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Modernizing energy regulation to keep pace with an evolving sector

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CHECK AGAINST DELIVERY

“Modernizing energy regulation to keep pace with an evolving sector”

Good afternoon and thank you, Max Cananzi, for the introduction.

First, let me say what a pleasure it is to be here this afternoon.

You know, I last spoke at the OEN over three years ago, in April 2014. I’m not sure if it’s something I said back then, but it certainly has taken a while to get invited back!

When I was last here, I spoke about the importance of maintaining consumer confidence in a period of rapid change and the important role the OEB plays in that respect.

Today, I want to share some thoughts on the ongoing changes we are seeing and how energy sector evolution continues to inform regulatory evolution.

But before I begin, let me take a moment to acknowledge OEB staff and Board members who are here with me today. Much of what I am going to talk about today has been the result of their collective efforts and I want to thank them for willingly embarking on this journey with me.

Now, back to sector and regulatory evolution.

So what is “regulatory evolution”?

Well for me, it’s about the OEB’s approach to regulation and how that approach is evolving to address the changes underway in the broader

energy sector. And, it goes without saying, at least to all of you in this room, that those changes can be complex and disruptive.

Changes that are driven by:

- Technological innovation;
- The emergence of new business models;
- Heightened consumer expectations about service and affordability;
- And, of course, new public policy initiatives.

Over the last little while, many stakeholders have been calling for a more modern regulatory framework that can better keep pace with the speed and degree of transformation occurring, both in energy markets and systems.

Let me say, at the outset, that the OEB agrees.

As a regulator, we strive to be knowledgeable, engaged and proactive.

We have demonstrated our willingness, and our commitment, to anticipating and responding to energy sector transformation and the many challenges and opportunities that will come from it.

Now, as I said, it's been three years since I last spoke at the OEN and much has happened since then:

- In the electricity distribution sector, we have seen the Hydro One IPO, the creation of a new mega-utility in the GTHA, and other mergers and acquisitions that have extended the footprint of a growing number of Local Distribution Companies (LDCs) outside and beyond the territory of their municipal owners;

- We have seen a growing interest on the part of some LDCs to pursue and develop businesses outside their core distribution business and, indeed, the government has now relaxed long standing restrictions on the business activities of electricity LDCs and their affiliates;
- Consolidation in the electricity sector has been matched by Mergers and Acquisitions (M&A) activity in the natural gas sector, such as the merger of Enbridge and Spectra, the owners of the two largest gas distributors in Ontario, and the entry of a new player, Epcor, with its purchase of Natural Resource Gas Limited;
- And, we now see real rivalry for the expansion of gas distribution facilities to service new communities and territories;
- 2016 brought the Climate Change Action Plan that commits the province to significant emission reduction over the next 30 years. The centerpiece of that plan is, of course, the new cap and trade regime that went live earlier this year;
- As we continue to invest in modernizing our energy system, we have seen the impact on electricity prices and new measures adopted under the Fair Hydro Plan to moderate those increases;
- And, of course, we are now awaiting the next Long-Term Energy Plan that will set out how the province proposes to maintain a supply of reliable, clean and affordable energy into the future.

These are only a few of the many changes occurring that have, or will, impact the energy sector and the work of the Ontario Energy Board in significant ways.

Regulation and Public Policy

The scope and complexity of these changes highlight the need to look at the work of an energy regulator, like the OEB, in the context of a much broader public policy environment, particularly when that environment is as dynamic as it has been here in Ontario.

But this trend is not new, and is not unique to Ontario.

The last 10 years or so has brought into sharp focus the overlap of energy regulation and environmental and climate change policy.

In that period, we have also seen the interconnection between energy regulation and broader concerns about economic development and the welfare of our citizens and consumers, particularly those who are more vulnerable and have low incomes.

These points of overlap and interconnection have, quite understandably, heightened the interest of governments in what energy regulators do.

We see this not only in Ontario, but in other jurisdictions such as, New York, the UK and California, where energy regulators have emerged as thought leaders on energy regulation in a sector that is changing rapidly.

The OEB has much to learn from looking at what our fellow energy regulators in other jurisdictions are doing. Indeed, we have already learned a lot.

But our own approach to sector evolution must ultimately reflect the particular institutional arrangements and market conditions right here in Ontario.

