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ONTARIO ENERGY BOARD
2006 ELECTRICITY DISTRIBUTION
RATE HANDBOOK HEARING

FINAL ARGUMENT
OF POLLUTION PROBE

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Murray Klippenstein
KLIPPENSTEINS
Barristers & Solicitors
160 John St., Ste. 300
Toronto, Ontario
M5V 2E5

Solicitors for Pollution Probe

TABLE OF CONTENTS

Introduction 1

Background and Context to This Hearing 1

Background Factor 1—The Board's objectives set out in The Ontario Energy Board Act 1

Background Factor 2—Present Government Policy 1

Background Factor 3--The Ontario Energy Board's Already-Established Regulatory Rules for the Promotion of Energy Conservation 2

The OEB's Regulatory Framework for the Electric Utilities' "Customer-Side of the Meter" Conservation and Demand Management Programmes in 2006 3

1. Lost Revenue Adjustment Mechanism (LRAM) 3

2. Shared Savings Mechanism (SSM) 4

a) Continuation of the 2005 SSM 4

b) Mr. Heeney's Alternative 5

c) The OEB's December 17, 2004 Draft SSM Guidelines—Ineligibility of Rate Base Programmes 6

3. Pre-Approval of Input Assumptions 7

4. The Input Pre-Approval and Audit Processes 8

5. Mr. Goulding's and Mr. Heeney's Alternative Proposals 9

6. Pre-Approval of Avoided Costs 10

7. CDM Budget for 2006 10

8. Conservation Expenditures Variance Account 11

9. Reporting 12

Distribution System Losses 12

Costs 14

Introduction

Pollution Probe hereby respectfully provides its submissions to the Ontario Energy Board for consideration in the Board's 2006 Electricity Distribution Companies Rate Handbook hearing.

Pollution Probe's submissions are limited to three issues: a) the Ontario Energy Board's (OEB's) regulatory framework for Ontario's electric utilities' "customer side of the meter" conservation and demand management (CDM) programmes; b) financial incentives to motivate Ontario's electric utilities to reduce their system losses; and c) costs.

Background and Context to This Hearing

It is Pollution Probe's submission that the Board's consideration in this hearing of the Board's future regulatory framework for the electric utilities' "customer side of the meter" CDM programmes in 2006 should take into consideration and be consistent with three important existing background factors: a) the objectives set out in the *Ontario Energy Board Act*; b) present government policy; and c) the OEB's already established regulatory rules for the promotion of energy conservation by the province's gas and electric utilities. It is submitted that all three factors strongly support the detailed position later set out in these submissions.

Background Factor 1—The Board's objectives set out in the Ontario Energy Board Act

According to section 1 of the *Ontario Energy Board Act*, the Board shall be guided by the following objectives:

1. To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service;

2. To promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.

Pollution Probe submits that the cost-effective and cost-saving conservation framework and measures advocated herein advance these objectives. For example, by moderating or reducing demand for electricity in a prudent manner, these measures will help avoid future price increases, and will prolong the adequacy of existing supply.

Background Fact 2—Present Government Policy

According to the Premier of Ontario, the Government's goals include:

a) phasing out Ontario's dirty coal-fired power plants;

b) reducing Ontario's electricity use by 5% by 2007;
c) making Ontario a North American leader in conservation; and
d) moving Ontario from a culture of waste to a culture of conservation. [Ex. D7.3, Tab 2, pp. 2 & 3]

These goals were further elaborated in the April 15, 2004 speech to the Empire Club by Minister Duncan, who announced that the "current disincentives" acting against the promotion of conservation by electric utilities will be removed and the utilities will "benefit" from promoting conservation. Minister Duncan also said that Ontario's electric utilities will play a key role in building a "conservation culture in Ontario".

> "Our sector reforms would also support conservation at the local level. The Ontario Energy Board would also establish a framework to help local distribution companies deliver energy conservation programs as appropriate. The current disincentives for local distribution companies would be removed, and LDC's would benefit from empowering their customers to conserve electricity and making their own systems more efficient.
>
> We believe that LDCs can and should be agents of change at the local level to promote conservation. LDCs are extremely well placed to encourage conservation and energy efficiency in the communities they serve, and we will need all their expertise, ingenuity and leadership to help build that conservation culture in Ontario." [Ex. D7.3, Tab 2, p. 2]

Pollution Probe submits that its proposals in these submissions are fully consistent with the above government goals, and further are very important and powerful mechanisms for implementing those policies. Pollution Probe in fact submits that its suggestions below are critical to achieving those ambitious government goals.

