

ONTARIO ENERGY BOARD

IN THE MATTER OF a proceeding initiated by the Ontario Energy Board to make certain determinations respecting conservation and demand management (“CDM”) activities as described in the Electric Distribution Rates (“EDR”) Handbook and Total Resource Cost (“TRC”) Guide pursuant to sections 19(4) and 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Schedule B (“OEB Act”)

**WRITTEN REPLY FILED ON BEHALF OF
ONTARIO ENERGY BOARD STAFF**

January 16, 2006

INTRODUCTION

1. At the conclusion of hearing submissions in this proceeding on December 22, 2005, the Board Panel offered all parties an opportunity to provide written reply to the various oral and written submissions made by other parties. This Board Staff reply submission is not intended to re-argue the points previously made by Staff in its written submission provided to the Board on December 20, 2006, but rather to reply to select issues that arose during the proceeding.

ISSUES

2. Board Staff has identified three issues that it wishes to address in reply. The first is whether it is appropriate for the Board to invoke s. 83 of the OEB Act to mandate standards and criteria for CDM spending in this proceeding. The second relates to the application of the prudence test to determine whether and when it would be appropriate for the Board to order an LDC to spend money on CDM in a greater amount than the amount proposed by the LDC. In particular, Board Staff will address assertions made by some intervenors during the proceeding that suggest the application of a prudence test for the purpose of evaluating proposed CDM expenditures is out of the ordinary or unconventional as well as their proposal that the Board apply some sort of “looser” type of prudence test for the proposed CDM spending. The third provides clarification on issues related to the TRC Guide.

OEB Act - Section 83

3. In his submissions on behalf of Pollution Probe, Mr. Klippenstein quoted s. 83(1) of the OEB Act.¹ That section reads as follows:

“The Board may establish standards, targets, and criteria for evaluation of performance by generators to whom section 78.1 applies, transmitters, distributors and retailers.”

¹ Transcript, page 78, lines 5-11.

4. Mr. Klippenstein pointed out that this section empowers the Board to set targets and criteria, including setting targets and criteria for spending on CDM over and above the third tranche spending to which LDCs have committed.
5. Section 83(1) does provide the Board with such power, which the Board may exercise as it determines appropriate. However, it is submitted that this proceeding is not the appropriate place to set those standards.
6. This proceeding was commenced in the context of the 2006 LDC rate applications and specifically, as a result of parties other than the LDCs requesting that the Board mandate that LDCs make CDM expenditures in amounts greater than those proposed by the LDCs in their rates. The purpose of this proceeding is to produce a binding generic order with respect to this issue and two other related issues for the purpose of setting 2006 distribution rates. The purpose of this proceeding *is not* to invoke the Board's broad powers to set standards and criteria. The procedural order reflects the purpose of this proceeding. It states:

“The Board’s Report on the 2006 EDR Handbook (RP-2004-0188) stated that the Board would not mandate a minimum expenditure target of LDC spending on CDM programs. The Board also stated that an LDC may apply for spending on CDM as part of its 2006 distribution rates applications, but that such spending must meet the TRC test established in the TRC Guidelines. The issue in this proceeding is whether the Board should order an LDC to spend money on CDM programs in an amount that is different from the amount proposed by an LDC in a test year and, if so, under what circumstances?”

7. As a result, parties to the proceeding were not asked to provide, and did not provide, evidence with respect to appropriate standards and criteria to guide the Board in exercising its powers pursuant to s. 83(1). The Board therefore has no evidence before it upon which to determine such standards and criteria

8. This proceeding was commenced to provide distributors and rate payers with simple and clear direction from the Board about how rates will be set for 2006. It would be confusing and counter productive to transform it into a s. 83(1) investigation.

