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February 9, 2004

Mr. Paul Pudge
Board Secretary
Ontario Energy Board
2300 Yonge Street, 26th Floor
P.O. Box 2319
Toronto, ON M4P 1E4

Dear Mr. Pudge:

Comments on the OEB Staff Report on Demand Side Management and Demand Response in the Ontario Energy Sectors (RP-2003-0144)

We appreciate the opportunity to comment on the OEB Staff Report to the Board on Demand-Side Management & Demand Response in the Ontario Energy Sector. Guelph Hydro Electric Systems (GHES) supports the broad government objectives to introduce DSM and DR to the electricity sector in Ontario. These initiatives will be key contributors to ensuring Ontario's electricity needs are met.

GHES supports the general approach taken in the Staff Report, in terms of implementing a hybrid public and private sector model, the establishment of a Central Agency to manage province-wide DSM programs, and the funding of DSM through a transparent consumption (kWh) charge. We also support the implementation of a transitional DR program by the IMO, as well as TOU rates for Standard Supply consumers in the long run, and for the larger designated consumers in the short term, where practical. GHES believes that local distributors have an important role to play in the delivery of DSM programs. We disagree with the OEB Staff recommendation that appears to exclude LDCs from participating in DSM program delivery.

We have the following comments:

DSM/DR Advisory Group Report

GHES understands that there was a considerable level of support in the DSM/DR Advisory Group for the OEB-Utility model. The OEB Staff Report appears to totally reject this Advisory Group model. The Central Agency model recommendations of the Advisory Group included provision for the delivery of DSM programs by several players, including LDCs (AG Report 4.2.5). However, the OEB Staff Report appears to explicitly exclude LDCs from delivering DSM programs under a Central Agency model.

Central Agency versus OEB-Utility Models

The two basic model structures described in the AG report are not mutually exclusive. Both approaches have pros and cons. We believe that a hybrid model, with a Central Agency component to manage province-wide programs in a cohesive manner, together with a degree of autonomy for local implementation of area-specific programs by local delivery channels, would incorporate the benefits of both basic approaches, while limiting the shortcomings inherent in both. We believe that the unique positions of LDCs, with inherent knowledge of local market conditions and strong relationships with local customers, puts them in a prime position as a key local DSM delivery channel. We, therefore, support the Staff recommendation to use a hybrid approach, although we see a delivery role for LDCs, which the Staff Report specifically excludes.

Exclusion of LDCs as DSM Delivery Channels

We offer a number of comments on the Staff Report arguments in favour of excluding LDCs from DSM program delivery. We believe that the Staff Report arguments are flawed as noted below in our comments.

Concern #1: 'Energy efficiency programs should be province-wide for consistent coverage. The patchwork coverage through utilities tends to result in a confusing variety of programs for consumers.'

Response #1: We agree that consistency in programs is an important goal. The Advisory Group OEB/LDC model specifically made provision for a joint venture DSM entity for portfolio management (AG Report 5.2.2) and mechanisms for avoiding conflicting program (5.5.1). If the OEB Staff argument is intended to favor the Central Agency Model, it should not exclude LDCs from delivering programs managed by a Central Agency. In addition, there may be the disadvantages of a homogenized province-wide approach, as described in the AG Report (4.6): "A cookie-cutter approach to DSM is neither customer-focused, nor cost-effective in a province as large and diverse as Ontario". We believe that a Central Agency managed portfolio that includes LDCs as DSM delivery channels, and permits LDCs to implement targeted local programs where appropriate (perhaps with oversight), would achieve the benefits of both centralized and decentralized models, while simultaneously overcoming the limitations inherent in both models.

Concern #2: 'Utilities often integrate their DSM/DR programs into marketing strategies for building load and retaining customers. These competing goals subordinate the goal of conservation'

Response #2: This may have a valid argument for vertically integrated utilities prior to deregulation and competition. The 'wires-only' LDC with a defined service area has less of a need to embark on customer retention strategies at the expense of program delivery, and customer retention is of more interest to a commodity retailer than the regulated LDC. Performance Based Regulation attempts to improve the quality of distribution services while reducing the costs of those services. DSM can be one of those distribution services, as it is in the natural gas industry. The existing regulatory mechanisms, apparently very successfully used by the natural gas industry (DSMVA, LRAM, SSA), would work just as effectively in the electricity industry.