Background Factor 3--The Ontario Energy Board's Already-Established Regulatory Rules for the Promotion of Energy Conservation

Pollution Probe submits that several well-established regulatory rules in Ontario provide excellent tried and tested precedents for the measures suggested by Pollution Probe herein.

A number of years ago, the OEB established a Lost Revenue Adjustment Mechanism (LRAM), a Shared Savings Mechanism (SSM) and a Demand Side Management Variance Account (DSMVA) for Enbridge Gas Distribution.

In response to this regulatory framework Enbridge has developed some of the most cost-effective utility-sponsored conservation programmes in North America. Specifically, Enbridge's conservation programmes are reducing its customers' bills by $785 million net of all costs. [Ex. D.11.3] In addition, Enbridge's ratio of bill savings to utility expenditure, i.e., 7 to 1, is dramatically higher than the bill savings to utility expenditures ratios, i.e., 2 to 1, for many U.S. electric utilities. [Ex. D7.3, Tab 2, p. 9]

The OEB has established a LRAM and a DSMVA for Union Gas. Union Gas is now seeking OEB approval for a SSM for its 2005 rate year. [EB-2005-0211, Ex. A, Tab 4, p. 6]

In its landmark December 7, 2004 RP-2004-0203 decision the OEB permitted Ontario's electric utilities to establish LRAMs and SSMs so as to motivate them to aggressively and cost-effectively pursue CDM in 2005.

Pollution Probe submits that these existing measures provide a well-considered, tested and workable basis for further development of the electricity sector conservation framework as set out below.

The OEB's Regulatory Framework for the Electric Utilities' "Customer side of the Meter" Conservation and Demand Management Programmes in 2006

Pollution Probe's various specific submissions on different aspects of the OEB's regulatory framework for Conservation and Demand Management Programmes for electric utilities for 2006 are set out below.

1. Lost Revenue Adjustment Mechanism (LRAM)

To ensure that the electric utilities will not be penalized for implementing effective, "customer side of the meter", CDM programmes in 2006, they should be allowed to recover, in a subsequent rate year, the lost distribution revenues plus carrying costs that they experience as a result of their CDM programmes.

The appropriate methodology for calculating LRAM balances for 2006 will depend on whether the utility's rates are established on a historic test year or a future test year basis as described below.

<u>Scenario #1: Fiscal 2006 rates are not a function of a load forecast which takes into account the impact of the utilities' conservation programmes.</u>

A utility's lost distribution revenues, for each rate class, should be calculated by multiplying the *incremental* reduction in its kWh and kW volumes, as a result of its conservation programmes, by its distribution charges per kWh and kW.

<u>Scenario #2: Fiscal 2006 rates are a function of a load forecast which takes into account the impact of the utilities' conservation programmes</u>

If the actual electricity savings of a utility's conservation programmes are greater than forecast, the utility should be *allowed* to recover its lost distribution revenues plus carrying charges from its customers in a subsequent rate year. Conversely, if the actual electricity savings of a utility's conservation programmes are less than forecast, the utility

should be *obliged* to return its *excess* distribution revenues plus carrying charges to its customers in a subsequent period.

Pollution Probe endorses the procedures for calculating a utility's *incremental* savings that are outlined in Mr. Gibbons' evidence. [Ex. D7. 3, Tab 2]

2. Shared Savings Mechanism (SSM)

a) Continuation of the 2005 SSM

Ontario's electric utilities have many competing objectives. In particular, under the OEB's ratemaking rules, the utilities can increase their profits by increasing their delivery volumes and/or by reducing their delivery costs. As a consequence, the development of leading-edge, innovative and aggressive, "customer side of the meter" conservation programmes will not be a high priority for the utilities' boards of directors or senior management if the promotion of energy conservation is merely a cost-centre, instead of a profit-centre.

In its landmark December 7, 2004 RP-2004-0203 decision the OEB permitted Ontario's electric utilities to apply for a SSM incentive equal to 5% of the Total Resource Cost Test net savings created by their fiscal 2005 "customer side of the meter" CDM programmes. That is, if a utility's fiscal 2005 CDM programmes reduce its customers' bills by $100 million, the utility receives a $5 million conservation profit bonus.

