

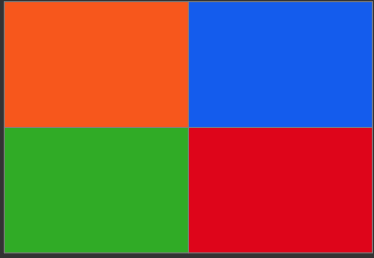
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Smart Governance for Smart Electricity

# Moving Forward from the Auditor General's Report

April 12, 2012

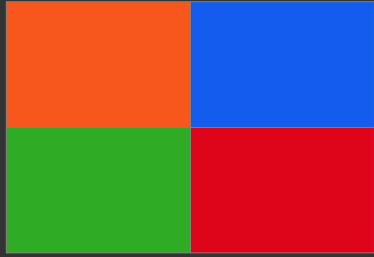
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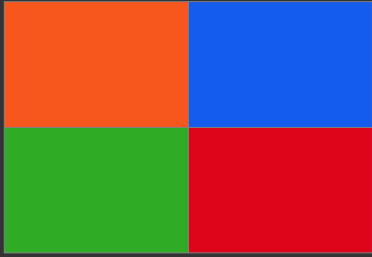
## Smart Governance for Smart Electricity

- INTRODUCTION



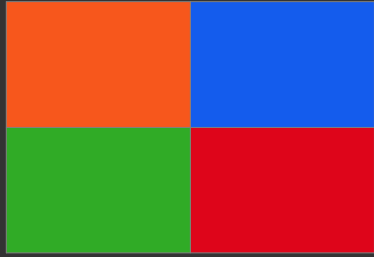
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- Comments on two of the three Auditor General's (AG's) 2011 electricity-related audits:
  - renewable energy initiatives
  - regulatory oversight



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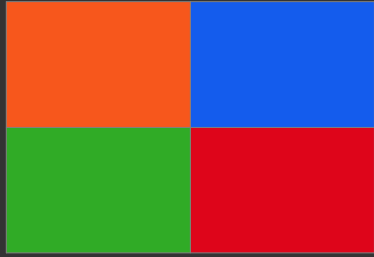
- Focus of comments
  - what the AG's findings say about the need for transparency and accountability for decisions affecting electricity prices
  - what the AG's findings say about the adequacy of the institutional framework for decisions affecting electricity prices



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## Smart Governance for Smart Electricity

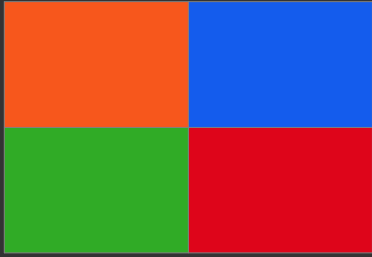
- RENEWABLE ENERGY INITIATIVES



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## Key Findings of the AG's Report

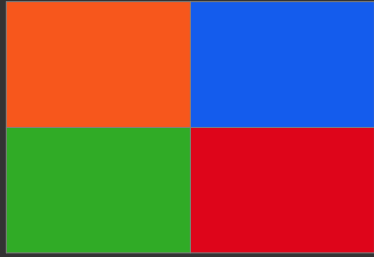
- (a) Billions of dollars were committed to renewable energy without fully evaluating the impact, the trade-offs, and the alternatives through a comprehensive business case analysis
- no independent, objective, expert investigation had been done to examine the potential effects of renewable energy policies on prices, job creation and greenhouse gas emissions
  - no thorough and professional cost/benefit analysis had been conducted to identify potentially cleaner, more economically productive and cost-effective alternative to renewable energy (AG's Report, p. 97)



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## Key Findings of the AG's Report

(b) The Ministry rejected the OPA's proposed reduction of 9% to FIT prices for electricity from ground-mounted solar projects, something the AG asserts would have reduced the cost of the program by about \$2.6 billion over the 20-year contract terms. (AG's Report, p. 90)

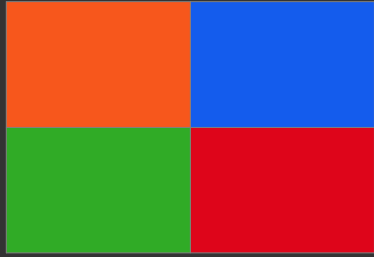


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## Key Findings of the AG's Report

(c) The OPA recommended, in February, 2010, a cut in the FIT price paid for power from microFIT ground-mounted solar projects. The AG observes that, had the revised price been implemented when first recommended by the OPA, the cost of the program could have been reduced by about \$950 million over the 20-year contract term. (AG's Report, p. 90)

