



EB-2007-0096

IN THE MATTER OF the *Ontario Energy Board Act, 1998*,
S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an Application by Toronto Hydro-
Electric System Limited for an Order or Orders granting
approval and recovery of amounts related to Conservation
and Demand Management activities.

BEFORE: Paul Sommerville
Presiding Member

Paul Vlahos
Member

Cynthia Chaplin
Member

DECISION AND ORDER

Introduction

On March 26, 2007, Toronto Hydro-Electric System Limited (“Toronto Hydro”) filed an amended application with the Ontario Energy Board (the “Board”) under section 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15 (Schedule B). Toronto Hydro seeks approval and recovery of amounts related to the Lost Revenue Adjusted Mechanism (“LRAM”) and Shared Savings Mechanism (“SSM”) in relation to Conservation and Demand Management (“CDM”) activities undertaken by Toronto Hydro in 2005 and 2006. The Board assigned file number EB-2007-0096 to this portion of the application.

The application also addressed several aspects of Toronto Hydro's smart metering activities, one of which was considered as part of the adjustment to Toronto Hydro's distribution rates, effective May 1, 2007, while the remaining issues, the Board has determined, would be considered in a separate proceeding.

Toronto Hydro applied for approval and recovery of an LRAM amount of \$3,111,432, and a pre-tax SSM amount of \$7,290,767, for a total recovery of \$10,402,199. Toronto Hydro proposed that the LRAM and SSM amounts be recovered through rates over a six month period, beginning November 1, 2007.

On May 18, 2007, the Board issued Procedural Order Number 1 which outlined the schedule for the proceeding, including a technical conference and an oral hearing. On June 6, 2007, the Board held a technical conference, and on June 21, 2007, the Board held an oral hearing.

This Decision and Order addresses the following issues:

- Shared Savings Mechanism
- Lost Revenue Adjustment Mechanism
- Summer Challenge Program
- TAPS program
- Social Housing free ridership
- Custom projects free ridership
- CDM Programs involving affiliates
- Verification of CDM results
- Allocation and Recovery of LRAM / SSM
- Cost Awards

Shared Savings Mechanism (“SSM”)

The SSM is a financial incentive for utilities to implement effective CDM programs. Toronto Hydro has applied to recover an SSM amount of \$7,290,767. In its application, Toronto Hydro reported that the SSM amounts are based on free-rider adjusted quantities, and that the SSM amount has been grossed up for payments in lieu of taxes (“PILs”). The SSM amount being sought for recovery is a pre-tax amount. This approach attracted considerable commentary from several intervenors, who argue that the grossing up of the SSM to account for PILs is not consistent with the Board's earlier decision on the question, and is not appropriate.

The Board's approval of an SSM for electricity distributors appears in an oral decision, dated December 7, 2004, in proceeding RP-2004-0203, which addressed, in part, a Motion by Pollution Probe. That Decision stated, in part:

With respect to incentive plans, or SSM as it's described, the Board proposes to adopt the plan put forward by Pollution Probe.

Those supporting Toronto Hydro's approach argued that it provided an appropriate incentive for CDM activities within the sector. They suggested that "reducing" the incentive to what amounted to an after tax amount of 3.2 percent would diminish the interest of utilities in pursuing CDM activities. Some went so far as to suggest that a rejection of Toronto Hydro's approach would represent a retroactive change to the SSM architecture. In their view, this would be unfair to the extent that utilities may have engaged in CDM activities with an expectation of an after tax return of 5 percent of the net savings.

Toronto Hydro also suggested that the grossing up of the SSM for PILS "...is consistent with conventions around discussions of return on equity..."¹

The "convention" relied upon consists of the fact that returns on equity are typically expressed as being on an after-tax basis.

As is noted elsewhere in this Decision, it is not within the scope of this proceeding to revise seminal findings made by the Board in previous proceedings. The Decision which touches most directly on this issue is that referenced above on the Pollution Probe Motion (RP-2004-0203).

As noted, the Board in that case adopted the Pollution Probe "plan" for SSM. That plan very clearly did not contemplate that the relevant amounts would be grossed up to account for PILS, and this is clear from the record in that case, and the transcript of the Technical Conference in this case.

As part of the Pollution Probe Motion, it filed an Affidavit outlining its plan for the SSM. There is no reasonable construction of the plan described in that affidavit that would lead to a conclusion that it contemplated a grossing up for PILS.

¹ See response to Board Staff Technical Conference Question #6 dated June 6, 2007.

