



**Canadian
Manufacturers &
Exporters**

Ontario Division

**Electricity Conservation and Demand Management Activities
(CDM)**

EB-2005-0523

Canadian Manufacturers & Exporters

Submission

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1.0 Introduction

- 1.1 CME members represent 75% of all manufactured output in Canada (Ontario) and 90% of exports. Although many CME members are large corporations, nearly 80% are small to medium sized companies (SMEs).
- 1.2 Energy (commodity and distribution) costs are an important and growing component of the cost of doing business for manufacturers.
- 1.3 The Ontario Energy Board (OEB) on its own motion initiated a proceeding with respect to the conservation and demand management (CDM) activities of electricity Local Distribution Companies (LDCs).
- 1.4 The issues in this proceeding are:
 - 1.4.1 Whether the Board should order an LDC to spend money on CDM programs in an amount that is different from that proposed by the LDC in a test year and, if so, under what circumstances.
 - 1.4.2 Whether, with respect to section 2.1 of the TRC Guideline, the Board should require LDCs to demonstrate free-rider levels for all CDM programs on a program-by-program basis.
 - 1.4.3 Whether with respect to section 2.2 of the TRC Guideline, the Board should order that an LDC is only entitled to claim incremental benefits associated with its participation in a CDM program with a non-rate regulated third party.
- 1.5 Six intervenors – Green Energy Coalition (GEC), Pollution Probe (PP), Newmarket Hydro Ltd. (NHL), Enbridge Gas Distribution Inc. (EGD), Low Income Energy Network (LIEN), and Hydro One Networks Limited (HONI) – submitted affidavits and/or cross-examination testimony on some or all of these issues.
- 1.6 CME’s submission responds to this evidence and to the issues posed by the Board.

2.0 OEB Mandated CDM Spending

Issue

- 2.1 Should the Board order an LDC to spend money on CDM programs in an amount that is different from that proposed by the LDC in a test year and, if so, under what circumstances?

Positions of Parties

- 2.2 Figure 1 compares CME’s position on this issue with that of GEC, PP, NHL HONI, LIEN and EGD.

Figure 1 CDM Issues: Positions Compared

| Issue | CME | NHL | HONI | GEC | LIEN | PP | EGD |
|------------------------------|-----|-----|------|-----|-------------------------|-------------|-------------|
| OEB mandate LDC CDM spending | No | No | No | Yes | Yes but low income only | No position | No Position |

Newmarket Hydro's (NHL) Position

- 2.3 NHL opposes the Board mandating CDM spending on LDCs and suggests the Ontario Power Authority (OPA) “is mandated to both *conduct independent planning* for demand management and conservation of electricity, and to directly contract for and *engage in activities* that promote or facilitate these ends.”¹
- 2.4 NHL proposes that:²
- 2.4.1 “Relevant electricity CDM initiatives be designed, developed, co-ordinated, implemented, and monitored on a Province-wide basis by a responsible provincial body or bodies.”
- 2.4.2 All LDCs charge a common conservation charge.
- 2.4.3 LDC should facilitate local implementation and delivery of provincial CDM initiatives, as well as specific LDC system initiatives in their service areas.
- 2.4.4 The Board maintain a focussed role on the prudence and cost effectiveness of LDC proposed CDM expenditures, rather than on a piecemeal basis in LDC rate hearings.

HONI Position

- 2.5 Likewise, HONI is opposed to the Board mandating additional LDC CDM spending “through third tranche funding.”³ Among other things, HONI states:
- 2.5.1 “It would be unusual and unprecedented for the Board to order an LDC to spend money on CDM programs in an amount that is different from the amount proposed by an LDC, particularly if the order is to spend more money than the LDC has requested (or more than has already been approved in the case of third-tranche CDM funding).”⁴
- 2.5.2 “It would be prudent to allow LDCs to ramp up their CDM programs and budgets in a measured way and studied manner ... (and that) changes to the (transitional) framework developed for so-called third-tranche CDM funding ... ‘after the fact’ would increase the level of risk for LDCs”⁵
- 2.5.3 “There is considerable uncertainty regarding (among other things) the on-going role of LDCs and the CDM activities they should be pursuing vis-à-vis the OPA, the IESO and other entities.”⁶

¹ Affidavit, Newmarket Hydro Ltd., December 2, 2005, page 8, paragraph 17

² *ibid*, page 5, paragraph 12.

³ EB-2005-0523, Cross Examination of Todd Williams, December 9, 2005, page 8, lines 22 to 25.

⁴ *Op. cit.* page 3, paragraph 13.

⁵ HONI Affidavit, Todd Williams, December 2, 2005, page 2, paragraph 10.

⁶ *ibid*, page 2, paragraph 11.

- 2.5.4 The Board’s decision and order in EB-2005-0315 states: “the Board’s authority ‘does not extend to ordering LDCs to engage in specific demand management activities’”.⁷
- 2.5.5 LDCs “do not feel that it would be prudent for them to increase their CDM budgets at this time (and) ... they are not fully comfortable they would be able to clearly demonstrate the prudence of any additional CDM spending, which would be imprudent.”⁸
- 2.5.6 “A lot of LDCs have concerns about their ability to demonstrate the prudence of their CDM expenditures”.⁹