The 2005 SSM is in the best interests of electricity consumers for two reasons. First, by motivating the electric utilities to aggressively and cost-effectively pursue CDM, it will lead to larger bill savings for customers. Second, as Mr. Goulding and Mr. Gibbons (the expert witnesses for Board Staff and Pollution Probe respectively) have both noted, CDM will reduce the need for expensive new sources of supply and thereby also reduce electricity rates. [Transcript Volume 9, para. 258, 259 and Volume 10, para. 1021]

The 2005 SSM is also consistent with government policy since it will motivate our electric utilities to "be agents of change at the local level to promote conservation."

The OEB's experience with natural gas utility conservation programmes has demonstrated that a SSM is necessary to motivate utilities to aggressively and cost-effectively promote energy conservation.

In its E.B.O. 169-III Report (July 23, 1993) with respect to gas conservation programmes, the OEB stated that it expected Ontario's gas utilities to aggressively promote energy conservation. However, it declined to allow the gas utilities an LRAM and a SSM. This may have been a major mistake, as the subsequent performance of Enbridge Gas Distribution and Union Gas suggests. For example, Enbridge failed to achieve its conservation targets by 19% to 70% between 1995 and 1998 inclusive. As a result, in order to encourage improved performance, the Board established a SSM for Enbridge

commencing in 1999. After the incentive was established, Enbridge exceeded its annual conservation targets by 21% to 67% from 1999 to 2001. [Ex. D7.3, Tab 2, p. 5]

Unlike Enbridge, Union Gas does not have a shareholder conservation incentive. As a consequence, the positive impact of a shareholder conservation incentive can also be seen by comparing Enbridge's and Union's forecast bill savings for 2004. Despite the fact that Union Gas is Ontario's largest natural gas utility, in terms of throughput volumes, its energy efficiency targets for 2004 are dramatically lower than those of Enbridge. Specifically, the forecast energy cost savings for Union's 2004 conservation programmes are 56% less than those of Enbridge ($79.4 million for Union versus $180.4 million for Enbridge). [Ex. D7.3, Tab 2, p. 6]

Finally, the benefits of an SSM can be seen by comparing the cost-effectiveness of Enbridge's conservation programmes with those of U.S. electric utilities. Enbridge's ratio of TRC net benefits per dollar of utility spending is 7 to 1, whereas the corresponding ratios for Efficiency Vermont, the Massachusetts electric utilities and Southern California Edison are all less than 2 to 1. Clearly there is a huge gap between excellent and merely "adequate" conservation programmes. [Ex. D7.3, Tab 2, p. 9] The initial energy conservation budget for Ontario's electric utilities is $225 million. If an SSM increases the utilities' conservation cost-effectiveness ratio from 2 to 1 to 7 to 1, Ontario's electricity consumers will benefit from an extra $1.125 billion of bill savings ($225 million x 5).

As Mr. Gibbons has noted, a SSM with a 5% incentive rate will generate incremental net bill savings for customers as long as it motivates the utilities to increase the gross bill savings of their CDM programmes by 5.3%. [Ex. D7.3, Tab 2, p. 6]

Therefore, it is Pollution Probe's submission that the OEB should continue its fiscal 2005 SSM with its 5% incentive rate in 2006 since it is consistent with: a) the objectives of the *Ontario Energy Board Act*; b) government policy; and c) the Board's established regulatory policies with respect to the promotion of energy conservation by energy utilities.

In addition, it is Pollution Probe's submission that, for the purposes of the SSM award, incremental TRC net savings should be calculated in accordance with the methodologies outlined in Mr. Gibbons' testimony.

b) Mr. Heeney's Alternative

According to the Canadian Energy Efficiency Alliance's (CEEA's) expert witness, the CEEA supports a SSM incentive which equals 5% of the TRC net benefits as proposed by Pollution Probe. [Transcript Volume 11, para. 83]. However, Mr. Heeney also believes that an incentive based on kWh savings would be acceptable. [Ex. D.11.2, pp. 5 & 6]

It is Pollution Probe's submission that an incentive which is a function of kWh savings is inconsistent with the objectives of the *Ontario Energy Board Act* which require the Board to "protect the interests of consumers" and "promote economic efficiency and cost effectiveness in the…demand management of electricity".