During the Technical Conference, Pollution Probe (the author of the SSM plan adopted by the Board) reacted strongly and negatively to the suggestion by Toronto Hydro that it understood that it provided for the grossing up applied by the utility.²

To be fair, in submissions made later in the proceeding Pollution Probe attempted to soften its approach on the issue, suggesting that grossing up may not be inappropriate. But this revisionism cannot change the fact that the plan the Board approved did not contemplate grossing up.

Further, the Board does not accept the argument advanced by Toronto Hydro, that the SSM should be presumed to be a post-PILS amount simply because of some presumption that it is related to return on equity and that return on equity is presumed to be a post-tax amount.

First, such a presumption cannot displace the simple fact that the Board adopted a plan that did not contemplate grossing up for PILS. Second, there is no compelling reason to align the SSM with return on equity.

The Board observes that the natural gas utilities in Ontario do not gross up their respective SSM incentive amounts for taxes and the amounts approved by the Board are pre-tax.

The Board rejects the suggestion that an SSM of 5 percent on a pre-tax basis is a retroactive change.

Accordingly, Toronto Hydro must recast its claim to reflect this finding that the SSM is not subject to grossing up to account for PILS.

The Consumers' Council of Canada raised a policy issue in its submissions. It questioned whether publicly-owned distributors should be eligible for an SSM, and, if so, whether 5 percent is the appropriate level. VECC made similar submissions. The Board notes that the purpose of this proceeding is to implement past Board decisions and to dispose of amounts arising from Toronto Hydro's CDM activities in 2005 and 2006. The Board has clearly approved an SSM for all distributors; those decisions are not being reviewed here.

² Transcript of the Technical Conference dated June 6, 2007, page 80, lines 11 et seq.

Lost Revenue Adjustment Mechanism (LRAM) Amounts

The LRAM ensures utilities receive revenue on energy volumes they would have sold if they had not implemented CDM programs. Toronto Hydro applied to recover an LRAM amount of \$3,111,432. The load reductions that form the basis of the LRAM amount were not adjusted for free riders³. Toronto Hydro's proposal to include lost revenue associated with free riders was supported only by the Electricity Distributors Association. All other parties that commented on the issue argued that lost revenue associated with free ridership should be excluded in the calculation of the LRAM amount to be recovered from ratepayers. Pollution Probe also suggested that the lost revenue should include carrying charges.

Toronto Hydro's rationale for its position is that the utility's load forecast at the time it filed for 2006 rates did not, explicitly or implicitly, account for autonomous conservation (free ridership). In Toronto Hydro's view it is not reasonable to expect Toronto Hydro to have created a forecasting model that accounted for CDM where programs such as those approved by the Board had not been implemented previously in Ontario, and where even early results from the Toronto Hydro programs, implemented in 2005 and 2006, would not have been available until 2006 at the earliest.

The Board does not accept Toronto Hydro's proposal. The LRAM adopted by the Board is to include the appropriate free ridership rates.

Toronto Hydro should not be compensated through the LRAM for revenue reduction that did not result from its CDM programs. In addition, to compensate Toronto Hydro for the effects of natural conservation would be to retroactively set Toronto Hydro's 2006 rates, which would be inconsistent with sound regulatory practice. Toronto Hydro will have the opportunity, as it acknowledges, to prospectively incorporate the impacts of existing CDM programs and natural conservation in its load forecast in the 2008 rate rebasing proceeding. The Board therefore finds that it is appropriate for the LRAM amount to be reduced in accordance with the free ridership rates found throughout this Decision.

The Board finds that Toronto Hydro is entitled to carrying charges on the LRAM balances. Toronto Hydro had calculated those charges at \$128,727. The carrying

³ Free riders are those customers who would have adopted the energy efficiency measures regardless of a program.

charges shall be recalculated on the reduced LRAM balances as set out in this Decision.

The revised calculations shall be submitted with Toronto Hydro's draft rate order.

Summer Challenge Program

Some parties argued that there is an overlap between load reductions caused by the Summer Challenge program and reductions caused by other CDM programs. The Summer Challenge program is an incentive-based demand reduction initiative targeted towards residential and small business commercial market segments. Toronto Hydro submitted that the Board has already approved a 10 percent free ridership rate for the Summer Challenge program in the RP-2004-0203/EB-2004-0485/EB-2006-0145 proceeding.

Toronto Hydro's witness stated that if parties have concerns respecting the program, such concerns should have been raised at the hearing which resulted in Board approval of the Summer Challenge program.