Prudence Test

9. In its argument in chief, Board Staff submitted that, if a party chooses to challenge an LDC's expenditures on CDM, the party should have to demonstrate that the failure to make the CDM expenditures was imprudent. Board Staff expounded upon the prudence test as follows:

“...what this means is that there is a presumption that the proposed expenditures are prudent, and that presumption is only overcome when there is specific evidence that the LDC acted unreasonably. So it is a strong presumption – not a conclusive presumption, but a strong presumption – in favour of the LDCs' proposed expenditures on CDM.”²

10. Board Staff went on to provide suggested guidance as to when the Board may determine that an LDC has made an unreasonable investment. In others words, under what circumstances a third party can be found to have rebutted the presumption of prudence. In this respect Board Staff submitted that:

“...the failure to invest in a CDM initiative should only be found to be imprudent where it can be demonstrated that an investment in CDM would have been a more cost-effective investment than an investment in distribution services to serve load.”³

11. This test amounts to an articulation of the legal prudence test that is regularly used by the Board and has been used by the courts. Although no party challenged the articulation of the prudence test put forward by Board Staff, some parties suggest

² Transcript, page 14, lines 18-24.

³ Transcript, page 15, lines 14-18.

that its application in the context of CDM expenditures would be unusual.

Specifically:

- In her submissions on behalf of the Coalition of Large Distributors (“CLD”), Ms. Newland characterized the use of a prudence review as “an unusual type of proceeding”.⁴
- In his submissions on behalf of Pollution Probe, Mr. Klippenstein suggested that the application of the prudence test is “at best an unnecessary complexity and at worst, or in reality, a very bad mistake”.⁵ He also suggested that the prudence test was a “complicated add-on” and was “legally mistaken”.⁶
- In his submissions on behalf of the Vulnerable Energy Consumers Coalition (“VECC”), Mr. DeVilles stated that the approach advocated by Staff “would unduly complicate rates proceedings that are already, in some people's views, excessively complicated. It would also present a parallel test of prudence in addition to the TRC Guide.”⁷
- In his submissions on behalf of School Energy Coalition (“SEC”), Mr. Shepherd suggested that the prudence test is “too mechanistic”, that it gives up “flexibility for certainty”⁸ and that the application of the test would be a “shockingly narrow view”⁹ of the Board’s role. He advocated that the Board should take a higher level look at “how well run the

⁴ Transcript, page 35, line 22.

⁵ Transcript, page 86, lines 12-13.

⁶ Transcript, page 87, lines 2-3.

⁷ Transcript, page 167, lines 3-7.

⁸ Transcript, page 139, line 17.

⁹ Transcript, page 136, lines 19-20.

distribution business is, how sensible the management judgements are that are being proposed.”¹⁰

12. Board Staff sees no basis for the suggestion by some parties that the application of a prudence test to determine when an LDC should be required to make additional expenditures on CDM is somehow unusual or exceptional or that it outside of the normal purview of the Board’s role in rate-setting. It is well established, within the context of a rate proceeding, that utilities may only recover prudently incurred costs. The prudence test is simply an articulation of the analysis that is always conducted to determine what are “prudently incurred costs”. It is not a new concept. In fact, it is routinely used by the Board to determine the appropriateness of utility expenditures. A prudence review is therefore implicit in every rate case.

13. The submissions of VECC, SEC and Pollution Probe suggest that there are two ways to review utility expenditures: one is the prudence test (which they dismiss as legalistic and mechanistic); and the other is some kind of looser determination of how well a utility is run. In other words, the idea being put forward – for the first time in a rates case as far as Board Staff is aware – is that the Board conducts two types of analysis: a strict prudence test and a loose prudence test. Board Staff does not agree that there is such thing as a loose prudence test and submits that there are good reasons that the Board should be reluctant to develop one here.

14. The Board’s job in reviewing utility expenditures is not a general supervision of utility management. Engaging in such a process would lead to interminable hearings where judgements of utility management are second guessed at every turn. This proposed loose test is unconstrained by a focussed and disciplined review of whether prudently incurred expenditures ought to be passed through to customers. Adopting the loose prudence test would create a new regulatory role for the Board and intervenors which, it is submitted, could be troublesome.

¹⁰ Transcript, page 136, lines 23- 25.

15. In addition, Pollution Probe's suggestion that utilities should be directed to make every expenditure that would pass the TRC test is equally unconstrained. The open-ended nature of this approach is described at paragraph 28 of Board Staff's submission and will not be repeated here.