Pollution Probe's reasons for this submission are twofold. First, a kWh incentive would give the utilities an equal incentive to save electricity during peak and off-peak times. The value of savings a kWh at the time of system peak demand is dramatically higher than the value of saving a kWh during an off-peak period (e.g., 3 a.m. on a Sunday morning). Therefore an incentive based on kWh savings will not motivate the utilities to implement CDM programmes which will maximize bill savings.

Second, a kWh incentive could give a utility a conservation profit bonus even if the actual costs of its conservation programme are greater than its benefits. [Transcript Volume 11, para. 293]. Such an outcome would be directly contrary to the OEB's legislative mandate to promote "cost effectiveness".

c) The OEB's December 17, 2004 Draft SSM Guidelines—Ineligibility of Rate Base Programmes

The OEB's December 17, 2004 Draft SSM Guidelines propose that "customer side of the meter" conservation programmes, which have a rate base component, should be ineligible for a SSM reward. [Ex. D7.3, Tab 3]

It is Pollution Probe's respectful submission that this proposal is inappropriate for two reasons. First, since "customer side of the meter" programmes are typically less rate base intensive than utility side of the meter programmes, this rule would bias utility conservation expenditures in favour of "utility side of the meter" conservation programmes. Table 1 illustrates how this could occur.

Table 1

	Customer Side of the Meter Conservation Programme	Utility Side of the Meter Conservation Programme
Total Cost	$10,000	$10,000
Rate Base	$4,000	$5,000
Operating Cost	$6,000	$5,000
TRC Net Benefits	$25,000	$20,000
Annual Return on Rate Base at 10%	$400	$500

As Table 1 shows, the customer side of the meter and the utility side of the meter conservation programmes both have the same total cost, namely, $10,000. Furthermore, the "customer side of the meter" conservation programme is in the best interests of the ratepayers since it will reduce bills by $25,000 versus a $20,000 bill reduction for the

"utility side of the meter" programme. However, if the "customer side of the meter" programme is ineligible for a SSM reward, the utility will prefer the "utility side of the meter" programme which increases its earnings by $500 per year, compared to $400 per year for the "customer side of the meter" conservation programme.

Therefore, it is Pollution Probe's submission, that the Board's draft guideline will not encourage Ontario's electric utilities to become "agents of change at the local level" to help their customers conserve energy.

In addition, Pollution Probe is opposed to the draft guideline since it will remove the utilities' financial incentive to maximize the TRC net savings of "customer side of the meter" conservation programmes which have a rate base component. That is, the rationale for striving diligently to obtain the greatest magnitude of benefits possible in the circumstances is much weakened. Passable mediocrity would appear as acceptable as continued excellence. Pollution Probe submits that the Government's clear and ambitious conservation goals require an aggressive approach to incentives in this context.

3. Pre-Approval of Input Assumptions

According to the Conservation Working Group (CWG):

1. The calculation of the energy and bill savings associated with utility-sponsored conservation programmes depends on many input assumptions (e.g., avoided costs, kWh, kW and kVa savings per measure, measure lifes and free rider rates).

2. A retroactive, post-audit adjustment of some or all of these assumptions by the OEB could delay, complicate and jeopardize the ability of an electric utility to recover its conservation expenditures and/or its expected LRAM and SSM claims.

3. By minimizing regulatory risk and uncertainty the OEB can eliminate a serious disincentive to the implementation of innovative and aggressive conservation programmes by Ontario's electric utilities and streamline the regulatory process.

4. If the OEB's audit reveals a discrepancy between a pre-approved and an actual input value, the actual value should be considered along with any other relevant information in establishing future pre-approved values.

The CWG has recommended that:

1. Each electric utility should be permitted to seek pre-approval of its proposed input assumptions for some or all of its conservation programmes from the OEB.

2. The OEB should use the pre-approved values when determining a utility's LRAM claim and/or SSM reward. [Ex. D7.3, Tab 4, CWG Recommendation #7]

As the Board is aware, in its RP-2002-0133 *Partial Decision With Reasons* it gave Enbridge Gas Distribution pre-approval for some of the inputs that are to be used to calculate its SSM award. See Appendix B, pages 68 to 71 of the Board's *Decision* for more details.