It was argued that it is unfair to ratepayers for Toronto Hydro to claim, retroactively, such significant LRAM and SSM amounts related to this program in the absence of any substantive evidence to support those claims. It was recommended that the LRAM related to this program should be reduced significantly, up to 75 percent, as suggested by the Consumers Council of Canada ("CCC"). The 75 percent would incorporate the 65 percent free rider rate cited in the Summit Blue Report that was filed as an exhibit in this proceeding and 10 percent to account for the impacts of Toronto Hydro's other CDM programs.

The Board finds that it is not within the scope of this proceeding to revise free ridership rates that have been determined by the Board previously. To do so would be to violate an important regulatory principle which requires that notice of the proceeding ought to give interested parties a clear picture as to what is under consideration in the proceeding. There is also an important issue of fairness. Where a utility has relied on a clear pronouncement by the regulator, it ought not to be subject to retroactive revision, except in the most compelling case. With respect to the Summer Challenge program, the Board had previously established a 10 percent free-ridership rate. The Board will not revise that rate in this proceeding.

Having said that, the Board considers it important to express its concern respecting the free-ridership assessment for this program, and the related issue of the double counting of CDM effects.

By its very nature, the Summer Challenge program may reflect the effects of all other CDM measures in play at any given time. It reflects the diminished usage of electricity over a given period of time. Reduced usage can be attributable to CDM programs offered by the utility, natural conservation, or even the temporary leaving of the property for vacation. Success under the program may not be specific to any of these “causes”.

Evidence was filed in this case respecting closely analogous programs in other jurisdictions. A persuasive case was made that the free-ridership rate for this kind of program should be revised sharply upward. It is arguable that the Summer Challenge program and those like it ought not to be considered as independent CDM programs in any degree.

The Board will not be retroactively changing the rules under which Toronto Hydro undertook the program.

TAPS Program

The TAPS program is undertaken by Toronto Hydro in partnership with Enbridge Gas Distribution Inc. (“Enbridge”). Toronto Hydro stated that the portion of the program that was implemented by Toronto Hydro involved replacement of conventional bulbs with compact florescent bulbs, and the implementation of water saving measures for homes with electric water heaters. Toronto Hydro submitted that it has limited its SSM claim to electricity-related savings and that it is appropriate to claim 100 percent of the benefits relating to electricity savings.

CCC submitted that the LRAM and SSM amounts attributed to this program should be reduced, and the future attribution rule changed, because Toronto Hydro has paid only 8 percent of the costs (Enbridge has paid 92 percent) and its shareholders will benefit in a way which is disproportional to its efforts. VECC argued for a similar reduction. Toronto Hydro opposed this proposal and maintained that it is only claiming for electricity-related savings and that it should not be penalized because the benefits greatly exceed the costs.

The Board agrees with Toronto Hydro. The TAPS program was approved by the Board, and no question has been raised as to the accuracy of the results. Toronto Hydro used a cost effective delivery channel and as a result the benefits greatly exceed the costs. The Board finds that this sort of cost effective program delivery is to be encouraged, not discouraged, and we therefore will make no reduction to the resulting LRAM or SSM claims in this respect.

Energy Probe submitted that the LRAM and SSM should be reduced to remove the effect of flat rate water heaters. Toronto Hydro agreed that the LRAM should be adjusted, but noted that the amount was only \$5,388. Toronto Hydro did not agree that the SSM should be adjusted. It argued that the total resource cost (“TRC”) benefits would still be achieved even with flat rate water heaters, and therefore the shareholder incentive should not be adjusted. The Board accepts Toronto Hydro’s submissions. Although the amount is small, the LRAM claim will be adjusted to remove the impact of flat rate water heaters. The Board finds no basis for reducing the SSM claim; although distributor revenue may not be impacted, TRC benefits will still accrue.

Social Housing Free Ridership

Toronto Hydro’s CDM activities also involved provision of high efficiency refrigerators and stoves for Social Housing. While the TRC Guide stipulates a free ridership rate of 10 percent for these measures, Toronto Hydro applied a rate of 0 percent on the belief that it was entirely the result of the program that these measures were undertaken and that this is consistent with commonly understood free ridership behaviour in the low income/social housing sector. VECC urged the Board to use the 10 percent free ridership rate.