When I last spoke about regulatory evolution at APPrO some two years ago, I said that the OEB's approach to sector change would be "paced, and measured." I stressed that as we address the changes underway in the sector we must not lose sight of some key principles or objectives.

Principles that, at least in our view, are fundamental to the OEB's role as energy regulator:

- The need to provide a reliable supply of energy at a good price for consumers;
- The need for rates to be predictable;
- The need to maintain a financially viable and competitive sector;
- The need to provide sufficient flexibility to allow for innovation;
- And, the need to plan for the future – a future that is still unfolding.

When I say "we," I mean not only the OEB, but also utilities and other market participants. We all have to be guided by these principles.

An approach that is paced, and measured, and that has regard to these basic principles is the best way to maintain consumer confidence during a period of change and uncertainty.

Each of these principles is reflected in the OEB's key achievements over the past five years.

- They are reflected, perhaps first and foremost, in the renewed regulatory framework we put in place in 2012:

- That renewed framework emphasizes the need for robust customer engagement in the development of utility system plans and rate proposals;
 - It calls for utility system planning that paces and prioritizes investment over the longer term and for planning on a regional basis;
 - It sets out the OEB’s expectations for demonstrable, measurable improvements in utility performance, and establishes a public “scorecard” for utility performance that is accessible and meaningful to consumers;
 - Above all, it includes rate-setting methodologies that seek to shift utilities away from a focus simply on costs and cost recovery towards a stronger focus on long-term value for consumers.
- They are also reflected in a range of measures designed to assist and empower consumers, like:
 - The OEB’s redesign of electricity distribution rates to give residential customers a better signal regarding the cost and value of the delivery service they receive;
 - Our adoption of a roadmap for reforming the Regulated Price Plan will lead to consumers having greater choice and control. Several pilots to test consumer response to different pricing options will start shortly;

- The development of a new cyber-security framework will help protect the privacy of consumer information, as well as the system reliability on which consumers depend.
- In the natural gas sector, we have assessed the changing dynamics of the North American market and considered the implications for Ontario:
 - We have provided new guidance for the expansion of gas distribution service whether by the incumbent utilities or potential competitors and new entrants;
 - We have implemented the regulatory framework to govern the compliance by natural gas distributors with their important obligations under the new cap and trade regime;
 - And, we are now considering whether our approach to gas supply planning should also evolve.
- With respect to consumer literacy and consumer empowerment:
 - We have introduced new ways to give consumers a better understanding of the work of the OEB and, in turn, to provide the OEB with deeper insight into the perspectives of consumers;
 - We have adopted a Consumer Charter setting out the rights and responsibilities of residential energy consumers;
 - And, we are giving consumers a clearer voice in regulatory proceedings, including rate hearings and making sure that their concerns are considered and addressed.

All of our work has focused, and continues to focus, on ensuring that the entities we regulate are equipped to deliver, and are delivering, value to consumers over the long term and that consumers continue to have confidence in the sector.

Our achievements over the last five years are a strong foundation for the next five.

We recognize that, in many ways, what's been accomplished is just the beginning, and much more needs to be done to address the changes underway in the sector, and to equip both the OEB and the entities we regulate to address those changes in a way that continues to deliver long term value for consumers.

We have also concluded that this further work should take place against the back drop of a broader and enduring strategic approach.

And so, on the heels of having completed much of what is outlined in the RRF, the OEB is now developing, and close to finishing, a new strategic direction or “blueprint” for the next five years.

That “blueprint” will set out the OEB’s view about the role that it can best play in helping lead the sector through a period of evolution.

The “blueprint” will **not** represent a break from the past; far from it.

It will build on our work over the past five years.

It will maintain and sharpen our focus on efficiency, effectiveness, innovation, value for consumers, and our own effectiveness as a regulator.

It will continue to support our shared objective of delivering a high-performing energy sector that aligns the interest of utilities and their customers.

It will combine the OEB's current approach to consumer-centric regulation with a stronger emphasis on the new and different challenges posed by sector transformation.

Introduction to the "Blueprint"

We have chosen to call our new strategic direction a "blueprint" because that term denotes our expectation that it will be used to build new regulatory frameworks that are both robust enough and flexible enough to adapt to changing circumstances.

As in all good strategic planning exercises we started by asking ourselves a simple question:

"Where do we want the OEB and the sector we regulate to be in five years?"

