

February 9, 2007

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor, 2300 Yonge Street
Toronto ON M4P 1E4

Ms. Walli:

Re: PWU Submission on Board Staff Discussion Paper – Proposed Regulatory Framework for Conservation and Demand Management by Ontario Electricity Distributors in 2007 and Beyond, EB-2006-0266

The Power Workers' Union (PWU) represents a large portion of the employees working in Ontario's electricity industry and has utmost interest in regulatory proceedings that impact the energy industry and the provision of ongoing service quality, reliability and safety to customers. Attached please find a list of PWU employers.

The PWU is pleased to provide comments on Board Staff's Discussion Paper *Proposed Regulatory Framework for Conservation and Demand Management by Ontario Electricity Distributors in 2007 and Beyond*. Our comments are attached.

We hope you will find our comments helpful.

Yours truly,

Don MacKinnon
President

List of PWU Employers

Atomic Energy of Canada Limited (Chalk River Laboratories)
Barrie Hydro
BPC District Energy Investments Limited Partnership
Brant County Power Incorporated
Brighton Beach Power Limited
Bruce Power Inc.
Corporation of the City of Dryden - Dryden Municipal Telephone
Corporation of the County of Brant
Electrical Safety Authority
EPCOR Calstock Power Plant
EPCOR Kapuskasing Power Plant
EPCOR Nipigon Power Plant
EPCOR Tunis Power Plant
Erie Thames Services Corporation
Goldman Hotels Inc. - Hockley Highlands Inn & Conference Centre
Great Lakes Power Limited
Grimsby Power Incorporated
Halton Hills Hydro Inc.
Hydro One Inc.
Independent Electricity System Operator
Inergi LP
Innisfil Hydro Distribution Systems Limited
Kenora Hydro Electric Corporation Ltd.
Kincardine Cable TV Ltd.
Kinectrics Inc.
Kitchener-Wilmot Hydro Inc.
Lake Superior Power (Brookfield Power)
London Hydro Incorporated
Middlesex Power Distribution Corporation
Milton Hydro Distribution Inc.
Mississagi Power Trust (Brookfield Power)
New Horizon System Solutions
Newmarket Hydro Ltd.
Norfolk Power Distribution Inc.
Nuclear Safety Solutions
Ontario Power Generation Inc.
Orangeville Hydro Limited
PUC Services Inc.
Sioux Lookout Hydro Inc.
Sodexo Canada Ltd.
TransAlta Energy Corporation - O.H.S.C. Ottawa
Vertex Customer Management (Canada) Limited
Whitby Hydro Energy Services Corporation

EB-2006-0266

**Power Workers' Union
Submission to the Ontario Energy Board on
Board Staff Discussion Paper:
Proposed Regulatory Framework for
Conservation and Demand Management by
Ontario Electricity Distributors in 2007 and Beyond**

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Introduction

In 2004, the Minister of Energy allowed Ontario electricity distributors ("LDCs") to apply to the Ontario Energy Board (the "Board") for an increase in their 2005 rates by way of the third tranche of their incremental market adjusted revenue requirement, conditional upon a commitment to reinvest the equivalent of one year's incremental revenue in Conservation and Demand Management ("CDM"). As a result, the Board approved \$163 million in CDM funding for LDCs in 2005. The Board subsequently allowed LDCs to apply for additional CDM funding as part of the 2006 and 2007 distribution rate adjustment processes.

In July 2006, the Government of Ontario established a new policy direction for electricity CDM in Ontario by directing the Ontario Power Authority ("OPA") to assume responsibility for organizing the delivery and funding of CDM activities through LDCs. The directive issued by the Minister of Energy also established a three-year fund of up to \$400 million for CDM programs delivered by LDCs, to be administered by the OPA.

Given this new approach to CDM Board staff issued a discussion paper on January 25, 2007 (the "Paper") to examine the implications of this new approach for the regulatory treatment of LDC CDM activities, on which the Board invites comment.

The Power Workers' Union's submission stems from our energy policy statement:

Reliable, secure, safe and reasonably priced electricity supply and service, supported by a financially viable industry, and a skilled labour force, is essential for the continued prosperity and social welfare of the people of Ontario. In minimizing environmental impact, due consideration must be given to economic impacts, and the efficiency and sustainability of all energy sources and existing assets. A stable environment and predictable and fair regulatory framework will promote investment in technical innovation that results in efficiency gains.