LIEN Position

- 2.6 LIEN estimates that just over 14% of Ontario residents live at or below the pre-tax, post low-income cut-offs; and is, it suggests, a widely accepted Canadian measure of poverty.¹⁰
- 2.7 LIEN identifies four groups of low-income consumers:
- 2.7.1 Social housing – where social housing providers pay most electricity bills.
 - 2.7.2 Private tenant housing - where electricity is included in rent and the low-income consumer does not pay electricity bill directly.
 - 2.7.3 Private tenant housing - where the electricity is paid directly by renters.
 - 2.7.4 Private homeowners – where the low-income consumer pays electricity bills directly.¹¹
- 2.8 LIEN presented no evidence of how the 14% of Ontario residents are distributed among these four groups, but it does say that only two of the four groups contain low-income consumers that pay electricity bills directly.
- 2.9 LIEN asserts that “low-income customers cannot afford to pay the costs of any electricity upgrade: the typical uncommitted disposable income to buffer interruptions or face unexpected expenses of low-income households in Ontario is around \$200 per year.”¹²

⁷ Op. cit. page 5, paragraph 20

⁸ Op. cit. page 5, paragraph 21

⁹ EB-2005-0523, Cross Examination of Todd Williams, December 9, 2005, page 29, lines 2 to 4.

¹⁰ LIEN Affidavit, David Heeney, December 2, 2005, page 3

¹¹ LIEN, op. cit., page 3

¹² LIEN, op. cit., page 9

Mandate only for Low-Income Consumers

- 2.10 LIEN does not support the Board ordering LDCs to spend more money on all CDM programs only on low-income programs, where an LDC does not have programs specifically designed for such customers.¹³
- 2.11 Even here, LIEN would excuse the LDC if there were “special circumstances where they have reason not to have low-income programs”.¹⁴
- 2.12 With respect to the Board ordering LDCs spend more CDM money in areas other than for low-income groups, LIEN is uncertain and suggests, at best, the Board should “prod” an LDC to further CDM spending in particular areas rather than directing them to do so.¹⁵

GEC (Neme) Position

- 2.13 GEC alone recommends that the Board should order all LDCs to spend more money on CDM programs. Specifically, GEC recommends that the Board:
- 2.13.1 Issue a policy directive to require LDCs to pursue and acquire all CDM resources that are cheaper than supply alternatives.
 - 2.13.2 Lower an LDC’s rate of return for “failure ... to achieve adequate levels of cost effective CDM”
 - 2.13.3 Order electric LDCs to increase spending on end use efficiency components of CDM to at least 1% of total (distribution and commodity) revenues in 2006.
 - 2.13.4 Advise LDCs that it expects LDCs to spend approximately 2% of total revenues on efficiency programs in 2007 and 3% in 2008.
 - 2.13.5 Expects LDCs to develop portfolios of efficiency programs that collectively balance and address three goals:
 - 2.13.5.1 Short-term resource acquisition.
 - 2.13.5.2 Long-term market transformation; and
 - 2.13.5.3 Equitable access to programs for all customers.

CME Position

- 2.14 Set out below is CME’s response to the recommendations and comments in the various affidavits on the mandating issue.
- 2.15 In general, CME opposes all of GEC recommendations, with the exception of 2.11.5.3 and all of LIEN’s recommendations.

¹³ LIEN Affidavit, David Heeney, December 2, 2005, page 5

¹⁴ EB-2005-0523, Cross Examination of David Heeney, December 9, 2005, page 4, line 25, page 5, line 1

¹⁵ EB-2005-0523, Cross Examination of David Heeney, December 9, 2005, page 9, lines 6 to 16.

- 2.16 CME is opposed to the Board mandating higher levels of CDM spending than applied for by a utility, whether an electrical or a natural gas LDC.
- 2.17 However, if after a proceeding, the Board determines that elements of an LDC's CDM program are not cost effective, CME recommends the Board disallow programs, which on the evidence are not cost effective CDM expenditures.

Arguments Against Mandating

- 2.18 CME's position is based on the following:
- 2.18.1 The OEB does not have the authority to mandate additional CDM spending by an LDC.
- 2.18.2 The Board appears to share this view when, in EB-2005-0315, it stated:
- 2.18.2.1 "The Board does not have the authority to order either the OPA or the LDCs to take greater measures."¹⁶
- 2.18.2.2 "The Board's authority respecting LDCs' CDM activities is with respect to rates. Under the Ontario Energy Board Act, 1998, the Board sets LDC rates for distribution and retail supply. ... It does not extend to ordering LDCs to engage in specific demand management activities."¹⁷
- 2.18.3 The Board does not have the expertise to make judgements as to which CDM programs are cost effective in an LDC's service area and, in any event, such intervention would be the worst kind of micro management.
- 2.18.4 Further, in its report on the EDR Handbook, the Board stated that it is difficult to define with precision the optimum level of spending on CDM.¹⁸
- 2.18.5 CDM spending increases ratepayer costs. If the OEB mandated higher levels of CDM spending it would, in effect, be taxing ratepayers for services they may not want and for which they have no recourse.
- 2.18.6 The Board has an obligation to set just and reasonable rates. CDM expenditures that are not cost effective that may arise from the Board mandating a higher level of spending would not comply with this legal obligation.
- 2.18.7 Further, LDCs are not the best vehicles for delivering CDM programs. LDCs have an inherent conflict of interest with respect to CDM programs and their distribution business. In the natural gas arena this conflict has

¹⁶ EB-2005-0315, Ontario Energy Board Decision and Order, page 11.

¹⁷ Ibid page 10

¹⁸ RP-2004-0188, 2006 EDR Handbook, Report of the Board, May 11, 2005, page 104

resulted in the development of perverse techniques to overcome this conflict, such as LRAM¹⁹ and SSM²⁰. These techniques result in ratepayers paying higher rates.

2.18.8 It is not in the public interest to compound the mistakes of the natural gas arena by replicating such schemes for electricity LDCs.