It is Pollution Probe's submission that the CWG's recommendation is in the public interest since it will reduce the utilities' regulatory costs and risks and thereby remove a barrier to the aggressive promotion of "customer side of the meter" CDM programmes. Furthermore, this cost and risk reduction measure is very reasonable if the Board decides to re-approve the very low (5%) SSM incentive rate which it adopted for 2005. According to Mr. Goulding's evidence, a 5% rate is at the very low end of the range for shareholder conservation incentives. [Transcript Volume 9, para. 299, 300]

4. The Input Pre-Approval and Audit Processes

The CWG made the following recommendations about the OEB's Input Pre-Approval and Audit Process.

1. The OEB should hire an independent auditor to: a) provide it with technical advice with respect to the utilities' applications for pre-approval of input assumptions; and b) audit the utilities' LRAM and/or SSM claims.

2. The OEB should establish an Audit Advisory Committee consisting of one representative from each of the following province-wide constituencies: a) residential, commercial and institutional customers; b) industrial consumers; c) environmental groups; and d) electricity distributors. The Audit Advisory Committee should provide advice to: a) the OEB with respect to the selection of the independent auditor and other audit-related issues; and b) the independent auditor. [Ex. D7.3, Tab 4, CWG Recommendation #8]

Pollution Probe supports the CWG's recommendations. In addition, Pollution Probe would like to make the following further recommendations about the input pre-approval and audit process.

1. The OEB should invite nominations and select an Audit Advisory Committee as soon as possible. The Board should financially reimburse Advisory Committee members for their time.

2. The recommendations of the Auditor and/or the Advisory Committee should be posted on the OEB's web site to allow citizens, intervernors and utilities to provide their comments. Funding should not be provided for submissions with respect to the recommendations of the Auditor and/or the Advisory Committee.

3. The Auditor and/or the Advisory Committee may alter their recommendations in response to comments received by the Board and then submit a final recommendation to the Board.

4. Any party may petition the Board for a written or oral hearing with respect to the recommendations of the Auditor and/or Advisory Committee.

5. After the OEB has given pre-approval to a specific input for a specific utility, another utility (the applicant) should be allowed to file a notice of intent with the OEB to also use the pre-approved input. The OEB should then give the applicant permission to use the pre-approved input or state why the applicant cannot use the input because of some unique aspect of its territory or system.

5. Mr. Goulding's and Mr. Heeney's Alternative Proposals

Mr. Goulding agrees that the OEB should pre-approve the utilities' inputs. [Transcript Volume 8, para. 176, 177]. However, according to Mr. Goulding, the OEB should accept input estimates provided by organizations such as the Canadian Electricity Association subject to challenge:

"I would tend to think that a better approach might be to have utilities file using inputs from a reputable third party, and that could be using, for example, assumptions that are developed by the Canadian Electricity Association, it could be a variety of published sources, and to assume that these inputs are correct, subject to challenge." [Transcript Volume 8, para. 178]

Pollution Probe strongly disagrees with Mr. Goulding's proposal. The Canadian Electricity Association is a trade association for electric utilities. Therefore it cannot be assumed that its interests are always aligned with those of electricity consumers. The OEB's duty, unlike the Canadian Electricity Association, is to protect the interests of Ontario's electricity consumers. Therefore the OEB must rigorously scrutinize all inputs in order to ensure that the utilities' LRAM and SSM awards will be reasonable and fair to the utilities' customers as well as its shareholders.

According to Mr. Heeney, each electric utility should be allowed to hire its own auditor to audit its LRAM and SSM claims. [Ex. D.11.2, pp. 15, 16] Pollution Probe believes that this proposal is not the best way to advance the public interest in this context since it will lead to needless duplication of effort, inconsistent results and the potential for excess LRAM and SSM rewards.

Considerable judgment and expertise must be applied to the auditing of CDM programme inputs. If each utility hires its own auditor, the time consuming process of determining the correct input values will be repeated by up to 90 different auditors. This will involve unnecessary duplication and expense which will ultimately be borne the ratepayers. Furthermore, it will lead to inconsistent findings and hence inconsistent LRAM and SSM awards. This inconsistency will be unfair to the utility shareholders and it will make it more difficult for the OEB and the public to determine which utilities have the most cost-effective CDM programmes.

Finally, if each utility can hire its own auditor, it will have an incentive to hire an auditor who will make judgments that favour the utility's shareholder at the expense of its customers. Therefore, if the utilities are permitted to hire their own auditors, the public will be very skeptical about the validity of the utilities' savings estimates and the legitimacy of their LRAM and SSM rewards.