The overarching principles that guide the PWU's comments on Conservation and Demand Management (CDM) are:

- Cost of CDM should not exceed benefit to cost bearer.
- CDM should not impact the regulated sector's financial viability.

The following are the comments of the Power Workers' Union (the "PWU") on the recommendations stated in the Paper.

The framework that staff is proposing for the dual funding model implicitly encourages LDCs to seek funding from the OPA, and to rely on funding through distribution rates where OPA funding is not available or where funding through distribution rates is more appropriate.

The proposed framework is generally consistent with the PWU's comments on the options paper issued by the OPA in 2006.¹ While the PWU has recognized the need for LDC specific custom projects unique to their service areas, which may not be funded through the OPA, we have also stated that such projects should "require OPA liaison to ensure consistency in evaluation criteria and the OPA's comprehensive awareness of LDC specific initiatives."² Such a requirement would be consistent with the need for strong leadership through central coordination of CDM efforts by a single body, i.e. the OPA's Conservation Bureau.

¹ OPA, Role of LDCs in CDM in 2007: Options Paper for Consultation, 2 May 2006

² PWU, Comments on the Role of LDCs in CDM in 2007, 16 May 2006

The Paper states that “funding through distribution rates should be restricted 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.”³ While these criteria are appropriate, the PWU submits they are not sufficient. The OPA’s accountability for program design and province-wide CDM results will be best supported by a protocol under which the OPA is consistently engaged on all CDM programs delivered by LDCs. For example the Board could require, in any application for a CDM program to be funded through distribution rates, that the LDC include the OPA’s feedback as to the proposed program’s consistency with the OPA’s CDM framework for the province. This type of protocol would also provide the Board with a valuable perspective in determining whether a LDC’s customized initiative is appropriate for funding through distribution rates.

Board staff recommends that the Board continue to make the current form of LRAM available to LDCs to address revenue erosion resulting from LDC CDM activities, regardless of whether the programs are funded by the OPA or through distribution rates.

Clearly a mechanism such as a Lost Revenue Adjustment Mechanism (“LRAM”) is needed to compensate LDCs for revenue erosion resulting from CDM activities, or else there would be a disincentive for LDCs to support and deliver CDM programs, contrary to public policy objectives. However, the Paper’s recommendation would specifically exclude the impacts from CDM programs delivered by parties other than the OPA or the LDC in determining the LRAM, stating that “those impacts can continue to be factored into rates through prospective forecasting in the rate setting process.”⁴ In the view of the PWU, this exclusion is not appropriate at this time.

Firstly, this reasoning does not account for LDCs who have not submitted any load forecasts thus far for rate-setting purposes, as the vast majority of LDCs followed the Historical Test Year approach in their applications for 2006 distribution rates and thus relied on 2004 actual load as their basis for electricity usage. This basis will remain in effect until 2008, 2009 or 2010, depending on when the LDC is required to rebase,

³ page 7
⁴ page 10

according to the Board's new Multi-year Electricity Distribution Rate Setting Plan.⁵ Certain LDCs will therefore not have the opportunity to factor any CDM impacts into their load forecasts until 2010.

Secondly, for those LDCs that followed a Forward Test Year ("FTY") approach in their 2006 rate applications, there is no evidence to support Board staff's implicit assumption that their load forecasts considered the impacts of CDM initiatives delivered by parties other than the LDC or the OPA.

Thirdly, although future cost of service applications must include a load forecast as part of a FTY filing,⁶ there is no adequate basis to suggest LDCs will be able to factor the impact of third-party CDM programs into their forecast, when they are not even expected to factor the impact of CDM initiatives being delivered by the LDC itself. It is unreasonable to expect LDCs to have sufficient knowledge of the prospective impacts of CDM programs to which they are not a party, as they may have no knowledge whatsoever of such programs at the time their load forecast is being prepared.