2.18.9 Moreover, the Ontario Power Authority (OPA), not the OEB, is the body mandated to determine how much CDM is appropriate within the context of an Independent Power System Plan.²¹

2.19 Indeed, the OPA’s strategic objective #3 is to Develop, Coordinate and Stimulate Electricity Conservation and Demand Management.²²

Other Issues Raised in Affidavits

2.20 Below are CME’s comments on other issues prompted by the affidavits and/or the related cross-examination testimony.

Utility vs. Central Agency Model

2.21 GEC and NHL posit two different views of how CDM programs should be planned and delivered in Ontario.

2.22 GEC and LIEN appear content with utilities delivering CDM programs, provided they are directed to increase the amount they spend.

2.23 NHL, on the other hand, favours “electricity CDM initiatives (being) designed, developed, co-ordinated, implemented, and monitored on a Province-wide basis by a responsible provincial body or bodies” and suggests the OPA should be the responsible body.²³

2.24 Indeed, NHL revisits an issue considered by the OEB staff in its January 23, 2004 report to the Board entitled “Demand-Side Management and Demand Response in the Ontario Energy Sectors”, namely whether Ontario’s CDM activities should be conducted under the “utility” or “central agency” model.²⁴

2.25 HONI is clearly concerned about what it believes “is considerable uncertainty regarding ... the ongoing role of LDCs and the CDM activities they should be pursuing vis-à-vis the OPA, the IESO and other entities’.

2.26 Figure 2 illustrates the two models.

¹⁹ LRAM = lost revenue adjustment mechanism.

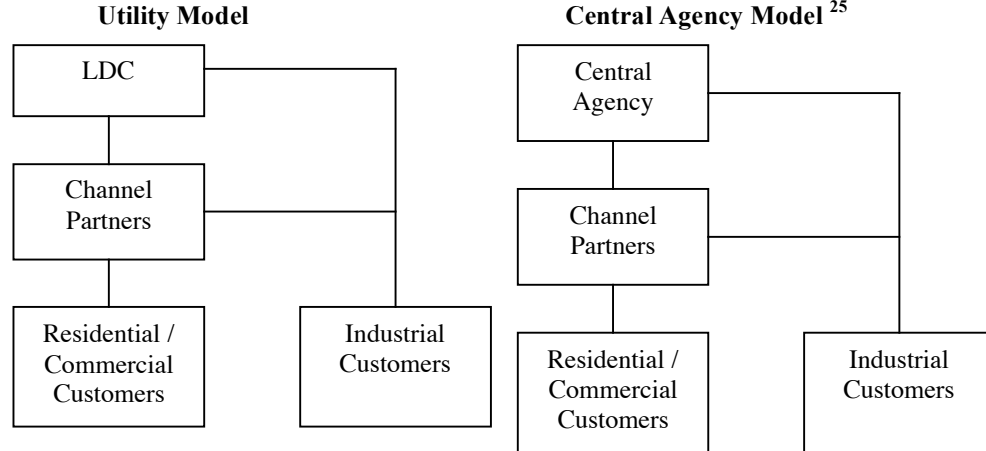
²⁰ SSM = shared savings mechanism

²¹ Part 11.1 of The Electricity Restructuring Act, 2004

²² Ontario Power Authority, Evidence EB-2005-0489, Exhibit B, Tab 1, Schedule 1, Page 1.

²³ Newmarket Affidavit, December 2, 2005, page 5, paragraph 12

²⁴ Staff Report to the Board, “Demand-Side Management and Demand Response in the Ontario Energy Sectors”, January 23, 2004, pages 13 to 16.

Figure 2

- 2.27 The Board, in its report to the Minister of March 1, 2004, recommended: “that a conservation agency oversee demand-side management and demand response activities in Ontario’s electricity sector” and listed a number of responsibilities for the agency and the role of LDCs.²⁶
- 2.28 In 2004, CME declared that it was indifferent to either a Central Agency or Utility model, provided that:
- 2.28.1 There should be no LRAM.
- 2.28.2 If a DSMVA is in place, along with an incentive mechanism (e.g., SSM), the volumetric target should be adjusted proportionate to the additional DSMVA budget used.
- 2.28.3 If an incentive mechanism (e.g., SSM) is in place, the incentive should not be based on a TRC calculation.
- 2.28.4 There should be no dedicated CDM charge or tax on either electricity or natural gas consumers.

Defaulted to Utility Model

- 2.29 Since the Board’s March 1, 2004 report to the Minister, Ontario appears to have defaulted to the utility model, with the Board’s active involvement. Some reasons for this include:
- 2.29.1 Notwithstanding their mandates, the OPA and the Conservation Bureau have not taken an active role in electricity CDM. Indeed, the OPA’s 2006

²⁵ The Agency model could take a variety of forms. See 3.3 of the OEB staff report.

²⁶ “Demand-Side Management and Demand Response in the Ontario Electricity Sector”, Report of the Board to the Minister of Energy, March 1, 2004, pages 8 and 9.

fees application, and the related December 8, 2005 Technical Conference, suggest that they do not intend to do so anytime soon.

