

**IN THE MATTER OF a process initiated by the
Ontario Energy Board to review the regulatory
treatment of conservation and demand management
activities by electricity distributors.**

**SUBMISSIONS ON STAFF DISCUSSION PAPER
FROM THE
SCHOOL ENERGY COALITION**

General

1. The School Energy Coalition (“SEC”) believes that the Staff Discussion Paper (the “Paper”) is a useful first step in addressing the issues and considerations raised by the conservation and demand management activities of electricity distributors (“LDCs”), whether funded through distribution rates with Board approval, or funded by the Ontario Power Authority (“OPA”) under its separate mandate.
2. However, we also believe that the situation raises fundamental questions about the Board’s regulatory role, and about the relative responsibilities of the various players in the new energy market in Ontario.

Scope of the Inquiry

3. In considering these issues, we note that the definition of CDM used by the Board and the OPA, as mandated by the government, is much broader than the area of “conservation” activities that are commonly seen, for example, with the gas utilities. As set out on page 4 of the Paper, CDM could include, for example:
 - a. Classic programs to promote efficient use of energy on the customer side of the meter;
 - b. Actions by the LDC, as a user of electricity, in using it more efficiently;
 - c. Actions by the LDC in reducing line losses and other distribution inefficiencies;
 - d. Programs to control peak demand, either in emergencies or generally;
 - e. Programs to incent customers (or the LDC, for that matter) to shift for specific end uses from electricity to other energy sources, such as natural gas;
 - f. Load building programs where electricity is a preferred energy source for a specific end use (such as personal transportation, perhaps);

- g. Promotion of customer-owned load displacement or partial load displacement generation;
 - h. Promotion of distributed merchant generation in the LDC's franchise area; and
 - i. Building of distributed generation by the LDC.
4. Two things need to be noted about this broad brush approach to CDM.
 5. First, it is not clear that the same regulatory approach should apply to all of these activities. For example, funding out of distribution rates may be appropriate for some of these activities, and not others. As another example, it is not obvious that all of these activities are most effectively carried out in a regulated entity, as opposed to in an unregulated affiliate. Of course, it is also true that, given the very different risk profiles of these activities, the fair disposition of the profits from these activities might be different from one category to the next.
 6. Second, it is evident that the load and therefore revenue impacts of these activities on the LDC will not be the same. Those in the energy industry are used to thinking of conservation activities as reducing volumes (whether cubic meters of gas, or kilowatt hours of electricity), but some of these activities are potentially load building in their results. This should affect how they are funded, how they are regulated, and how "lost revenues" are calculated and reimbursed.

The Changing Energy Policy Landscape

7. The Paper correctly points out that responsibility for energy policy issues relating to CDM does not rest solely with one entity or another. A number of entities now have some part of that responsibility, and there is considerable overlap. For example, the government, through the Ministry, has the power to give directives and otherwise frame overall policy, and all other players, including OPA and the Board, have to march in step with those decisions. On the other hand, the Ministry often passes on significant policy discretion to the OPA or the Board along with the responsibility to implement government policy. All parties also also both constrained and empowered by the legal mandates given to them and to each other.
8. The OPA thus has responsibility to deliver CDM, along with policy discretion and a budget to do so, while the Board also has responsibility to deliver CDM through its regulatory role, along with policy discretion and a rate setting mandate that gives it too a budget to do so. This is further complicated by the fact that the Board is the OPA's regulator. Everything the OPA spends its money on, and therefore essentially everything it does, is subject to Board oversight on the basis of prudence, which in this context means optimization of spending for the benefit of the ratepayers. The additional responsibility to review the IPSP on a regular basis adds a further level of Board responsibility in an area that already has considerable overlap.
9. In our view, the Board should be asking, in a broader way, how these realities affect its relative roles in CDM as i) a regulator of regulated entities, and ii) a developer of energy policy. In this regard, we propose that the Board adopt, at a minimum, two basic principles that, even if somewhat obvious, may help the Board navigate through these new responsibilities and overlapping mandates:

- a. **Regulatory Obligation.** The Board has an obligation as regulator to assess whether any funds collected from ratepayers by a regulated entity are being spent, or proposed to be spent, prudently. This obligation is in no way lessened if the regulated entity, or some other body, also has supervisory or similar authority over the spending of those amounts. The Board may not decline to exercise its regulatory function because some other body is charged with an overlapping responsibility. It can only decline to exercise that regulatory function if the government, by legislation, specifically exempts those activities from regulatory oversight.
- b. **Policy Constraints.** Conversely, the Board is constrained from deciding energy policy issues where the responsibility for deciding those policy issues has been allocated by government to someone else. Further, where the Board must determine a policy matter as part of any of its mandates, it must in all cases do so in a manner that is consistent with any applicable policy already determined by government.