The Board notes that the assumed free ridership rates in the TRC Guide were developed pursuant to a Board proceeding, with substantial participation from stakeholders. Deviation from the Board-approved rates would require persuasive evidence from a distributor or a Board decision or pronouncement that postdates the issuance of the TRC Guide. While no significant evidence was provided in this case, the Board acknowledges that in its decision in the Natural Gas Generic Demand Side Management (“DSM”) Issues Proceeding, EB-2006-0021 (the “Generic Gas DSM Proceeding”) the Board adopted a free ridership rate of 1 percent, which was the result of a settlement among the participants.

The Board agrees that it is not likely that a 0 percent free ridership rate would be appropriate, however, it does find that it may not be reasonable to apply 10 percent for these particular programs in the social housing sector. To the extent possible and practical, the Board strives to standardize policies and practices in the electricity and natural gas sectors. The Board therefore finds that the appropriate free ridership rate to be prescribed for Toronto Hydro's Social Housing programs is 1 percent. The Board recommends that Toronto Hydro conduct further research on what the most appropriate rate should be for Social Housing programs.

Custom Projects Free Ridership

Custom projects have been defined in the Board's TRC Guide as those projects where an LDC facilitates the implementation of specialized equipment and technology not identified in the Assumptions and Measures list in the TRC Guide. For custom projects, the Board adopted a default free ridership rate of 30 percent. There are three CDM projects which may be considered custom projects, for which Toronto Hydro used a free ridership rate of 10 percent. The three projects are the LED Traffic Lights program⁴, the Leveraging Energy Conservation program⁵, and the Load Displacement program⁶. Toronto Hydro's position is that the measures undertaken by the utility for the LED Traffic Lights and Leveraging Energy Conservation programs did not fall explicitly within the Board-approved measures list, but are similar enough to those in the TRC Guide list so as to justify a free ridership rate of 10 percent. In the case of the Load Displacement program, Toronto Hydro noted that the most accurate free ridership rate is 0 percent based on participants' confirmation that these projects would not have proceeded without the incentive provided by Toronto Hydro, but the utility applied a "conservative" measure of 10 percent.

A number of parties urged the Board to find that the appropriate free ridership rate is the TRC Guide default figure of 30 percent. Pollution Probe noted that the qualification by Load Displacement program participants that without the financial support of Toronto Hydro they would not have otherwise participated in the program "at this time" does not support Toronto Hydro's position that the free ridership rate is 0 percent. Energy Probe suggested that one of the Load Displacement projects, the Cadillac Fairview's TD

⁴ The LED Traffic Lights program involved replacing traffic signals at intersections with light-emitting diode (LED) technology.

⁵ The Leveraging Energy Conservation program involved lighting retrofits to commercial sector buildings.

⁶ The Load Displacement program involved solar panels and Deep Lake Water Cooling projects.

Centre, should be removed in its entirety since a May 13, 2004 media release by that customer announcing its participation in Enwave's deep lake water cooling system predated appreciably the Board's approval of Toronto Hydro's CDM plan.

In the Board's view, Toronto Hydro's Load Displacement projects reasonably exhibit the definitional characteristics of custom projects and the free ridership rate is therefore assessed on that basis. The Board considers that there is sufficient doubt whether the Cadillac Fairview's TD Centre should be included at all in the calculation of LRAM. The Board also considers that the qualification "at this time" in the acknowledgements executed by Load Displacement participants casts sufficient doubt about the adequacy of Toronto Hydro's proposed rate of 10 percent. Inherently, considerable judgement is involved in assessing what is an appropriate free ridership rate for custom projects. In the Generic Gas DSM Proceeding, the Board heard evidence on the merits of addressing free ridership rates for custom projects on a project-by-project basis versus a portfolio average approach. The Board determined that a portfolio approach was most appropriate.

The Board notes that 30 percent has been established as a default figure in the TRC Guide. In the circumstances, and for consistency, the Board has concluded that the default free ridership rate of 30 percent is the appropriate rate for Toronto Hydro's LED Traffic Lights, Leveraging Energy Conservation and Load Displacement programs, and the Board so finds.

CDM Programs Involving Affiliates

Energy Probe submitted that it is fundamentally wrong for Toronto Hydro to be shifting ratepayer CDM funding to its owner, the City of Toronto, and other affiliates as part of a customer side CDM program. It recommended that the Board reduce the LRAM and SSM claims for the amounts associated with affiliates, to in effect treat these programs as utility-side programs. Toronto Hydro opposed this proposal on the basis that the programs have already been approved by the Board.