- 2.29.2 The OEB approved LDC CDM plans arising from the dedication of the third tranche of the market adjusted revenue requirement (MARR).
- 2.30 Assuming that mandated CDM programs are to be the norm in Ontario, CME sympathizes with NHL's position in support of a central agency model, given the experience gained with:
- 2.30.1 The utility model since the Board's report to the Minister and the LDC CDM plans put in place since then.
- 2.30.2 The uneven levels of CDM sophistication among LDCs; and
- 2.30.3 The regulatory burden that could arise if there are over 90 LDC CDM plans.
- 2.31 CME's support for the agency model, however, is conditional on the caveats set out in paragraph 2.28 above applying to the agency model.
- 2.32 However, if it is determined that LDCs are to plan and deliver CDM programs, each LDC should be responsible for determining the level of CDM spending that it believes is appropriate and is cost effective. This level of CDM spending should then be brought forward in the LDCs rate application and be subject to regulatory review.

Enforced and Level of Ratepayer CDM Spending

- 2.33 As part of the central agency model, NHL favours the imposition of "one conservation charge in the rates charged by all Ontario LDCs to their customers, which would include all conservation or demand side management initiatives",²⁷
- 2.34 In varying degrees, both GEC and LIEN, favour governmental intervention to enforce CDM spending and impose that cost on ratepayers.
- 2.35 LIEN does not indicate a particular level of spending on low-income CDM spending. It only suggests by implication that it should be considerable and indeed that CDM grants to low-income consumers should be close to 100%, since low-income consumers have only \$200 per year of disposable income for all contingencies.²⁸
- 2.36 GEC, on the other hand, recommends that the Board order LDCs to increase their CDM spending to at least 1% of total revenues (distribution and commodity) in 2006, 2% in 2007 and 3% in 2008.²⁹ CME strongly opposes this recommendation.
- 2.37 CME opposes both NHL's one conservation charge in rates, and GEC's proposal to link CDM spending to a percentage of an LDC's revenues.

²⁷ Op. cit. Newmarket Hydro, page 5, paragraph 12(b)

²⁸ LIEN, op. cit. page 9

²⁹ GEC Affidavit, Chris Neme, page 16

- 2.38 If the government wishes to mandate CDM spending in either of both the electrical and natural gas sectors, the funds for this spending should be provided from the tax base and approved by the Legislature. Ontario's utilities should not be used as a conduit to avoid Legislative approval of what in effect it is an energy conservation tax.

Component of a CDM Budget

- 2.39 If the Board orders LDCs to spend a percentage of their distribution and commodity revenues on CDM, as recommended by GEC, and allows LDCs to be eligible for LRAM and SSM, CME urges the Board to establish clear rules as to what constitutes a CDM budget.
- 2.40 The cost causality principle suggests a CDM/DSM budget has four components: a CDM program budget, including administration and research; CDMVA costs; LRAM costs, and SSM costs.
- 2.41 Figure 3 illustrates the total cost to ratepayers of a CDM budget when all four cost components are taken into account and assumes that over a 3-year period an LDC's:
- 2.41.1 CDM program budget is \$20 million a year.
- 2.41.2 CDMVA is 20% of the program budget, i.e., \$4.0 million.
- 2.41.3 LRAM is \$5.0 million in a full year, or \$2.5 million in the first year.
- 2.41.4 SSM is \$8.0 million per year.
- 2.42 Given these assumptions, the CDM cost to ratepayers in year 1 would be \$34.5 million, in year 2 it would be \$39.5 million, and in year 3 it would be \$44.5 million.
- 2.43 CME urges the Board to rule that, based on the cost causality principle, CDMVA, LRAM and SSM costs be included in the calculation of a CDM budget, including accumulated LRAM costs from previous years.

Figure 3 Illustrative CDM Costs – 2006 to 2008

| | <u>CDM Budget Component</u> | <u>2006 \$ Million</u> | <u>2007 \$ Million</u> | <u>2008 \$ Million</u> |
|---|------------------------------|------------------------|------------------------|------------------------|
| 1 | Program Budget | 20.0 | 20.0 | 20.0 |
| 2 | CDMVA | 4.0 | 4.0 | 4.0 |
| 3 | 2006 LRAM ³⁰ | 2.5 | 5.0 | 5.0 |
| 4 | 2007 LRAM | - | 2.5 | 5.0 |
| 5 | 2008 LRAM | - | - | 2.5 |
| 6 | SSM | 8.0 | 8.0 | 8.0 |
| 7 | <u>Total 2006 DSM Budget</u> | <u>\$34.5</u> | <u>\$39.5</u> | <u>\$44.5</u> |

- 2.44 Further, if LDCs are to be allowed an LRAM, CME urges the Board to require LDCs to show the total amount of LRAM included in their rate applications, not just the variance, and to include this amount in the CDM budget being sought.

³⁰ The \$2.5 million 2006 LRAM is half the assumed total LRAM for that year. The full year 2007 LRAM attributable to 2006 DSM activities would be \$5.0 million. The same applies to 2008.

Central Planning (Government Intervention) vs. Market Forces

- 2.45 Two different economic models are at play in this proceeding: a central planning (government intervention) model and a market forces model.
- 2.46 GEC, LIEN, and NHL assume electricity consumers will not invest in energy conservation, or at least not invest enough in response to rising energy costs, and that government intervention is needed to force consumers to pay for a range of CDM programs that may or may not be of direct benefit to them. This line of thinking espouses a “we know best” central planning ideology.
- 2.47 CME rejects the central planning model.
- 2.48 In CME’s view, the Board should not endorse mandated CDM spending and, instead, should opt for a “let the market place work” approach, with consumers deciding for themselves the appropriate level of conservation and demand management they believe is in their best interest, based on their reaction to the price of electricity.
- 2.49 If the Board does endorse mandated CDM spending, it has an obligation to ratepayers to explain and justify why that approach is better than letting the market place determine the appropriate level of CDM investment.