As we formulated our answer to that question, we considered developments in the energy sector both in Ontario and more broadly. We looked at trends in consumer behavior, technology innovation trends in utility ownership and structures, and the actions of other regulators.

Changing Consumer Dynamics

We noted the heightened consumer expectations about service and affordability.

Large commercial and industrial customers have been engaged in managing their energy consumption for many years, incented in some cases by programs such as the recently expanded Industrial Conservation Initiative.

New technologies, including smart appliances, home energy systems, distributed generation and small energy storage units are bringing the same opportunities to smaller customers as well.

In Ontario, consumers seem focused less on the promise of technology and much more on the “basics” of service and price.

This concern about electricity prices is an important reminder of the need to be sensitive to the economic impact on consumers of new infrastructure investment, including investments to support the deployment of new technologies.

Prices and simple economics will be key factors in determining the pace at which new technologies are deployed.

Technological Innovation

We also recognized that much of this technological innovation, in the electricity and natural gas sectors, has been driven by the focus on reducing carbon emissions.

In the electricity sector, we see the evolution of the “smart grid,” with new information technologies for managing networks, distributed energy and storage resources, microgrids, and new uses for electricity such as electric vehicles.

In the natural gas sector, we see technologies that enable the use of natural gas as a transportation fuel, and growing interest in renewable natural gas as a source of supply.

Some of these new technologies support “traditional” utility functions and customer relationships, while others may impact the utilization of existing infrastructure and challenge or “disrupt” existing business models.

Trends in Public Policy

As I mentioned earlier, Ontario is now committed to significant Greenhouse Gas emission reductions over the next 30 years under the new Climate Change Action Plan and its centerpiece the new cap-and-trade system.

Obligations under that system will fall most heavily on fossil fuel distributors, including the natural gas distributors the OEB regulates.

But, over the longer term, the impact of the Climate Change Action Plan and the shift away from fossil fuels will be felt throughout the broader energy sector, including the electricity distributors and transmitters we regulate.

The accelerated deployment of distributed energy technologies, electric vehicles and electric-powered mass transit, together with increased investments in energy efficiency, will impact all aspects of utility operations and planning.

Although the pace of these developments is uncertain, the potential significance and complexity of their impact is clear.

They will present new risks to be assessed and managed.

Both the OEB and the entities we regulate must be equipped to anticipate and to address these trends.

Changes in the Structure of the Ontario Energy Sector

We also considered the trend towards consolidation in the Ontario distribution sector.

The reports of both the *Distribution Sector Review Panel*, in 2012, and the *Premier's Advisory Panel on Government Assets*, in 2015, concluded that consolidation could facilitate efficiencies and cost savings for the electricity distribution sector, and better equip distributors to address the changes underway in the energy sector.

And while we have seen increased M & A activity in the electricity sector, particularly among electricity distributors, we think that over the five years of the “blueprint”, Ontario’s electricity distribution sector will likely continue to be characterized by considerable diversity among LDCs, as to size, density, geographic footprint, growth, and investment requirements.

Market and Planning Outlooks

We also found the IESO’s *20 Year Planning Outlook* very helpful in thinking about the next five years; in particular, the IESO’s emphasis on the need to remain flexible to understand the drivers of change and risk in the sector and to address regulatory frameworks that may not meet the needs of an evolving sector.

The Work of Other Regulators

Finally, we looked at the ways in which other energy regulators are thinking about, or addressing, sector evolution. Some regulators are adopting a “proactive” approach and seeking to lead utilities to a particular model sanctioned by the regulator. While others are adopting a “wait and see” approach and reacting to the challenges of sector evolution as they arise.

No regulatory model has yet emerged as the preferred “industry standard,” but many of the key questions that other regulators are grappling with are instructive and very similar to the challenges facing the OEB.

The ways in which other energy regulators are addressing these issues reflect the particular institutional arrangements, the market structure and broader policy framework prevailing in their jurisdictions. The same should be true of the OEB.

We think it is premature to sanction or mandate, as some regulators have, a particular new business model for utilities, or a specific new “platform” to accelerate the deployment of distributed resources.

However, we think that a simple “wait and see” approach is not sufficient for Ontario.

In our view, the complexity and the uncertainty associated with the potential impacts of both technological innovation, public policy commitments, among others, suggest that a different approach is needed.

