COMMENTS OF THE CONSUMERS COUNCIL OF CANADA

RE: Board Staff Discussion Paper – Proposed Regulatory Framework for Conservation and Demand Management by Ontario Electricity Distributors in 2007 and Beyond

EB-2006-0266

INTRODUCTION:

On January 25, 2007, the Ontario Energy Board ("Board") notified interested parties that Board Staff had prepared a Discussion Paper setting out a proposed regulatory framework to address rate-related matters stemming from local distribution company ("LDC") involvement in the delivery of conservation and demand management ("CDM") programs funded by the Ontario Power Authority ("OPA") and through distribution rates. The Board indicated that it would be assisted by written submissions on the various elements of the Discussion Paper. These are the comments of the Consumers Council of Canada ("Council").

GUIDING PRINCIPLES:

The Discussion Paper sets out four guiding principles that should be considered in the design of the regulatory framework for electric CDM in Ontario. The principles are:

1. Implementation of government policy should be facilitated;
2. Regulatory certainty and predictability should be provided;
3. Confusion in the CDM marketplace should be minimized; and
4. Administrative efficiency should be attained to minimize regulatory burden to LDCs, and costs to ratepayers. (p. 2-3)

The Council views these as important and appropriate principles, and would add the following:

1. Cross-subsidization of utility shareholders by utility ratepayers should be minimized to the extent possible;

2. The regulatory framework should not have elements that discourage the development of market-based CDM initiatives by private service providers;
3. The framework should encourage the LDCs to pursue CDM in the most cost-effective ways possible;
4. Protocols must ensure, to the extent possible, that LDCs are only compensated for revenue actually "lost" because of their efforts.
5. To the extent the Board views incentives as appropriate they must be tied, to the extent possible, to actual savings achieved.

FUNDING:

The Discussion Paper identifies the four mechanisms for LDC CDM funding available from the OPA. These are the recently announced LDC CDM fund (of up to $400 million over the next three years), the Conservation Fund, the Technology Fund, and other OPA procurement needed to implement the Integrated Power System Plan ("IPSP") and other Ministerial Directives.

With respect to distribution rate funding the Board had, to date, provided three processes; third tranche funding, incremental 2006 funding and the 2007 supplemental funding covering the period ending September 30, 2007. The Discussion Paper states that, "most CDM funding for LDCs will be provided by the OPA, either through the Fund or other OPA procurement processes." (p. 7) It also notes that, "continued funding of CDM activities through distribution rates may be necessary, and that the continued availability of this funding stream is not precluded by the Directive or otherwise." (p. 7)

Accordingly, the Board Staff Proposal is to allow for a dual funding model. However, they indicate that to ensure effective use of OPA funding and to minimize duplication the distribution rate funding should be restricted to generally to initiatives targeted to customers within the LDC's licensed service area, and to initiatives that neither the OPA nor any other entity is already delivering within the LDC's service area.

The Council recognizes the importance of CDM in Ontario and acknowledges this as a key policy initiative being advanced by the Provincial Government through various directives. However, it is critical that the money spent on CDM, which ultimately comes from electricity ratepayers is spent responsibly and in the most cost-effective manner possible. Establishing the Conservation Bureau and ultimately, the OPA LDC CDM fund, has effectively centralized the oversight of CDM within the OPA. The amount of money expected to be spent on CDM over the next several years is significant and unprecedented. In addition, many of the LDCs are in the early stages of gaining experience with these types of programs.

From the Council's perspective LDC CDM should be facilitated through the OPA to the extent possible. With the amount of funding available through the OPA it should be largely unnecessary to continue with CDM programs funded separately through distribution rates.

The Board Staff proposal is to allow for CDM programs funded through distribution rates where OPA funding is not available or "where funding through distribution rates is more appropriate". The proposal would limit funding to initiatives targeted to consumers within the LDC's licensed service area or initiatives that neither the OPA, nor others are doing in that service area. (p. 7)

The Council is of the view that this proposal, as defined in the paper is problematic for the following reasons:

1. The process for approval is not defined. What is the process that the LDC should follow in order to get approval for LDC distribution rate funded programs?
2. Who and on what basis will make the determination as to what programs are appropriate or not? Is approval required before or after the programs have been launched?

3. What level of funding will be permitted for programs funded through distribution rates? Will there be some form of spending cap or will the costs be unlimited?;
4. How will the costs of those programs be recovered? What process will be followed to ensure the programs are delivered on a cost-effective basis?
5. If the process established by the OPA for facilitating LDC CDM is viewed as more onerous than that established by the OEB, will LDCs come to the OEB first and not participate in the OPA initiatives?
6. With both the OPA and the OEB funding and overseeing LDC CDM, the likelihood that duplication will occur is significant. In effect, two separate frameworks will be required to facilitate LDC CDM in the Province.

The Council is of the view that the OPA LDC CDM fund, should be sufficient to ensure that LDC CDM initiatives will be pursued in Ontario. Other OPA procurement processes will also be available to the LDCs. To the extent the Board wishes to allow for distribution rate funded CDM a rigorous approval process must be established. In addition, the onus should be on individual LDCs to justify why the OPA process is not sufficient and that their programs warrant special treatment. The OPA expect to allow for standard programs and custom programs within its proposed framework.

The Council is of the view that over the next few years the OPA process and the LDC CDM fund should guide LDC CDM in Ontario. Once the LDCs gain experience with CDM it may be appropriate to change the framework and the rules around CDM initiatives. Until that model is given a chance it would be inappropriate to set up another stream of CDM funding at the Board. If the Board allows for CDM programs to be funded through distribution rates, they should only do so under exceptional circumstances.