Electricity Shortage

- 2.50 GEC posits as a key element of its rationale the notion that “Ontario is facing a major capacity short-fall over the next 15 years”. While that may be a reality, GEC ignores the fact that much of that shortfall is the result of the government’s off-coal policy.

Distribution Ratepayers charged with reducing supply

- 2.51 GEC believes that: “in the end, all spending decisions should be guided by the basic premise that CDM should be aggressively pursued whenever demand-side management resources are cheaper than their supply-side alternatives.”³¹
- 2.52 In effect, according to GEC, electricity distribution ratepayers should invest to reduce supply-side investments that otherwise might need to be made, even if these investments are owned by other legal entities. This line of thinking is indicative of a central planning mentality.
- 2.53 The central planning model assumes that electricity consumers do not make rational decisions to protect their economic interests.
- 2.54 CME members have already made, and are continuing to make, significant cost effective CDM investments.
- 2.55 CDM spending should only be justified if it is cost effective. The decision as to what is, or is not, cost effective should be left to those who are best able to make those judgements. In CME’s view, individuals, not bureaucrats, are in the best position to make such judgements.

DSM Increases Jobs

- 2.56 GEC states that “DSM investments increase jobs” and suggests that consumers will have more disposable income, which they will spend on other goods and services. Presumably this additional disposable income comes from reduced energy costs.

³¹ GEC Affidavit, Chris Neme, page 5

- 2.57 Suggestions that consumer electricity bills are, or will be, lower as a result of CDM activities are frequently made, but no evidence is ever provided to substantiate that claim.
- 2.58 Although more circumspect, the Board is equally guilty of such thinking when it says that, as a result of CDM programs, ratepayers may in the short-term may pay more, not less. But in the long-term they should pay less. Again, there is no evidence to substantiate that view.³²

Political Support

- 2.59 GEC also states that: “political support for efficiency is strong” and references a speech by the Premier.³³ Contrary to the Premier’s rhetoric, the Government’s policy is to insulate consumers from the true price of electricity, which frustrates the operation of the market place and discourages energy conservation.
- 2.60 Complex, expensive and enforced energy conservation programs are devised to compensate for this interference in the normal market decision-making process where individuals choose their own level of energy conservation investment.

Low-income Consumers

- 2.61 CME disagrees with LIEN’s recommendation that the Board should mandate LDC CDM spending for low-income consumers.
- 2.62 LIEN asserts that, for many low-waged workers and people on social assistance and other income security programs, rising energy prices mean choosing between heating and eating and paying the rent.³⁴
- 2.63 Notwithstanding that emotional rhetoric, CME rejects the proposition that electricity or natural gas ratepayers should supplement social welfare payments.
- 2.64 If low-income consumers have difficulty coping with higher energy prices, the Legislature and/or Parliament should be the source of funding to assist these individuals, not ratepayers.
- 2.65 Indeed, if low-income consumers have only \$200 per year of disposable income available for unexpected expenses, LIEN’s suggestion of a zero free rider rule of thumb for low-income consumers is really academic. Regardless at what level the low-income free rider rate is set, low-income consumers would, according to LIEN, not have money to invest in CDM activities.
- 2.66 Given this, LIEN seems to be implicitly suggesting that low-income consumers should pay nothing for CDM products and technology and the total cost of CDM programs for low-income consumers should be borne by other ratepayers. CME strongly opposes this position, as it is tantamount to LIEN proposing that low-income consumers should get a 100% “free ride”.

³² RP-2004-0188, 2006 EDR Handbook, Report of the Board, May 11, 2005, page 105

³³ Affidavit, Chris Neme, December 2, 2005, page 5.

³⁴ LIEN, op. cit. page 4

3.0 Free Rider Rates³⁵

Issues

- 3.1 At issue is whether, with respect to section 2.1 of the TRC Guideline, the Board should require LDCs to demonstrate free-rider levels for all CDM programs on a program-by-program basis.
- 3.2 Within this issue is a sub issue, namely:
- 3.2.1 Should the most recent free rider rates be used to calculate TRC values or should the free rider rates assumed at the program design stage be “locked-in”, regardless of later knowledge that suggests a different free rider rate?
- 3.2.2 In other words, should free rider rates be used prospectively or retrospectively?

OEB TRC Guide – Section 2.1

- 3.3 Section 2.1 of the Board’s TRC Guide states:
- 3.3.1 Free rider adjustments are one of the key components for the TRC test.
- 3.3.2 Costs and benefits associated with free riders should be assessed as part of the TRC analysis. In determining overall savings, these participants should be excluded from the benefits attributed to the program.
- 3.3.3 The equipment costs associated with these participants should similarly be excluded from cost side of the equation.
- 3.3.4 Free rider estimates should be established through market studies and initial values have been provided in the Assumptions and Measures List.

Positions of Parties

- 3.4 Figure 4 compares CME’s position on this issue with that of GEC, PP, NHL HONI, LIEN, and EGD.

³⁵ **Free riders:** The definition of an energy conservation free rider is different from the definition of a free rider used in economics and political science. For example:

- 1.0 According to the Ontario Energy Board’s Total Resource Cost Guide, page 17, the standard definition of a free rider is “a program participant who would have installed a measure on his or her own initiative even without the program.”
- 2.0 “Free riders are individuals or businesses that purchase energy-efficient products and receive rebates but would have purchased the products on their own without CIP or the rebates.” Office of the Legislative Auditor, State of Minnesota, Evaluation Report, Energy Conservation Improvement Program, Report No. 05-04, January 2005.
- 3.0 In energy conservation a free rider, particularly in the Minnesota definition, is to be encouraged.
- 4.0 On the other hand, a free rider in economics and political science is someone “who takes more than their fair share of the benefits or do not shoulder their fair share of the costs of their use of a resource, involvement in a project, etc.” http://en.wikipedia.org/wiki/Free_rider_problem In this context, a free rider is a pejorative term. Under this definition, and LIEN’s description of the inability of low-income consumers to finance energy efficiency investments, low-income consumers would be 100% free riders, rather the 0% as recommended by LIEN.

