ONTARIO 360 – ENERGY POLICY – TRANSITION BRIEFING

Establishing greater evidence-based analysis of Ontario's energy procurement

Issue

Ontario's energy woes are well known. The province's advertised energy rates are among the highest in North America.[1] This represents a considerable burden for households and businesses. The incoming government needs to improve the way it oversees and allocates electricity costs.

Overview: Energy policy in Ontario

Since 2002 (when the previous electricity system of public ownership of Ontario Hydro went bankrupt and had to be replaced), the province has used electricity expenditures to support not just customer-driven system requirements, but also environmental and economic development goals.

True, the result of this focus has been to dramatically reduce carbon from Ontario's electricity system; but it was done so at an incredible cost. Estimates put the cost of reducing a tonne of carbon through the government's coal replacement policies as up to $300/tonne of carbon.[2] The market price of carbon is under $19/tonne.[3]

Many of the expenditures have been uneconomic, unnecessary or ineffective. This has included the smart metering program (which cost over $2 billion and provides virtually no customer value)[4], supply programs such as feed-in tariffs

[1] Andrea Holmes, Empowering Ontario: Constraining Costs and Staying Competitive in the Electricity Market, Ontario Chamber of Commerce, 2015. Available at: http://www.occ.ca/wp-content/uploads/Empowering-Ontario.pdf.
[2] Aegent Energy Advisors, Coal Replacement-Implied Carbon Cost, April 2008. Available at: http://www.aegent.ca/insights/coal-replacement-implied-carbon-cost.
[3] Ministry of Environment and Climate Change, Joint Auction #14: Summary Results Report, February 2018. Available at: https://files.ontario.ca/joint_summary_results_report_english_2018-02-28.pdf.
[4] Office of the Auditor General of Ontario, 2014 Annual Report (s. 3.11), 2014. Available at: http://www.auditor.on.ca/en/content/annualreports/arreports/en14/311en14.pdf.

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and bio-mass conversions ($9.2 billion above market price)[5], and conservation programs ($2.3 billion from 2014-2016 to reduce consumption while the province has surplus supply of low-carbon electricity).[6]

None of this spending was subject to the normal oversight mechanisms of public finance or independent energy regulation.

When these expenditures started to show up on customers' electricity bills, the government enacted the Fair Hydro Plan (FHP), which involves borrowing money, often from foreign investors, to finance a short-term reduction in electricity bills. The net cost of the FHP's short-term rate reduction is $21 billion to electricity customers and another $69-to-$93 billion to provincial tax-payers over the term of the FHP. [7]

But the FHP does nothing to manage the total costs currently incurred or control costs in the future. To the contrary, the province continues to spend on electricity resources -- and is planning additional resources -- despite record high electricity surpluses. Future costs are expected to rise, at a minimum, of 6.8 percent annually starting in 2027.

Instead of repairing the problems that led to unsustainable costs, the FHP perpetuates the current system by putting the government in charge of determining both the total cost of monthly electricity bills and how these costs should be allocated among customers.

[5] Office of the Auditor General of Ontario, 2015 Annual Report (s. 3.05), 2015. Available at: http://www.auditor.on.ca/en/content/annualreports/arreports/en15/3.05en15.pdf.
[6] Ibid.
[7] Financial Accountability Office, An Assessment of the Fiscal Impact of the Province's Fair Hydro Plan, May 24, 2017. http://www.fao-on.org/web/default/files/publications/Fair%20Hydro/Fair%20Hydro%20Plan.pdf.

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The need for reform: Establishing stronger independent oversight of energy-related decisions is key

There is no requirement that any of these policy choices or de facto public spending are subject to either independent oversight or cost/benefit analysis.

Provincial spending on infrastructure as well environmental and economic development policies would normally be subject to the oversight of public accounts, involving estimates of expenditures, a provincial budget and financial accountability to lenders who finance these costs. But electricity system spending is outside of this system.

Instead, electricity spending is paid for by costs imposed by energy agencies: the Independent Electricity System Operator ("IESO") and the Ontario Energy Board ("OEB").

The original purpose of both of these agencies was to efficiently manage electricity system costs. The IESO was given power to procure and recover the costs of resources needed to manage the electricity system, including both generation and conservation, and the OEB was given power to set rates for monopoly transmission and distribution services. In virtually all North American jurisdictions, procurements requirements are overseen by public utility regulators.

However, in Ontario, the IESO is subject to control only by the government, which has directed all of its procurements. While some of these procurements paid to meet the needs of electricity customers, many were to meet non-electricity related goals, hence the over-supply and above market costs. In other words, the agencies, which are supposed to act in the interests of electricity customers, have instead been designed to facilitate the government's spending or policy preferences.

Given the lack of oversight and good governance, the resulting over-spending was predictable, and perhaps even inevitable. If current and future costs are going to be managed, the province needs to change this approach.

How to move forward

There appear to be two paths to do this: (1) transfer financial responsibility of the electricity system to the provincial accounts so they can be managed like other infrastructure and social spending; or (2) make these expenditures subject to independent review so that the OEB is given the authority to conduct cost/benefit analysis of its procurement and spending choices. This would normalize our system so that IESO procurements are subject to regulatory, not political oversight.

The latter would be preferable given that it would better inoculate long-term operating and capital decisions from short-term politics. It would ensure that energy policy is more transparent and accountable and principally focused on the best interest of ratepayers. The OEB could review proposals for energy supply and demand resources and what procurements are needed to meet basic energy needs rather than other policy or political objectives. These choices would henceforth be rooted in clear evidence based on the OEB's review processes. In so doing, this new system of independent oversight would help to strengthen public trust and confidence in the system, and permit greater certainty and predictability for Ontario households and businesses.

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