For these reasons, the PWU supports the position of the Electricity Distributors Association ("EDA") in this regard:

If the OEB expects distributors to support all aspects of the provincial effort to create a culture of conservation, it would be appropriate to hold distributors harmless with respect to the success of this effort. To do so, it will be necessary to design an LRAM that takes into account the impact on throughput of all CDM initiatives, whether sponsored by the distributors themselves, the OPA's Conservation Bureau or others.⁷

The PWU also acknowledges the advantages of a more comprehensive mechanism, such as the Revenue Stabilization Adjustment Mechanism proposed by the EDA, to address lost revenue due to changes in demand, including those resulting from all forms

⁵ Howard I. Weston, OEB's Multi-year electricity rate setting plan (Speech to the Electricity Distributors Association Annual General Meeting), 27 February 2006

⁶ RP-2006-0170, Filing Requirements for Transmission and Distribution Applications, 14 November 2006

⁷ John Todd (ERA) on behalf of EDA, Designing an Appropriate LRAM for Electricity CDM Programs in Ontario, 25 August 2006

of conservation. Accordingly, the PWU supports Board staff's view that such alternative mechanisms should be considered as part of the process to develop 3rd Generation Incentive Regulation Mechanisms or during the Board's review of options for the fundamental redesign of electricity distribution rates.

Staff recommends that the Board should not provide a shareholder incentive mechanism for CDM activities funded by the OPA.

Board staff recognizes that the LRAM, while removing a disincentive for LDCs to implement CDM, does not provide an appropriate incentive. It is also reasonable to believe that the OPA is in the best position, in consultation with stakeholders, to design results-oriented incentive mechanisms that are most suitable for individual CDM programs.

The PWU therefore supports staff's recommendation, while adding that the Board should consider the need for adequate incentives to LDCs and other program delivery agents in any future Board review of OPA expenditures on CDM activities.

Staff recommends that the Board continue to provide an incentive mechanism for CDM activities funded through distribution rates, and that this mechanism be consistent with the model currently in place.

As noted in the Paper, no LDC application has been issued to date claiming a benefit under the Shared Savings Mechanism (SSM); it is therefore premature to consider extensive changes to the current mechanism. In refining the incentive, the Board would benefit from experience in applying the current SSM formula, and in reviewing the effectiveness of incentive mechanisms used by the OPA in competitive processes.

However, it would be appropriate at this time for the Board to reconsider its previous finding that the SSM should apply only to customer-side expenditures, and not to utility-side investments such as distribution system improvement projects.⁸ The Board concluded that the inclusion of capitalized assets into the rate base provides sufficient incentives, and that an additional incentive in the form of an SSM is not necessary.

⁸ RP-2004-0203, Applications by distributors for approval of CDM Plans: Oral Decision, 7 December 2004

In fact, the SSM provides a greater incentive than including assets in the rate base. While under a SSM the LDC “shares” the financial benefits of a CDM program with its ratepayers, the mechanism allows the LDC to achieve incremental earnings without drawing on its base pool of capital, since it recovers the CDM asset cost through a rate rider on its distribution rates (except for third tranche funding). The SSM therefore allows the shareholder to exceed the LDC’s allowed rate of return (provided the Total Resource Cost analysis yields a positive net benefit). An expert report commissioned by the Board for advice on the regulatory framework relating to LDCs and CDM concluded, “It is important to emphasize that any incentive needs to be in addition to the normal allowed return, otherwise it does not serve as an incentive at all.”⁹

Furthermore, the SSM amount is directly linked to the overall cost-effectiveness of the LDC’s CDM initiatives, since it is based on the net benefit of the Total Resource Cost (“TRC”) analysis, whereas the LDC’s return on capitalized assets is independent of CDM program effectiveness. The Board has previously recognized the need to address utility-side opportunities to reduce line losses, stating:

*Reducing line losses is an opportunity for conservation in this Province. The Board estimates that a 25% reduction in line losses could have a value of approximately \$120 million to ratepayers [...] It is therefore appropriate for distributors to have an incentive to do so.*¹⁰

In a recent distribution rate case decision, on the issue of line losses the Board added: “It is no longer acceptable to ignore the issue because the problem is complex. The costs to the province-wide distribution system are too great. Millions of dollars are at stake.”¹¹ In this same decision, the Board still allowed the applicant utility to use a variance account to record differences between actual and forecast line losses. Recognizing that line losses can be largely influenced by factors outside the distributor’s control, the Board chose not to follow a heavy-handed approach by making the utility fully accountable for its actual line losses.