This leads to the corollary of both principles:

- c. **Division of Responsibilities.** Where the Board's Regulatory Obligation and Policy Constraints are not 100% consistent, the Board should establish with all other entities involved (including specifically the OPA and the Ministry) a completely transparent and mutually agreed set of boundaries which eliminates or minimizes the overlap and ensures that conflicts between mandates will not arise. It is not enough for the Board to try to ensure that its actions keep within appropriate bounds. It must work collaboratively with the other entities to ensure that there is a mutual set of boundaries developed.

Guiding Principles

10. We agree with the first three guiding principles set forth on page 2 of the Paper, and we believe that they should be applied in the context of the three principles set forth in paragraph 9 of these Submissions, above.
11. However, with respect to Board Staff's fourth principle, on page 3 of the Paper, we re-iterate our past comments in other proceedings that regulatory efficiency is not an end in itself. Regulatory efficiency is a principle that applies only so long as the Board's goals of transparency and regulatory quality are also maintained. We propose that the principle be reworded as follows:

“4. The Board should as always fairly balance the need for regulatory efficiency with the need for transparency and thoroughness in its regulatory processes. The framework should provide for processes that are streamlined without sacrificing the quality or thoroughness of its review of regulated activities, and that avoid any unnecessary duplication of requirements on LDCs by the Board and the OPA while maintaining full public transparency of the LDCs' activities.”

12. We also believe that the Board should add a fifth principle, as follows:

“5. CDM programs should be accessible to all categories and classes of customers, and in all geographic areas of the province. Because of the Board’s unique role as regulator of all of the LDCs, the Board’s regulatory mandate should be interpreted to include ongoing review of whether the benefits of CDM are being fairly distributed between customer groups and/or geographic areas.”

Program Funding

13. The Paper proposes at page 6 ff. that LDCs have two potential sources of CDM funding: OPA and OEB. Aside from the obvious potential for duplication and overlap, we believe that this situation raises two other serious problems that need to be addressed.
14. First, this could easily lead to forum shopping. As any parent of teenagers knows, the ability to ask for money (or permission, or anything else) from either Mummy or Daddy for the same thing inevitably leads to unhappy consequences (including typically overspending) unless Mummy and Daddy have a tightly co-ordinated response.
15. Second, this could lead to informal competition between the two agencies. While of course neither agency would condone any form of official competition in the supply of CDM funds, human nature being what it is staff of both agencies could become competitive if the appropriate mechanisms are not implemented early on.
16. Both of these issues can, in our view, be solved by a simple but rigid rule: No LDC can apply for CDM money through the OEB (ie. to be collected in distribution rates) unless it has first sought that funding from the OPA, and the OPA has said that it is more appropriately funded through distribution rates. The OPA should establish a simplified inquiry process in which LDCs can seek OPA funding for a CDM program, and the OPA makes one of three decisions:
 - a. Determine that the funding application should be considered through OPA processes;
 - b. Determine that the program is not appropriate for funding; or
 - c. Determine that the program is more appropriately funded, if at all, through distribution rates.
17. In order to facilitate this bifurcation of responsibility, and prevent overlap, the Board and the OPA should establish and publish a joint set of criteria for which types of programs are most appropriately funded by the OPA or the OEB. The Paper proposes some considerations in this regard, and we would add some other examples of programs that might be more appropriately funded through distribution rates of a specific LDC or group of LDCs:
 - a. Pilot programs by “early adopter” LDCs that choose to take an aggressive, leadership role relative to other LDCs;
 - b. Joint programs with specialized local industries or ratepayers (e.g. a program targeting tobacco farmers in Southwestern Ontario); and
 - c. Localized leading edge programs requested/proposed by local governments or other public authorities.

In this, as in other areas of the practices of the Board and the OPA, the joint set of criteria should be as specific as possible, and in particular should go through the various types of CDM and describe the dividing up of responsibilities as clearly as possible in each case. For example, a specific criterion for something like distributed generation might be related to transmission issues, yet transmission issues for consumer education programs might be largely irrelevant. In one case, integration with the IPSP may be more important, and therefore the OPA's need to be involved stronger. Similarly, if an LDC seeks to spend money collected in distribution rates to participate in an OPA funded renewable generation program, the rule could be that the Board should not consider the application unless the OPA program specifically considered distribution rate funding in the program design.

18. In keeping with the general principles outlined earlier, we believe that clear joint pronouncements on matters such as the above will streamline the process, provide certainty to LDCs and their ratepayers, and encourage a conservation culture by giving local ratepayers the opportunity, through their LDCs, to take a leadership role.