Concern #3: 'If a utility is to pursue energy efficiency for social benefits, then the utility may need to get large incentive payments and revenue protection to overcome business conflicts. This compensation comes directly from customers.'

Response #3: It is our view that this argument is flawed. Any organization that delivers DSM – LDC or not – will expect a return on investment. This would come directly from customers either way. LDCs will experience revenue erosion due to effective DSM, regardless of who delivers the DSM. The only difference is that the revenue protection could be built in, as with the current Union Gas model, or it could be external – with lower than forecast growth (due to effective DSM) a factor affecting future rate applications.

Concern #4: 'A study of U.S. jurisdictions found that utility-led and Central Agency led models have similar administration costs. In addition, utility incentives can be as much again as those administration costs.'

Response #4: As previously noted, the incentives required to deliver DSM programs will be required regardless of the entity that delivers the programs.

Concern #5: 'The utility model is inconsistent with the restriction on business activities that attempts to make distributors neutral to market forces.'

Response #5: It is our view that this is not a valid issue. By their very nature, DSM programs are interventions in the market, as 'market forces' are unable to elicit the desired responses in the market. DSM programs could be delivered equally as well by a regulated distributor, as a regulated service, or by unregulated delivery channels. Regulation of DSM programs, as is currently done in the natural gas industry, is one means of making LDCs 'neutral to market forces'.

Concluding Comments

The Staff Report, if adopted, would virtually eliminate the OEB involvement in DSM/DR with the exception of a role in consumer education. The report recommends phasing out the existing natural gas regulated DSM process and the integration of gas and electricity DSM under a single Central Agency.

In Section 3.1.1 of the Report, Board Staff note that the regulatory oversight of Ontario's natural gas DSM has proven to be complex and, at times, controversial. The observation is made that regulating the number and variety of electricity distributors may compound complexity. We are keenly aware of the complexity that a large number of regulated distributors may introduce to the equation. However, we suggest that a review of the regulatory process to reduce the number and complexity of hearings would assist the OEB reduce it's burden while enabling the province to benefit from the involvement of LDCs in DSM and conservation initiatives. For example, province-wide 'standard' programs could be addressed in a single hearing. The original Staff Discussion Paper on DSM/DR included several examples where distributors have significant roles in the DSM process. This report also described industry structures and the relationships established to ensure efficient allocation of resources and monitoring of results (Section 4 "APPROACHES TO DSM" and Appendix C "Role of Electricity Distributors in Various Jurisdictions").

The Staff Report (Section 3.3) in support of phasing out the existing natural gas regulated DSM process comments: 'Otherwise, gas distributors could structure programs to their competitive advantage'. As we previously noted in our responses to Concerns #2 and #5, the comment appears to align private sector enterprise with regulated franchised distribution delivery entities. We disagree with these Board Staff comments.

DSM is a means to an end. It is an intervention in the marketplace to reduce the rate at which end-users consume electricity or natural gas. In the electricity sector, effective DSM programs will reduce the amount of new generation capacity required, delay the requirement for some transmission and distribution expansion and help make our end-users more efficient. However, one of the key objectives at this point in our history is to reduce the generation capacity additions needed. The 20 largest LDCs in the province deliver to over 80% of the end-users. So although there is a need for programs to be seen to have broad application on a 'province-wide' basis, it is likely that not all programs will fit all LDCs. If a key early objective is to reduce electricity demand at peak times then the Board may wish to reconsider targeted programs within LDCs that can deliver the "biggest bang for the buck".

We look forward to working with the Board, Board Staff, and our colleagues in the LDCs in the future on this very important initiative.

Yours sincerely,

GUELPH HYDRO ELECTRIC
SYSTEMS LTD.

J.A. MacKenzie
President & CEO