⁹ London Economics International LLC, Overview of C&DM practices in North America and potential alternatives for Ontario, prepared for the Ontario Energy Board, 20 December 2004 (page 50)

¹⁰ RP-2004-0118, 2006 Electricity Rate Handbook: Report of the Board, 11 May 2005

¹¹ EB-2005-0421, Application by Toronto Hydro for 2006 Electricity Distribution Rates: Decision with Reasons, 12 April 2006

It therefore seems appropriate for the Board to consider an incentive-based approach, which encourages LDCs to make prudent investments to reduce line losses, while allowing the continued use of variance accounts in recognition of the fact that line loss levels can be driven by factors over which the LDC has no control. The SSM represents such an incentive-based approach which can be applied with equal effectiveness to distribution system projects (such as line loss reduction initiatives) as it can be for customer-side expenditures.

Board staff recommends that a fully allocated costing methodology be applied to all LDC-delivered CDM activities. Capitalized assets associated with distribution rate funded CDM activities could be included in the rate base. Assets purchased with funds from the OPA would not be eligible for inclusion in the rate base.

The use of a fully-allocated cost basis is appropriate to avoid cross-subsidization between CDM and the other LDC business activities. This approach would be consistent with the requirements of the Affiliate Relationships Code dealing with transactions between a LDC and an affiliate: to the extent a LDC recovers certain costs from affiliates on a fully-allocated basis, those costs are then not recoverable through distribution rates. The same principle is applicable and appropriate to CDM activities, in the context where net revenues and incentives resulting from CDM activities are not considered part of the LDC's regulated revenue requirement. On the other hand, a marginal costing approach, which leverages the LDC's underlying "fixed" costs, would constitute a subsidy which distorts the LDC's true cost-effectiveness in CDM relative to its other operations.

It is also appropriate to exclude assets purchased with OPA funding from the LDC's rate base. An analogy can be made with distribution assets which are partly funded by customers for system expansion: the value of capital contributions received from customers is excluded from the LDC's rate base. Likewise, it is appropriate to exclude from the rate base any assets funded with contributions from other parties, including OPA funding for CDM assets.

However, it would be appropriate to reconsider the recommendation that the LDC's rate base could include assets purchased with CDM funding from incremental distribution rates (not including third tranche funding). In this case, while the full cost of the asset has

been borne upfront by ratepayers through a rate rider on distribution rates, the LDC would then be entitled to recover the asset cost again over time, through its depreciation expense and allowed return on capital. Thus, this treatment would result in a double cost recovery for the LDC.

The PWU submits a more suitable approach would be to exclude such CDM assets from the utility's rate base and instead allow those investments to be eligible to the SSM incentive, as proposed earlier. This approach would encourage LDCs to make CDM investment decisions based on their effectiveness as measured consistently by TRC analysis, rather than considering the differences in incentives between capital and operating expenditures.

Should the Board determine that this approach would constitute a more appropriate regulatory treatment for LDCs' capital investments in CDM, it would be reasonable to exclude CDM investments which have been already approved by the Board from being subject to a different regulatory treatment than the one in place at the time the LDC made its investment decision.

Consistent with staff's recommendation for the treatment of costs associated with OPA-funded CDM activities, Board staff recommends that revenues earned from OPA CDM contracts be kept separate from the LDC's distribution revenue requirement.

The inclusion of revenues earned from OPA CDM contracts in the LDC's revenue requirement would negate any incentive for the LDC to participate in those initiatives; it is therefore reasonable to exclude such revenues when determining the LDC's regulated revenue requirement.

The PWU suggests the recommendation be reworded, however, to state that "net revenues earned from all CDM activities" be kept separate from the LDC's distribution revenue requirement. "Net revenues" makes it clear that the LDC would also remove any CDM program delivery costs (on a fully allocated basis) from the recoverable distribution expenses included in its regulated revenue requirement. Changing "OPA-funded CDM activities" to "all CDM activities" would be consistent with the need to ensure appropriate LDC shareholder incentives for all CDM activities, whatever the source of funding.

