, Cost & Benefits.*** Many parties would like the Board to take on a role of independent market oversight, in effect regulating DERs indirectly through assigning values to things like location, technology, dispatchability, etc. While there is no doubt a need for objective information on the costs and benefits of DERs, they are not regulated by the Board. We therefore are concerned that the Board's role in assigning costs and values not end up expanding the Board's regulatory scope beyond that delegated by the Legislature.

17. ***Planning and Operations.*** SEC believes that any comprehensive response to sector evolution requires that the Board re-think the utilities' basic approaches to, and assumptions in, system planning. Right now, system planning is about deploying capital to satisfy system needs. In the future, that is not likely to be the right mindset. This area is sufficiently important that it probably should have a separate working group.

18. ***Cost Recovery & Investment Signals.*** The use of phrases like "cost recovery" and "align rates with underlying costs" presume a cost of service approach to rates. This is inconsistent with any serious review of the structure of utility remuneration.

Scope *(slides 51 and 52)*

OEB Staff has provided preliminary proposals for the scope of each of these two initiatives. We have commented on the Issues List, above, and have the following additional comments. Our comments on issues apply equally to scope.

19. ***Utility Remuneration.*** The entire proposed scope of this consultation is far too narrow, and assumes a particular view of utility remuneration. It talks about "revenue requirement", "return", "incentives", "earnings sharing", and "variance accounts". It expressly omits things like competition, margins, asset ownership costs and benefits, etc. This suggests that the Utility Remuneration consultation will look only at how to tweak the current cost of service/IRM structure. It does not appear to consider replacing it with something better. In our view, it is insufficiently ambitious given the challenges facing the sector in the next few years.

20. ***Responding to DERs.*** While we do not object to any of the scope proposals in this section, it would appear to us that it presupposes some of the issues that have to be addressed during the process. See our comments above.

Consultation Process *(slides 59 and 60)*

SEC agrees with the approach of using working groups to look more closely at individual issues and consider possible solutions. However, we have some specific additional suggestions:

21. ***Evidentiary Basis.*** A lot of the consideration by working groups should be driven by data, whether technical or economic information, or information on the experiences in other jurisdictions. In our view, OEB Staff should early on set out the areas in which they plan to get expert work done – empirical analysis, jurisdictional scans, etc. There should also be two express steps in the process that are not there currently. First, parties should be allowed to propose studies of their own, with appropriate time frames, and the Board should consider and approve those that have merit. All parties, not just those who are cost-eligible, should be required to get prior Board permission before embarking on these studies or other evidence production. Second, for all evidence brought in by parties or OEB Staff, there should be a process for other parties to ask questions (like interrogatories) so that everyone can understand the evidence more clearly.

22. ***Working Group Objectives.*** It will be important that OEB Staff, with the Board's approval, set out in writing the objectives/scope/mandate of each working group, and how interrelationships between the working groups will be handled.

23. ***Hearing.*** If any major changes to the regulatory approach of the Board are being considered, the Board will have to make a decision. SEC believes that, unless this process ends with revisions, but not fundamental changes, to the status quo, the Board should plan for a generic hearing as the culmination of the process. Fundamental changes have the potential to have far-reaching impacts. Generic hearings are not the only way to make decisions, but where decisions challenge the status quo, they have advantages. It will be important, we believe, that utilities, customers, and other stakeholders all believe there was a formal, transparent decision-making process in which all had a full right to be heard.

Conclusion

SEC has commented in the past that this consultation has a very broad scope, and will be difficult for OEB Staff and the Board to manage efficiently. The temptation will be to narrow it down, to make it more manageable, but in doing so the Board would also be limiting the range of solutions available to solve problems. In our view, it is better to keep this broad, because the potential changes to the sector are substantial, even if that means that keeping it focused and productive will be an ongoing challenge.

With that having been said, SEC appreciates the opportunity to participate, and looks forward to active involvement in the working groups and other aspects of the process going forward.

All of which is respectfully submitted.

Yours very truly,
SHEPHERD RUBENSTEIN PROFESSIONAL CORPORATION

Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested Parties