There is reference in the Discussion Paper to the Board Staff proposal to restrict distribution rate funding to initiatives targeted to consumers within the LDC's licenced service area. The Council supports this not only for distribution rate funded programs (if allowed), but also for OPA funded programs. The Council does support LDCs undertaking CDM programs in other service areas. If the Board disagrees with this position the Board needs to be explicit about what it will allow in this regard, and provide a justification as to why one LDC would be permitted to pursue CDM beyond its service territory.

REVENUE PROTECTION:

Board Staff has proposed that the Board make use of the current form of lost revenue adjustment mechanism ("LRAM") to address revenue erosion resulting from LDC CDM activities, regardless of whether those programs are funded by the OPA . (p. 10)

The Council accepts that over time there is the potential for CDM programs to erode the revenue of LDCs. Accordingly, the Council has supported, in the past, the use of LRAM to remove the disincentive for LDCs to pursue CDM. The CDM efforts of the Ontario LDCs are new and actual results have been very difficult to measure. To date it is not clear as to what extent there has been any measurable revenue erosion. Before adopting the current LRAM going forward Board Staff should undertake analysis to determine the extent to which revenue has been lost. If the financial impact has been minimal the need for an LRAM may be premature. It is not clear how many LDCs, if any, have sought approval for an LRAM adjustment.

The Board's proposal for setting rates over the next several years envisions that all LDCs will have their rates re-based within that period. That rebasing may be sufficient to capture the impact of all historical CDM. Going forward the Council is of the view that a different form of LRAM should be considered, one that balances the need for administrative simplicity with the need to ensure adjustments are only made to reflect real lost revenue.

For those LDCs that apply to be compensated for "lost revenue" there should be a rigorous onus placed on those LDCs to demonstrate that actual revenue has been lost through their programs.

INCENTIVE MECHANISMS:

Board Staff has recommended that shareholder savings mechanisms ("SSMs") not be available for CDM activities funded by the OPA. (p. 11) With respect to CDM activities funded through distribution rates Board Staff is recommending that the Board continue to provide an incentive mechanism for CDM activities funded through distribution rates, and that the mechanism be consistent with the model currently in place.

Some parties have been advocating an enhancement of the formula for superior performance, but to date no LDC has applied for an SSM. It is not at all clear that the publicly owned LDCs in the Province require an incentive to pursue CDM. LDCs have been pursuing CDM over the past several years and no LDC to date has indicated that, in order for them to continue to provide CDM to their customers, a shareholder incentive is required. The Council does not see a need at this time to provide SSM for programs funded through distribution rates. Given that it is expected that most CDM will be carried out through the OPA programs, an SSM model does not appear to be required.

There is an expectation that the OPA funded activities will include incentives. The Council agrees that it would be redundant to also allow for an SSM for activities funded through the OPA. To the extent that LDCs are expected to receive incentives or profit related to the OPA funded activities, the Council submits that depending upon the ultimate accounting treatment adopted by the Board there should be some consideration as to whether LDC ratepayers should share in that profit.

COST ALLOCATION:

Board Staff is recommending that a fully allocated costing methodology be applied to all LDC-delivered CDM activities. They also indicate that capitalized assets associated with distribution rate funded CDM activities be included in rate base. Assets purchased with funds through the OPA should not be eligible for inclusion in rate base. (p. 15)

The Council is supportive of this approach as the OPA activities are required to be funded through commodity rates through the Global Adjustment. To the extent distribution assets and personnel are used to support these programs the costs should be accounted for on a fully allocated basis. As Board Staff notes, this will ensure a level playing field with other CDM service providers. In addition, to the extent rates are reduced to reflect this allocation there is no cross-subsidy from distribution rates to the OPA funded activities. This will ensure that the true costs of pursuing the programs are accounted for properly.

Although the Council is supportive of this approach a number of outstanding issues need to be resolved:

1. What are the rules around defining how the fully allocated costing methodology should apply? How will the application of those rules be monitored by the Board ?
2. What is the process and timing associated with removing costs associated with the OPA activities from distribution rates? When will the rates be adjusted?
3. Will LDCs be permitted to incur incremental expenditures associated with the OPA activities, and if so, how are those costs recovered?

REVENUE ALLOCATION:

Board Staff has proposed that the treatment of cost and revenues associated with the OPA activities be kept separate from the LDC's revenue requirement. Under a fully allocated costing methodology this is an appropriate approach. Having said that the

Council is of the view that the Board will need to set out the appropriate accounting protocols to ensure the costs and revenues are dealt with appropriately.

PROGRAM EVALUATION:

With respect to program results the Council submits that, if an LDC is making a claim for an LRAM that the obligation should be on the LDC to provide complete audited results to demonstrate that revenue was actually "lost". For OPA funded activities it will be imperative that the Board and the OPA coordinate how programs are to be evaluated and audited. They must be carried out on a consistent basis. The Council submits that there should definitely be coordination regarding application of the Total Resource Cost Test ("TRC") and efforts should be made to update all of the elements of the TRC test on a regular basis.

With respect to the programs funded through distribution rates, if allowed, the Board will need to better define what is expected in terms of reporting, especially with respect to audits. It is not clear in the Discussion Paper as to what is envisioned. When are results to be reported? How will the LRAM adjustments be made? What constitutes an appropriate audit?