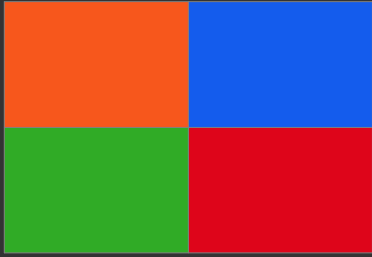




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## Key Findings of the AG's Report

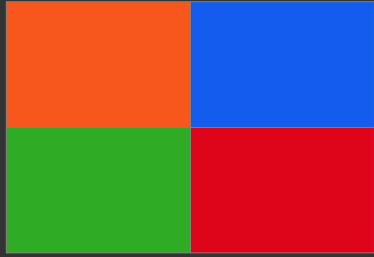
(d) With respect to the agreement with the Korean Consortium, “no economic analysis or business case was done to determine whether the agreement with the consortium was economically prudent and cost-effective, and neither the OEB nor the OPA was consulted about the agreement. (AG’s Report, p.91)



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## Key Findings of the AG's Report

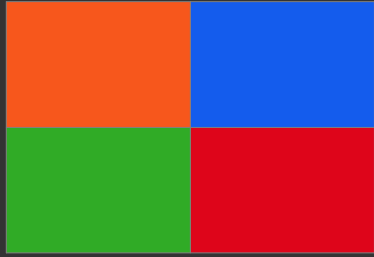
(e) Electricity ratepayers may have to pay renewable energy generators under the FIT program between \$150 million and \$225 million a year not to generate electricity. (AG's Report, p. 91)



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**Independent oversight for these decisions was non-existent**

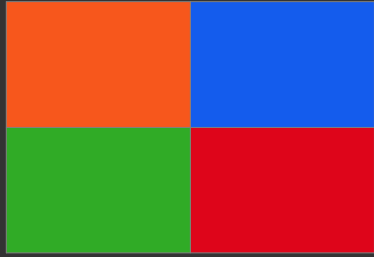
- the 2004 amendments to the OEB Act and the Electricity Act created a system of decision-making with four entities (the OEB, the IESO, the OPA and the Minister) each with discrete roles, substantially reducing both effective oversight and accountability



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## Independent oversight for these decisions was non-existent

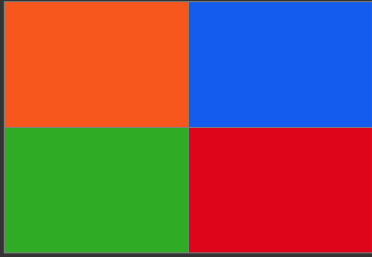
- the *Green Energy Act* further reduced that oversight
  - vested in the Minister power to issue directives which undermine the OEB's ability to exercise meaningful oversight
  - example, the obligation of the OPA by itself and with LDCs to meet certain determined CDM targets



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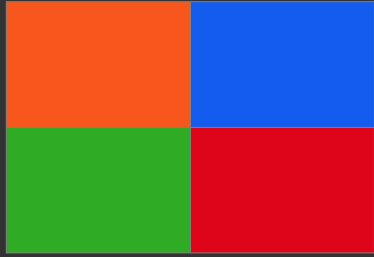
**Independent oversight for these decisions was non-existent**

- the AG observed that “The ministerial direction-making authority has limited the OEB’s ability to carry out its regulatory and oversight role on behalf of consumers with respect to renewable energy.”  
(AG’s Report, p. 101)



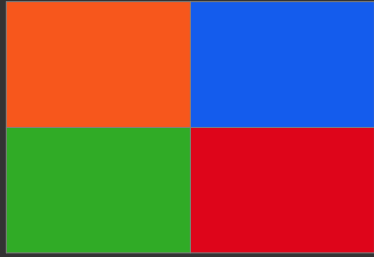
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- The AG's findings on the renewable energy initiative reveal the absence of both transparency and accountability for the decisions which, in substantial measure are driving up the forecast increases in electricity prices
  - electricity prices for the average consumer have increased 65% since the restructuring of the electricity sector in 1999, and prices are expected to rise another 46% in the next five years
  - 56% of the increase is due to investments in renewable energy