Figure 4 CDM Issues: Positions Compared

| Issue | CME | GEC | PP | NHL | HONI | LIEN | EGD |
|------------------------------|-----|-----|-----|-----|------|------|-----|
| Program specific free riders | Yes | Yes | Yes | No | No | No | No |

GEC (Neme) Position

3.5 GEC argues in support of requiring LDCs to demonstrate free rider levels of all CDM programs on a program-by-program basis.

Pollution Probe (Gibbons) Position

3.6 Pollution Probe recommends:

3.6.1 The Board’s TRC Guide’s list of 103 *a priori* free-rider rates should be rescinded.

3.6.2 If a utility wishes to obtain approval for free-rider rates(s) of one or more of its conservation program, prior to program implementation, it must provide the OEB with evidence to support the reasonableness of its proposed free-rider rates; and

3.6.3 Alternatively, when a utility submits its SSM claim, after the end of its fiscal year, it must provide evidence to support the reasonableness of its estimated free-rider rates.³⁶

Enbridge (Brophy) Position

3.7 On the other hand, EGD:³⁷

3.7.1 Supports free rider rates being set prospectively based upon the best information available at the time the rates are set.

3.7.2 Opposes a process whereby free rider rates are subject to challenge based upon information and analysis undertaken subsequent to the year in which the CDM and DSM programs are delivered.

3.8 EGD also:

3.8.1 Cites the Enbridge 2003 Rates Case ADR and the “2003 ADR Rules” as the basis for “calculating TRC savings for the purposes of determining the SSM, program assumptions including free riders will not be changed retroactively.

3.8.2 States intervenors should not be “incented” to bring forwarded after-the-fact information for the purposes of attempting to reduce a utility’s apparent entitlement to claim TRC benefits ... (as this) leads to delay and unnecessarily complicates the regulatory process”.

3.8.3 Deals with free rider rates in two contradictory ways:

³⁶ Affidavit of Jack Gibbons, October 14, 2005, page 9, paragraph 33.

³⁷ Enbridge Affidavit, Michael Brophy, December 2, 2005, pages 2 and 3.

- 3.8.3.1 First, EGD appears to agree that free rider rates should be based on the best available information;³⁸ and that
- 3.8.3.2 Second, EGD states free rider rates should be set prospectively and not be subject to change retroactively.³⁹

NHL Position

- 3.9 NHL believes “It is neither practical nor desirable to require LDCs to demonstrate free rider levels on a program by program basis, particularly where the programs are designed or coordinated on a province-wide basis”⁴⁰ and recommends no change in Section 2.2 of the TRC Guideline is warranted.⁴¹

HONI Position

- 3.10 HONI favours “‘locking-in’ free riders and other measure characteristics up front (as it) provides some certainty regarding cost recovery, lost revenue recovery and potential shareholder incentives.”⁴²
- 3.11 In HONI’s view requiring LDCs to demonstrate free rider rates on a program-by-program basis will delay implementation of CDM programs and divert funds from program implementation. Both of which will reduce the level of customer savings, which could also jeopardize realization of the government’s CDM targets.⁴³

LIEN Position

- 3.12 Among other things, LIEN believes:
- 3.12.1 “The Board should not require LDCs to demonstrate free rider levels for CDM programs on a program-by-program basis”.
- 3.12.2 “The (free rider) rule of thumb estimate for programs specifically targeted at low-income consumers ought to be zero.”⁴⁴
- 3.12.3 That using approved free rider rates should be accepted and that any free rider changes “should be adopted on a going-forward basis, not retroactively (since) ... this reduces the regulatory risk that LDCs face ... (and) there is no evidence of LDCs ‘gaming’ the system to date.”⁴⁵
- 3.12.4 Risk “undermines (an LDC’s) willingness and ability to deliver conservation.”⁴⁶

³⁸ Enbridge Affidavit, page 4, paragraph, 13

³⁹ *ibid*, pages 4 and 5, paragraph 12

⁴⁰ *Op. cit.* page 17, paragraph 29

⁴¹ *ibid*, page 1, paragraph 30

⁴² *Op. cit.* HONI, page 7, paragraph 27.

⁴³ *Op. cit.* HONI, pages 7 and 8, paragraph 31.

⁴⁴ LIEN affidavit, pages 7 and 9.

⁴⁵ LIEN, *op. cit.*, page 9

⁴⁶ EB-2005-0523, Cross Examination of David Heeny, December 9, 2005, page 15, lines 2 and 3.

Issues Raised in Affidavits

- 3.13 Below are CME's comments on issues prompted by the affidavits and/or cross-examination testimony.

CME Position

- 3.14 CME agrees with GEC and Pollution Probe with respect to requiring LDCs to demonstrate free rider levels for all CDM programs on a program-by-program basis.

LRAM and SSM

- 3.15 CME opposes the use of the total resource cost (TRC) methodology for determining the incentive an LDC should receive from its CDM activities and in this disagrees with Pollution Probe's recommendations related to the LRAM and SSM.