Distribution Load Reductions/Revenue Protection

19. We believe that the Paper, starting on page 8, proceeds from an incorrect premise, ie. that all CDM activities will reduce LDC revenues. As we have noted earlier, in the broader definition of CDM, this is not at all the case. CDM activities can reduce or increase volumes, they can change the timing and thus value of load, they can increase or reduce the operating costs of the utility, and they can affect the reliability (and therefore value) of delivered power.
20. We therefore agree with Board Staff that the current LRAM may not, in the long term, be sufficiently sophisticated to deal with all aspects of the impact of CDM on profitability, and we agree that a more comprehensive approach should be considered as part of 3rd Generation IRM.
21. However, we do not agree with the limited scope of that review that Board Staff appears to be proposing. Board Staff appears to reject "a comprehensive reconsideration of the traditional approach to establishing rates that reflect the business risk of the distributors". With respect, we believe that such a fundamental review should be carried out, and that, for example, shifting the weather risk to the ratepayers should be considered as part of that analysis. In our view, the changing nature of electricity consumption in Ontario, and the changing roles of distributors and others as a result, cry out for a review of this type, and we recommend it.
22. In the meantime, it does not appear to us that the LRAM has to be as simple as it is, limited only to a small subset of CDM activities. We suggest that the Board consider expanding the LRAM as follows:
 - a. Rates should include forecasts (whether under cost of service or IRM methods) of costs and revenues based on explicit assumptions about:
 - i. Impact on revenues of all CDM activities (through changes in energy delivered, peak demand, etc.), including all load building activities; and

- ii. Impact on costs (other than CDM program costs) of CDM activities (through reduced line losses, lowered maintenance costs, etc.).
- b. If the overall cost and revenue impact of CDM and load building activities in fact is greater or less than the net forecast impacts, the net difference should be either collected from ratepayers or refunded to ratepayers, as the case may be.

The effect of this proposal would be to ensure that all impacts of CDM activities on revenues are considered, not just the subset relating to customer-side conservation programs.

Incentive Mechanisms

- 23. We agree with the Board Staff recommendations on incentive mechanisms – take no action on new or revised incentive mechanisms at this time – but for different reasons.
- 24. Board Staff propose, on page 11, that LDCs must be paid incentives in excess of their normal return to do anything the Board or the government wants them to do. We do not agree. There are circumstances in which incentives are useful ways of causing beneficial behaviour to take place. There are, though, many circumstances in which incentives are unnecessary or even counter-productive.
- 25. In our view, the drive for more and more incentives by some energy sector participants wrongly portrays LDCs as, essentially, coin-operated. While this is undoubtedly sometimes the case, in most instances it is not, and policies designed on the basis of this assumption will be wrong.
- 26. LDCs and their staff are for the most part driven by a service mandate, in which delivering a quality service to their local customer base is the key motivator. Yes, it is expected that they deliver a fair return to their shareholder and lenders (usually one and the same), but it is rare that the municipalities who are their shareholders push the utility to maximize profits at all costs. Where this is not the case, the Board should step in and deal with that problem discretely, since it undermines the integrity of our distribution system.
- 27. Subject to those few exceptional cases, we believe that just as LDCs do not get an incentive for operating in a safe manner, it should, in the long term, be unnecessary to give them an incentive for operating in an efficient manner. They should have protection against the negative revenue impacts of CDM, but they do not, in the long term, require incentives to do something that should simply be part of providing a quality service to their ratepayers.
- 28. That having been said, in the short and medium term the need is to shift the culture at LDCs to a more pro-CDM culture, and that may require economic tools different from those that would be used in the normal course of business. As much as we disagree with the current SSM structure, we agree with Board Staff that it is premature to try to redesign it. We propose, instead, that the redesign of the SSM be included as an issue in the upcoming review of 3rd Generation IRM.
- 29. With respect to OPA funded CDM activities, we believe that the OPA should include in its program design appropriate mechanisms to incent LDCs and others to participate. Incentive

mechanisms for those programs should be integrated into the program design, and we agree with Board Staff that trying to add another layer on top of that may well invoke the law of unintended consequences.

Cost Allocation

30. We agree with the proposals of Board Staff on pages 13 to 15 supporting fully allocated costing, for the reasons they have set forth.
31. We also note that, while it may be true that CDM activities should be subsidized, it is the responsibility of the OPA in their program design to determine the amount and nature of that subsidy. The subsidy is in all cases the spending of public money. It should not be the accidental result of a cost allocation methodology, but should be the deliberate result of a program design decision on the part of the entity, the OPA, having the mandate to make that determination. In addition, it should come out of the funds earmarked for that purpose, the CDM budget of OPA.