Staff recommends that LDCs be required to provide audited evaluation results when filing LRAM claims with the Board, and that the audit scope [for CDM programs funded by the OPA] should be limited to confirming that the participation rate within the LDC service area is accurate and that the energy savings assumptions used in the calculation of the lost revenue amount are the current ones used by the OPA.

In principle, the recommendation of Board staff is reasonable for purposes of evaluating an LDC's lost revenue claim. The PWU suggests that the reference to "energy savings" assumptions (kilowatt-hours) also include "demand" savings (kilowatts or kVa), since a number of key CDM initiatives are targeting reductions in peak demand rather than, or in addition to, energy savings, and the LDC's revenue loss may arise from demand reductions as well as from reduced energy consumption.

Staff recommends that LDCs undertake program evaluations [for CDM activities funded through distribution rates], and provide audited results to the Board.

Given that electricity distribution ratepayers would be directly funding the cost of these CDM activities, as well as any resulting lost revenue claim and incentive mechanism based on the results of these initiatives, it is reasonable for the Board to expect comprehensive evaluations and audited results, including measurement and verification evidence. Whereas the Paper recommends a specific audit scope for programs funded by the OPA, no scope is identified in this recommendation. For purposes of clarity to all LDCs, the PWU submits the audit scope should be aligned with the Board's reporting requirements for these CDM programs.

Board staff recommends that the Board limit its reporting requirements for CDM programs funded by the OPA to only the information that the Board needs to assess an LRAM claim, and that the information only be required when such a claim is filed.

It is reasonable to limit the LDCs' reporting requirements to the information required by the Board to exercise its authority. Presumably the Board will specify to the OPA more comprehensive reporting requirements for its CDM activities, so the Board can properly exercise its oversight responsibilities over the OPA itself. It is essential that the OPA's funding of CDM programs, including its funding to LDCs, be subject to regulatory

scrutiny, whether this oversight occurs either through the OPA's revenue requirement application or in the review of its Integrated Power System Plan ("IPSP").

For CDM programs funded through distribution rates, Board staff recommends that the reporting requirements be based on the current annual reporting requirements for third tranche and 2006 funding.

As mentioned in the Paper, the Board has initiated a process to review the LDC's 2005 annual reports, the results of which may identify opportunities for improvement in the LDCs' CDM reporting requirements. The PWU notes that overall LDC spending on CDM by the end of 2005 was approximately \$34 million,¹² or approximately 21% of the total approved third tranche funding, and a number of LDCs had spent a much lower portion of their third tranche funding at that time. Therefore, a review of 2006 annual CDM reports would also be helpful, in determining whether the existing reporting requirements effectively assist the Board in reviewing compliance with the LDCs' Board-approved plans, as well as in assessing the effectiveness of the CDM programs and related EM&V (Evaluation, Monitoring and Verification) processes.

The PWU therefore suggests the Board expedite its review of LDCs' 2006 annual CDM reports, to determine potential opportunities for improvement from a broader base of information. The existing reporting requirements should remain in effect until this review is completed, as they provide information which is useful to the Board and to other interested parties. Opportunities for improvement that arise from the Board's review of the 2005 reports may be adopted, provided any such changes do not lead to significant delays in the reporting requirements for 2006 and beyond. Given the major significance of CDM targets in the IPSP, it is important for the Board and stakeholders to ensure the reported results of ongoing CDM activities are timely as well as comprehensive.

Board staff is of the view that consideration of the LDCs' CDM activities should form part of the Board's SQR review.

It is appropriate for the Board to consider the LDC's CDM activities in its review of Service Quality Regulation (SQR), to the extent these activities impact the areas where the LDCs are subject to the direct oversight of the Board, i.e. LRAM claims and CDM

¹² OEB, CDM Quarterly Reports: Quarter 4 2005, 1 March 2006

programs funded through distribution rates. However, the outcome of this review should avoid unnecessary overlap with any LDC requirements stemming from CDM contracts with the OPA, as well as with the Board's requirements of the OPA itself in respect of its CDM funding. The PWU therefore submits that the scope of the LDCs' CDM activities included in the SQR review should be limited, to areas where the Board exercises direct oversight over the LDCs.