We believe that the OEB has the opportunity, and the responsibility, to play a leadership role in *supporting* and *guiding* the sector it regulates through the evolution underway.

- By *Supporting* - I mean helping prepare utilities, other market participants, and consumers for the change, uncertainty and opportunity that lies ahead;
- By *Guiding* - I mean working to secure the benefits and mitigate any adverse consequences of that change and uncertainty.

The OEB can best provide that *support* and *guidance* by maintaining and sharpening our focus on efficiency, effectiveness, innovation, value for consumers, and our own effectiveness as a regulator.

To this end, our strategic “blueprint” will combine the principles of consumer-centric regulation, that I outlined in my 2014 OEN remarks, with a stronger emphasis on the new and different challenges posed by sector evolution.

Strategic Challenges

Our new “blueprint” will reflect 4 key areas of focus for the OEB. We have come to call these areas of focus our “Strategic Challenges”:

Our first challenge - Transformation & Consumer Value. How can the OEB help ensure that the evolution of the sector brings a stronger focus on demonstrable value to consumers?

A key area of focus here will undoubtedly be the Renewed Regulatory Framework (RRF), the framework that sets out the OEB’s approach to the remuneration of electricity and gas utilities.

The RRF was introduced five years ago. Our expectation at the time was that the RRF would drive:

- Stronger customer engagement by utilities;
- More robust system planning and regional planning and;
- As I indicated earlier, a stronger focus by utilities on long-term value for consumers.

I am confident that we have achieved the first two objectives. We are seeing utilities engage more effectively with their customers and undertake more robust system planning. But I am less confident that we are seeing the stronger focus on longer term value for consumers that we had expected and hoped for.

Energy regulators in other jurisdictions are considering new approaches to the remuneration of utilities.

In particular, they are looking at ways of treating traditional capital investments versus non-capital expenditures that might better encourage the adoption of innovative and least-cost solutions by utilities.

We need to assess whether similar regulatory reforms are warranted in Ontario and how they might further enhance efficiency and innovation in the sector.

Our second challenge - Innovation & Consumer Choice. How can the OEB incent and enable innovation – innovation that will benefit consumers by giving them more choice and control?

Changes to the RRF should encourage utilities to adopt and facilitate innovative solutions – whether they be capital or non-capital solutions.

We need to continue to advance our design of network and commodity rates, in order to support the efficient use of infrastructure and enable greater customer choice and control.

We will also need to review our codes and rules to ensure that they meet the needs of an evolving sector. Our rules will need to be more flexible and adaptable. We need to avoid barriers, real or perceived, to the adoption of innovative and low-cost solutions.

Getting the rates, prices and rules right will be a key step in helping ensure that consumption and investment decisions are based on sound economics.

Our third challenge - Consumer Confidence. How can the OEB best work to strengthen and sustain the confidence of consumers during a period of accelerating change?

We will move beyond the concept of consumer protection and actively continue our work to better inform, assist, and empower consumers:

- Helping consumers understand their rights and choices;
- Making sure consumers are treated fairly by utilities and other service providers.

We will also continue to work to make sure that consumer perspectives are welcomed, respected and addressed in all regulatory processes.

And we will encourage and support efforts to ensure that the benefits of innovation and sector transformation are realized by all types of consumers.

Finally, Regulation “Fit for Purpose”: How should the OEB equip itself to meet the challenges of sector transformation?

We need to ensure that the OEB has the expertise needed to address sector evolution.

Our own organization and processes will need to remain flexible and adaptable to changing needs.

Our work will need to be supported, as it always has, by effective engagement and collaboration with consumers, with regulated entities, and all our stakeholders, including coordination with the government and other agencies.

Conclusion

Our strategic “blueprint” will set ambitious, but achievable, goals for both the OEB and the sector we regulate.

The development of the “blueprint” has, in a way, been the easy part.

The much more challenging task will be working through the details of how we will meet our strategic goals and objectives.

Like the “blueprint,” determining specific actions and priorities will be informed by our ongoing dialogue with stakeholders.

Like all regulatory change initiatives, there will undoubtedly be much controversy and debate along the way.

It's a dialogue that is essential if the OEB is to develop an informed and responsive action plan that delivers the regulatory evolution needed to keep pace with the ongoing evolution of Ontario's energy sector.

Thank you.