Revenue Allocation

32. On the other hand, we do not believe that the Board Staff proposals on revenue allocation – excluding OPA funded CDM revenue from distribution revenue – are appropriate.
33. The fundamental problem arises because CDM activities are contained within the regulated utility, and carried out by utility personnel. If the CDM activities were carried out in an affiliate, with appropriate protections against inappropriate affiliate activity, etc., then much of the problem does not arise.
34. However, where the CDM activities are carried out within the utility, they change both the risk profile and the profit signals within the utility. This may be acceptable, and it may not, but what is certain, in our view, is that the Board should determine whether it is acceptable only after a disciplined review of these impacts. It is not something that can be assumed without investigation.
35. An example may help demonstrate this. The OPA may launch a province-wide program to incent the installation of ground source heat pumps, and a small local utility may decide to participate in a very aggressive fashion. As a result, the utility initiates a retail contracting operation, allocating a substantial percentage of its capital and human resources to this new activity. On the one hand, the risk of this combined distribution/retail sales business has changed dramatically, and for the worse. This is especially true if the small LDC has the desire to succeed, but limited experience in this different type of business activity. And, on the other hand, the profit profile of the LDC has also changed radically. Key managers and other personnel, driven perhaps by personal bonuses and the like, could potentially be motivated to focus on their sales campaign to the detriment of keeping the trees trimmed.
36. Of course, this extreme example is not going to happen often. That having been said, some impacts of this sort - changes in risk profile and profit signals – are likely to arise in many LDCs as long

as CDM activities are carried out inside the utility and profits are not integrated with distribution profits.

37. There is no simple answer to this, because Board Staff is absolutely right that letting the ratepayers scoop the net profits could be a disincentive to the optimization of CDM activities. Probably some form of sharing is best, but getting that formula right, and integrating it with controls over the risk changes, would require information that is not currently available to the Board.
38. Therefore, we propose that the Board Staff rule – all CDM profits separate from distribution profits – be implemented on an interim basis, subject to two caveats. First, the Board should retain an appropriate consultant to review methods of ensuring that risk and profit impacts can be contained in LDCs with substantial CDM activities. Second, in the meantime the Board should require any utility that either forecasts or experiences a net profit that is more than 10% driven by CDM profits to apply to the Board for a review of their CDM activities (OPA and ratepayer funded) and their impact on utility operations. This may only apply to one or two LDCs per year, but until a more robust solution is found, we believe that this form of oversight is a necessary protection for ratepayers.

Evaluation and Reporting Requirements

39. This is a further area in which, in our view, the Board and the OPA should establish joint policies and procedures. It is not enough to say that the OPA may need some information, and the Board other information. This creates a risk, not only of an excessive paperwork burden on LDCs (creating a barrier to CDM activities), but also of inconsistent data going to the OPA and the Board.
40. It is also not enough for the Board to say “This is the information we need, and the OPA can determine what they need independently”.
41. Instead, the Board and the OPA should work together to establish a set of common informational filings. These may be of two types: periodic entity-related information; and program specific information. The former category, focusing on the overall CDM budgets, revenues, activities and results of an LDC, may in general be of more interest to the Board as the regulator of the entity, but if properly designed it will also provide useful information to the OPA that will help them both deal with the program delivery agents and design better programs in the future. Similarly, the latter category, focusing on the costs and results of individual programs, may in general be of more interest to the OPA as the promoter of the programs, but it can also be of great assistance to the Board in understanding the specific CDM activities of the LDCs, and the effects on the LDCs’ operations and financial health.
42. Information on CDM programs, spending and results is of interest, not just to the regulators, the OPA, and the government, but also to other LDCs and to the members of the public that are paying for it. Transparency is a crucial aspect of the Board’s mandate and responsibility, and therefore we believe it is up to the Board to insist that all CDM informational filings should be made public and promulgated through the OPA and/or Board websites and other means.

43. The Board has, we think, correctly identified as appropriate the evaluation and audit principles established for Gas DSM. In establishing a joint set of information reporting rules with the OPA, the Board should urge the OPA to adopt this same principle.
44. We do not agree, however, that the Board should limit the use of the audit principle as set forth on page 17. The more thorough approach used by the gas utilities, in which the auditor is expected to do whatever is required to provide an opinion on the results, is the better approach.
45. The regular publication of detailed, easy to understand, and independently audited information - costs, ratepayer benefits, shareholder benefits, program structures, and societal impacts - on LDC CDM activities will, in our view, greatly improve public acceptance of CDM initiatives and the spending of ratepayer money to pursue them.

Conclusion

46. We appreciate the opportunity to provide our comments on this Staff Discussion Paper, and hope that our input is of value.

Respectfully submitted on behalf of the School Energy Coalition this 9th day of February, 2007.

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Per: _____
Jay Shepherd