TRC is the Wrong SSM Metric

- 3.16 In CME's view, rewarding LDCs on the basis of societal benefits, calculated using a series of questionable assumptions, is the wrong metric.
- 3.17 If there is to be a CDM/DSM incentive, it should not be based on a TRC calculation. A more appropriate metric would be one based on a utility rate of return relative the CDM/DSM program budget.
- 3.18 Utility CDM/DSM service providers, under the current system, recover all of their costs and incur no risk.
- 3.19 In CME's view, there is no logic in linking a utility's CDM incentive to a share of society's future benefits as measured by the TRC, a measure that is increasing rapidly with rising electricity and/or natural gas prices. When energy prices increase, a utility's incentive increases, with no additional effort on its part. This is patently unfair to ratepayers.
- 3.20 In the alternative, if the Board determines that a TRC calculation is to be the basis for determining SSM incentives, CME strongly recommends the Board require LDCs identify free rider levels of all their CDM programs on a program-by-program basis.
- 3.21 As well, the Board has an obligation to explain and justify to ratepayers why LDCs should be rewarded on an estimate of societal benefits, based on assumptions, such as free rider rates, that are highly likely to be wrong.

Raising Incentives

- 3.22 CME also does not agree with Pollution Probe's suggestion that the way to reduce free rider rates is to provide higher incentives.⁴⁷

⁴⁷ Ibid, page 6, paragraphs 23 and 24.

Prospective vs. Retrospective Application

- 3.23 CME disagrees with EGD’s assertion that free rider rates should be set prospectively and not on the basis of the latest available information.
- 3.24 CME also disagrees with the Board’s finding in RP-2003-0133 that “the Board questions the degree to which the company (EGD) can manage free rider participation to achieve higher SSM benefits.”⁴⁸ Such a finding suggests an incomplete understanding of how the SSM system works.
- 3.25 Moreover, when EGD referenced the so-called “2003 ADR Rules”, it failed to mention that the 2003 ADR Settlement was a partial agreement.⁴⁹ CME and Energy Probe opposed that aspect of the settlement.
- 3.26 It is clear that EGD is primarily interested in maximizing the level of the incentives it is able to claim and that it is not interested in the accuracy of its claim.
- 3.27 In CME’s view, CDM (DSM) programs are currently designed to maximize utility incentives. This is an issue to which the Board should give very careful consideration to eliminate LDCs “gaming” the system to reap unconscionably high incentives.
- 3.28 EGD acknowledged that locking in the free rider rate prospectively could result in an SSM based on a higher TRC than it actually delivered. It also stated that the TRC might also be less.⁵⁰
- 3.29 Given rapidly rising energy prices the chances of a free rider rate being lower are remote, indeed.
- 3.30 In any event, from CME’s point of view, the issue the Board needs to address is one of fairness as between LDCs and ratepayers based on using the most accurate information available.
- 3.31 From CME’s point of view, if a higher free rider rate is used at the beginning of a program than, in fact, is justified, then the LDC should be able to use the lower free rider rate if, subsequently, this information come to light. The obverse should equally apply if the subsequent free rider rate is higher than the original assumption.

Regulatory Delay

- 3.32 CME disagrees that using the latest free rider information leads to delay and unnecessarily complicates the regulatory process. There is no evidence to support that assertion.

⁴⁸ RP-2003-0133, Partial Decision with Reasons, “For Rates for 2003 – Demand Side Management”, paragraph 109.

⁴⁹ HONI, Affidavit, page 3, paragraph 12.

⁵⁰ EB-2005-0523, Cross Examination of Michael Brophy, December 9, 2005, page 10 lines 7 to 12

- 3.33 EGD, HONI and LIEN reference the need to reduce LDC risk and/or uncertainty⁵¹ and the reduction in a utility's entitlement to claim TRC benefits⁵² as a result of using the most accurate free rider rates and other TRC variables. The implication being that, in their view, the rules should be structured to keep LDCs harmless, with ratepayers assuming all of the risk and costs.
- 3.34 The OEB has a responsibility to ensure that ratepayer interests are protected against LDC attempts to claim large incentives based on under estimating free rider rates and against an imbalance in the sharing of risk, costs and uncertainty.

Weighing the Evidence

- 3.35 Finally, we should note that both Mr. Williams⁵³ and Mr. Heeney⁵⁴ were authors of the report "Improvements to DSM Incentive Recommendations", commissioned by Enbridge Gas Distribution Inc.,⁵⁵ which supported the use of prospective, rather than retrospective, free rider rates and other variables.
- 3.36 As such, their evidence should be considered "tainted", since as consultants they are highly unlikely to espouse opinions different than their former client.
- 3.37 Given this, even though Mr. Williams and Mr. Heeney may be considered CDM "experts", they are still consultants hired to provide a report for a client. Consultants serve the needs of their clients. Indeed, serving a client's needs is the basis of a good consultant. For these reasons, the Board should not give their evidence undue weight.

4.0 Attribution

Issue

- 4.1 At issue is whether, with respect to section 2.2 of the TRC Guideline, the Board should order that an LDCs should only be entitled to claim incremental benefits associated with its participation in a CDM program with a non-rate regulated third party.

OEB Report – 2006 EDR Handbook (RP-2004-0188) – Section 2.2

- 4.2 Section 2.2 of the TRC Guide states in part:
- 4.2.1 A fundamental issue for the evaluation of CDM programs is whether the effects observed after the intervention occurs can be attributed to the intervention under evaluation (otherwise known as causality).
- 4.2.2 Since it can be expected that there will be multiple delivery points of CDM, including other electric LDCs, gas LDCs, electric retailers, gas marketers,

⁵¹ HONI, Affidavit, page 7, paragraphs 27 and 30

⁵² Enbridge Affidavit, page 3, paragraph 10

⁵³ EB-2005-0523, Cross Examination of Todd Williams, December 9, 2005, page 30, lines 20 to 21.