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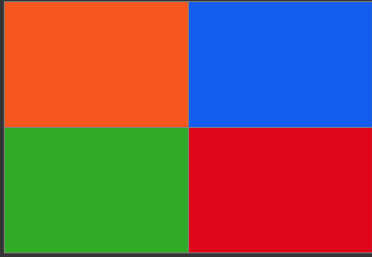
- What the AG's report does not comment on, but could have, are the costs of connecting renewable energy sources to the distribution and transmission grid, the cost of CDM programs, and the cost of the so-called smart grid
  - these costs are borne by HON and by LDCs
  - the OEB's authority to examine the prudence of these costs was limited by the constraints imposed by the government's direction-making authority



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- What is required is not just a review of certain cost components of the renewable energy initiative (for example, FIT contract prices), but a wholesale re-thinking of the system of independent oversight and regulatory oversight
  - if there is any theme arising from the AG's Report on the renewable energy initiative, it is the critical importance of independent oversight of decisions affecting electricity prices
  - curious then, that the fall out from the AG's Report on regulatory oversight should be initiatives to weaken the existing system of oversight

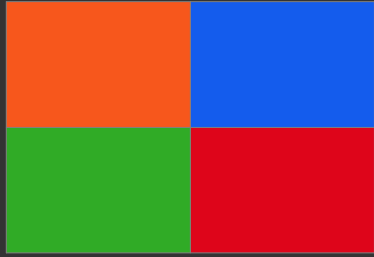




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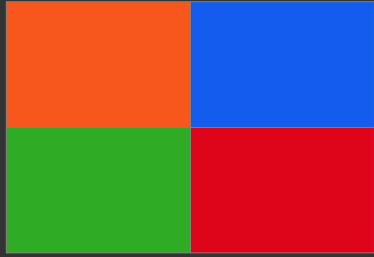
## Why is Regulation Required?

- the distribution and transmission of electricity are monopolies delivering an essential service
- the inherent potential for abuse of monopoly power is exacerbated by:
  1. Decisions affecting electricity prices driven by unreviewable government directives; and
  2. LDCs' roles as centres of profit.



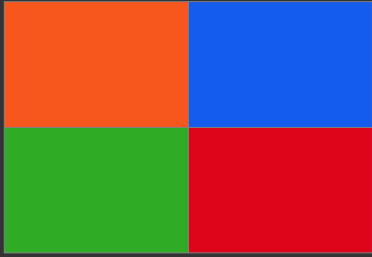
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- the Ontario Court of Appeal, in a 2010 decision, aptly summarized the conflicts in the regulatory process and the role of the OEB in balancing those conflicts:



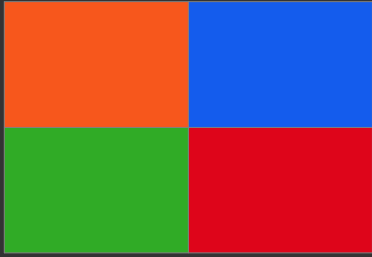
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- The principles that govern a regulated utility that operates as a monopoly differ from those that apply to private sector companies, which operate in a competitive market. The directors and officers of unregulated companies have a fiduciary obligation to act in the best interests of the company (which is often interpreted to mean in the best interests of the shareholders) while a regulated utility must operate in a manner that balances the interests of the utility's shareholders against those of its ratepayers. If a utility fails to operate in this way, it is incumbent on the OEB to intervene in order to strike this balance and protect the interests of the ratepayers. (*Toronto Hydro-Electric System Limited v. Ontario Energy Board*, 2010 ONCA 284 at p. 21)



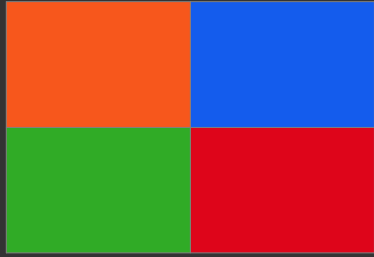
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- the focus of LDCs has shifted away from the protection of ratepayer interests towards maximizing the return for their shareholders
  - a return that is a hidden, indirect, and regressive tax
  - the Electricity Distributors Association's 2011 proposal for regulatory reform was replete with references to the need enhance shareholder return
    - but was essentially silent on the obligation to protect the interests of ratepayers with respect to prices



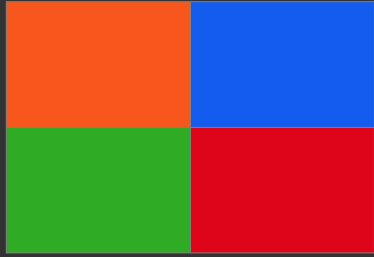
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- the complaint about the regulatory system is that it is too costly:
  - cost components:
    1. OEB Costs
    2. LDC Costs
      - internal regulatory compliance costs
      - increased because of government requirements for CDM programs, smart meters, connections to renewable energy sources
      - external consultants
        - to complete rate applications
        - to devise CDM programs
      - external counsel
    3. Intervenor Costs