16. It is important however, to appreciate the different functions of the TRC and the prudence tests in setting rates. The TRC Guide is primarily concerned with providing certainty for utilities in making investments in CDM. It provides a formula that may be applied prospectively to expenditures so that utilities that follow this formula are not subject to the risk of having their decisions subject to a retrospective review. Seen this way, and to this extent, passing the TRC test amounts to "deeming" that certain expenditures are appropriate. The TRC test is therefore, primarily aimed at forward-looking predictability and provides certainty to the utility in making decisions about CDM expenditures.

17. The TRC test is not designed to be used to challenge utility decision making. When utility decision making is challenged, restrictions are required so that the challenge is not open-ended. What this means is that the utility expenditures that comply with the TRC Guide are not subject to retrospective review. It also means that utility expenditures that are made outside of the TRC test are subject only to challenges based on prudence.

18. For all of these reasons, Board Staff submits that the time-tested and well established prudence test, as articulated by the Board in its decision in RP-2001-0032 and as reiterated by Board Staff in its submission of December 20, 2005 in this proceeding, continues to apply when a party or the Board challenges an LDC's expenditures, including CDM expenditures.

TRC Guide – Free Ridership

19. Board Staff would like to clarify two issues that arose during the hearing in relation to free ridership rates. First, in its oral submissions, Energy Probe expressed concern relating to Board Staff’s position on assumptions for free ridership values.¹¹ Energy Probe did not elaborate on the nature of its concern except to say that it related to paragraph 56 of Board Staff’s submissions. The intent of Board Staff’s statement in paragraph 56 was to highlight that fixed values for free ridership assumptions do not always work to the advantage of the utility. By their very nature, individual program assumptions will likely be inaccurate. The point that Board Staff makes in this paragraph is simply that because LDC’s will be implementing a portfolio of CDM programs, on the whole, the assumptions will yield acceptable and fair results to ratepayers.
20. Second, CCC indicated that the Board’s definition of free ridership in the TRC Guide is unclear.¹² Board Staff respectfully disagrees. In the TRC Guide, a free rider is defined as “a program participant who would have installed a measure on his or her own initiative even without the program”. In Appendix A to the TRC Guide, the Board further clarifies this definition by adding, that “this participant simply uses the program to offset the cost of installing or undertaking the energy efficient initiative”.¹³ The second part of the definition builds on the first portion and provides an example. Board Staff submits that this definition is clear and no further work is required on the issue.

TRC Guide – Process for Updating the Document

21. Many parties indicated support for a process to update the TRC Guide with the best available information. Board Staff supports this concept and submits that the process can be informed by work recently completed or committed to by the OPA.

¹¹ Transcript, page 130, lines 18-28.

¹² Transcript, page 146, lines 24-27.

¹³ TRC Guide, Appendix A, p.iii

Specifically, the information derived from the following OPA reports and initiatives may greatly assist the process of updating the fixed assumptions in the TRC Guide:

- a report released recently by the OPA entitled *Technology Assessment Study and TRC Analysis*¹⁴ dated December 2005;
- the OPA's offer to "undertake research that would encourage the refinement of the default free rider estimates;"¹⁵ and
- the completion of the OPA's pending study that will evaluate the "design and delivery of the LDC's own programs."¹⁶

Board Staff maintains its commitment to fixed assumptions for free-ridership values in the TRC Guide and submits that the continual improvement of the accuracy of these values will be of benefit to LDCs and to ratepayers.

ALL OF WHICH IS RESPECTFULLY SUMMITTED by the Ontario Energy Board Staff this 16th day of January, 2006.

¹⁴ Ontario Power Authority, December 2005, *Technology Assessment Study and TRC Analysis*, available at: http://www.powerauthority.on.ca/Storage/19/1491_Technology_Assessment_Study_and_TRC_Analysis.pdf

¹⁵ Written Submission of OPA, December 20, 2005, page 4.

¹⁶ Transcript, page 173, lines 2-3.