⁵⁴ EB-2005-0523, Cross Examination of David Heeney, December 9, 2005, page 10, line 1

⁵⁵ Exhibit #1

the Ontario Power Authority and various levels of government, it is important to understand the Board’s guidelines for the attribution of benefits especially in light of a potential claim for shareholder incentive.

- 4.2.3 While attribution is not a true adjustment to the TRC test, this issue is important for those LDCs that plan on seeking a shareholder incentive.
- 4.2.4 The Board advises LDCs that they are allowed to claim 100% of the benefits associated with a CDM program in which they jointly market and deliver the program with a non-rate regulated third party.

Positions of Parties

- 4.3 Figure 5 compares CME’s position on this issue with that of GEC, PP, NHL LIEN, HONI, and EGD.

Figure 5 CDM Issues: Positions Compared

| Issue | CME | GEC | PP | LIEN | NHL | HONI | EGD |
|------------------------|-----|-----|----|---------------|-----|------|-----|
| Claim 100% attribution | No | No | No | Yes Partially | Yes | Yes | Yes |

GEC (Neme) and Pollution Probe (Gibbons) Positions

- 4.4 Both GEC⁵⁶ and Pollution Probe oppose an LDC claiming more than the incremental savings that their effort produced.
- 4.5 Pollution Probe also recommends that the Board’s TRC “Guide’s attribution rule should be re-written as follows: “A utility can claim 100% of the incremental net benefits that it creates when it co-markets a conservation program with a non-rate regulated third party.”⁵⁷
- 4.6 Pollution Probe maintains that the Board’s TRC Guide on attribution permits LDCs “to earn excessive SSM incentives”.⁵⁸

Enbridge (Brophy) Position

- 4.7 EDG claims that:⁵⁹
- 4.7.1 Not allowing a utility to claim 100% of the benefits from a joint CDM/DSM program “would work as a disincentive to utilities who would otherwise seek out partners and non-ratepayer sources of funding for CDM/DSM initiatives if the attribution rules are changes to reduce a utility’s entitlement to claim TRC benefits.
- 4.7.2 It is not in the best interests of ratepayers if the attribution rates are changed to reduce a utility’s entitlement to claim TRC benefits, as the incentive develops partnerships and delivers programs on a cost-effective basis.

⁵⁶ GEC Affidavit, page 15.

⁵⁷ Pollution Probe Affidavit, pages 10 and 11, paragraph 41.

⁵⁸ Ibid page 10, paragraph 38

⁵⁹ Enbridge Affidavit, page 3.

HONI (Williams) Position

- 4.8 HONI believes that LDCs should be able to claim 100% of the benefits associated with participation in a CDM program with a non-rate regulated third party.
- 4.9 Further HONI argues that to do otherwise “could significantly delay LDCs’ CDM efforts and would divert funds from CDM implementation ... reducing the level of customer savings and jeopardizing realization of the government’s CDM targets”.⁶⁰

LIEN (Heeney) Position

- 4.10 LIEN believes that “the Board should not order an LDC should only be entitled to claim incremental benefits associated with its participation in a CDM program with a non-rate regulated third party ... (but an LDC) should be entitled to claim some increment, such as 20% ... of net benefits”.⁶¹

Issues Raised in Affidavits

- 4.11 Below are CME’s comments on issues prompted by the affidavits and/or cross-examination testimony.

CME Position

- 4.12 CME strongly opposes the Board’s current guidance that LDCs can claim 100% of the benefits associated with a CDM program in which they jointly market and deliver a program with a non-regulated third party, i.e., NRCan.
- 4.13 CME also opposes the LIEN suggestion that an LDC should be allowed to claim some increment, such as 20% of total net benefits, above the benefits the LDC created as a result of its efforts.
- 4.14 Since attribution of benefits from CDM activities is a factor only when there is an incentive system, to allow an LDC to claim 100% of benefits of a jointly marketed program would enable LDCs to earn excessive and unwarranted SSM incentives.
- 4.15 CME recommends that the Board require that LDCs can claim only the incremental net benefits that it creates when it co-markets a conservation program with a regulated third party (e.g., Enbridge Gas Distribution).
- 4.16 In CME view, the OEB has a responsibility to ensure that ratepayer interests are protected against LDC attempts to charge ratepayers for outrageous incentive claims based on benefits claimed, but not earned, by their efforts.
- 4.17 LDCs should only get credit for the incremental savings their efforts produce. To do otherwise would result in double counting and rewarding LDCs for results that they did not achieve. It could also result in an LDC receiving a grossly inflated incentive, which, in turn, could result in its skewing its CDM program design to achieve inflated incentive rewards.
- 4.18 CME supports the positions taken by GEC and Pollution Probe on attribution.

⁶⁰ HONI, op. cit., page 9, paragraph 36.

⁶¹ LIEN, op. cit., page 12.

5.0 Summary of CME Submission

- 5.1 In summary, CME recommends that the Board:
 - 5.1.1 Not mandate higher levels of CDM spending than that applied for by any utility, whether it is an electrical or a natural gas LDC.
 - 5.1.2 With respect to free rider rates:
 - 5.1.3 Require individual LDCs to develop and defend program specific free rider assumptions.
 - 5.1.4 Require free rider assumption to be based on the latest information available.
 - 5.1.5 With respect attribution, require that LDCs can only claim the incremental savings resulting from their CDM efforts.

Submitted this 20day of December, 2005

By

Canadian Manufacturers & Exporters