The Board agrees with Toronto Hydro. These programs were explicitly approved by the Board and there is no justification to make retrospective adjustments to the approved treatment of them. No adjustment to the LRAM or SSM will be made in relation to the participation of affiliates. The Board does expect that on a forward-looking basis the

level of affiliate programs should be assessed in the context of the overall program mix to ensure that distributors are not discriminating to the benefit of their affiliates.

Verification of CDM Results

VECC expressed some concern that Toronto Hydro did not undertake a rigorous evaluation process, and suggested that future claims, at least of the larger utilities, should be subject to the necessary scrutiny and rigor to ensure that the interests of ratepayers are protected.

The application by Toronto Hydro that is the subject of this Decision and Order is the Board's first experience with reviewing LRAM and SSM recovery by an electricity distributor. Due to the absence in this case of any independent or third party opinion on Toronto Hydro's program results, the Board had difficulty assessing the reasonableness of the amounts claimed by Toronto Hydro for LRAM and SSM.

The Board is comforted by the knowledge that claims for the recovery of LRAM or SSM relating to funding in 2007 and beyond must be reviewed by a third party, as set out in the Report of the Board on the Regulatory Framework for Conservation and Demand Management by Ontario Electricity Distributors in 2007 and Beyond, issued March 2, 2007. It would have been helpful in this case, if the Board had the benefit of a third party review of Toronto Hydro's claim for LRAM and SSM recovery to better inform its decision making.

The information to be filed by distributors for recovery of LRAM and SSM relating to third tranche and 2006 incremental spending is set out in the Board's Filing Requirements for Transmission and Distribution Applications, dated November 14, 2006. This document lists the minimum informational requirements. Given the impact on consumers of rate adjustments resulting from LRAM and SSM, the Board must ensure that amounts claimed are just and reasonable. The Board believes that for future claims relating to third tranche and 2006 incremental spending, the Board and stakeholders could be assisted by an independent third party review of program results, and claim amounts.

Allocation and Recovery of LRAM / SSM

Toronto Hydro proposed that the respective amounts be allocated to the various rate classes in the same proportion as they were generated by those rate classes. This approach is acceptable to the Board, and should be reflected in the rate order prepared by Toronto Hydro to reflect our findings.

The Board finds that the amounts approved in this Decision should be collected by way of a rate rider which is designed to recover the outstanding amounts over a six month period concluding on April 30, 2008.

Cost Awards

On July 26, 2007, the Board directed that any party eligible for an award of costs must file a claim with the Board and Toronto Hydro no later than August 9, 2007. If Toronto Hydro had any comments concerning any of the claims, these concerns were to be forwarded to the Board and to the claimant by August 23, 2007. Any response to Toronto Hydro's comments was to be filed with the Board and Toronto Hydro by August 30, 2007.

Each of Energy Probe, Pollution Probe, School Energy Coalition, VECC and CCC filed a cost claim with the Board and copied Toronto Hydro.

Toronto Hydro stated that it was their opinion that Energy Probe's claimed hours are excessive given the limited nature of this proceeding and the issues that were canvassed. On August 31, 2007, Energy Probe filed a reply. Energy Probe submitted that the hours it included in its Costs Submission are directly attributable to its review of the 30 engineering reports filed after the evidentiary portion of the proceeding had concluded, and are reasonable and appropriate. The Board agrees.

The Board has reviewed Energy Probe's, Pollution Probe's, School Energy Coalition's, VECC's and CCC's claim and finds all to be eligible for 100 percent of their claimed costs.

THE BOARD THEREFORE ORDERS THAT:

1. Toronto Hydro shall file revised 2005 / 2006 LRAM and SSM amounts based upon the Board's findings in this Decision. The Board expects that sufficient material will be provided which breaks out the revised amounts by program as well as rate riders and bill impacts for each rate class. The revised amounts should be filed with the Board and participating intervenors by September 25, 2007.
2. Parties who wish to comment on the revised numbers based upon the Board's findings must file their submissions by October 2, 2007. The Board expects that any comments will only be related to Toronto Hydro's interpretation of the Board's findings.
3. Pursuant to section 30 of the *Ontario Energy Board Act, 1998*, Toronto Hydro shall immediately pay Energy Probe, Pollution Probe, School Energy Coalition, VECC and CCC their respective costs as claimed.
4. Pursuant to section 30 of the *Ontario Energy Board Act, 1998*, Toronto Hydro shall immediately pay the Board's costs of and incidental to, this proceeding immediately upon receipt of the Board's invoice.

ISSUED at Toronto, September 11, 2007.

ONTARIO ENERGY BOARD

Original signed by

Peter H. O'Dell
Assistant Board Secretary