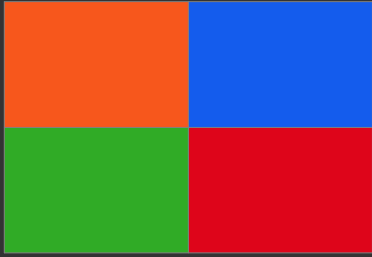
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- I observe, in passing that many of these costs are what I would describe as “churn” costs
  - the costs of complying with changing government policies
  - the costs of reorganization following the 1998 restructuring
  - the costs of complying with the renewable initiative



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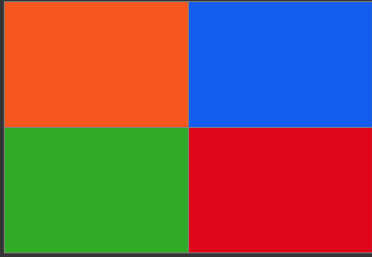
- what is required is an analysis of the costs of applications, followed by a cost/benefit analysis
  - ironic if the very things that were missing from the renewable energy initiative were not undertaken for regulatory costs



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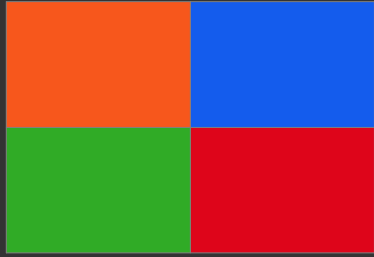
- regrettable that the immediate reaction of the OEB Chair has been to scapegoat intervenor costs
- the limited data which exists suggests that intervenor costs are tiny in relation to overall LDC costs
  - a 2008 OEB analysis of intervenor costs for LDC rate applications found that intervenor costs represented less than half of 1% of the annual revenue requirement, or about \$1.50 per customer





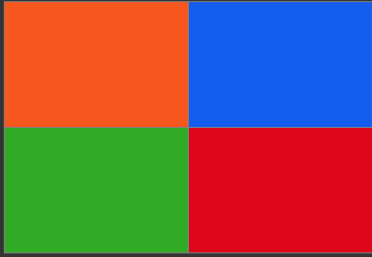
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- the benefits of that \$1.50 are:
  1. material reductions in revenue requirements and, therefore, rates
  2. public scrutiny of LDC costs, and accompanying accountability
  3. strengthening OEB decision-making by ensuring that all affected parties are heard from



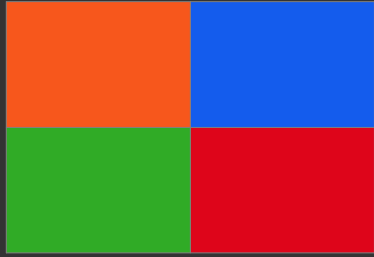
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- Alternatives:
  - OEB itself assuming the role of protecting consumer interests
    - overlooks the obligation of the OEB to balance competing interests
    - there would be a perception of an inherent conflict of interest that would fatally weaken the OEB's decision-making
  - Independent consumer protection office
    - under the AG and with sufficient funding to operate effectively



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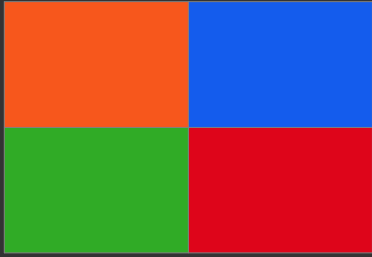
- whether those alternatives are preferable to the existing system is an open question
- -what is required is an open, transparent examination of the costs and benefits of the system of regulatory oversight in light of the public policy objectives
- -what is required, in other words, are the very things which were missing from the renewable energy initiatives and which are the subject of the AG's damning critique



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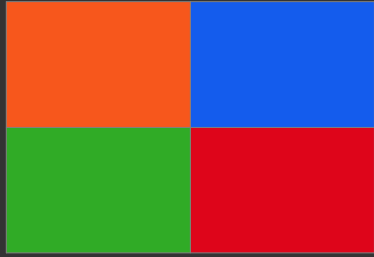
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- CONCLUSION



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- the policy focus now should be on ensuring that there are institutional mechanisms in place to prevent the problems set out in the AG's report
- that requires a top-to-bottom, public review of the adequacy of the existing regulatory structure
- the goals should be transparency and accountability



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