It is Pollution Probe's submission that the OEB must select the independent auditor to audit the utilities' LRAM and SSM claims in order to ensure that the utilities' CDM programmes are truly as cost-effective as they claim to be and to protect the interests of Ontario's electricity consumers.

6. Pre-Approval of Avoided Costs

> According to the CWG, a top priority for the OEB should be to issue pre-approved values for the avoided costs of electricity generation, transmission and distribution . [Ex. D7.3, Tab 4, CWG Recommendation # 7]
>
> It is Pollution Probe's hope that in their reply arguments Hydro One, Toronto Hydro, Enbridge Gas Distribution and/or Union Gas will offer to submit, within one month, electricity generation, transmission and distribution avoided cost values, for each of the next 15 years, for OEB pre-approval. In the absence of such an offer, the OEB should immediately hire a consultant (e.g., Navigant Consulting) to develop these avoided cost values as soon as possible. [Transcript Volume 10, para. 1045 - 1047]

7. CDM Budget for 2006

According to Mr. Goulding, since the Government has decided to obtain incremental electricity supplies from new relatively high-cost, natural gas-fired power plants in order to phase-out its dirty coal-fired power plants, the aggressive and cost-effective promotion of CDM will simultaneously reduce electricity bills and rates:

"Mr. Zbogar: Okay. Now, therefore, is it reasonable to assume that the aggressive and cost-effective promotion of C&DM by Ontario's electric utilities will lead to lower bills and to lower electricity rates?

Mr. Goulding: Yes, if you make the assumption that new generation is needed due to government policies, and that that new generation will be gas-fired." [Transcript Volume 9, para. 258, 259]

Therefore a high-level of utility spending on CDM is in the economic self-interest of all electricity consumers as long as the spending is cost-effective. According to Mr. Chernick, the Green Energy Coalition's expert witness, the electric utilities should be permitted to spend up to $2.50 per mWh on CDM without seeking individual approval from the OEB.

"Ms. Girvan: So, really, at most, what you would see the Board setting out in the handbook would be a guideline which says, They want the utilities to maximize TRC benefits, but anything above $2.5 per megawatt-hour – if you want to spend more than that, then you have to seek individual approval.

Mr. Chernick: Yes." [Transcript Volume 10, para. 399, 400]

Pollution Probe agrees with Mr. Chernick's recommendation. Therefore it is our submission that the OEB should give Ontario's electric utilities permission to spend up to $2.50 per mWh on "customer side of the meter" CDM programmes in 2006. Utilities that wish to spend more than $2.50 per mWh on CDM programmes should be required to seek OEB approval for their proposed CDM programmes and budgets so that the Board can ensure that the proposed spending is cost-effective. Finally, it is Pollution Probe's submission that the Board should encourage all utilities that believe that they can cost-effectively spend more than $2.50 per mWh on CDM in 2006 to seek its approval to do so.

8. Conservation Expenditures Variance Account

The CWG has recommended that the variance between a utility's actual and budgeted conservation expenditures should be recorded in a Conservation Expenditures Variance Account (CEVA). If actual expenditures are less than budgeted expenditures, the variance plus carrying charges should be returned to the utility's customers in a subsequent rate year. Actual expenditures up to 120% of budgeted expenditures plus carrying charges should be recorded to be recovered from ratepayers in a subsequent year. A utility should be permitted to seek OEB-approval, during the rate period, to record annual expenditures in excess of 120% of budgeted expenditures in the account. [Ex. D7.3, Tab 4, CWG Recommendation #10]

It is Pollution Probe's submission that this proposal is in the public interest for the following reasons.

1. Ontario's electric utilities should not be given an incentive to increase their profits by under-spending their conservation budgets.

2. Ontario's electric utilities should have automatic approval to exceed their conservation budgets by up to 20% to respond to unanticipated customer demands.

3. Enbridge and Union Gas have conservation expenditure variance accounts (i.e., Demand Side Management Variance Accounts or DSMVAs).

9. Reporting

Standardized reporting of utility conservation expenditures and results will facilitate the identification and adoption of best practices and simplify regulation.

The CWG has recommended that the utilities should file the following statistics about their conservation programmes on an annual basis:

- Annual kWh, peak kW and peak kVa saved;
- Annual kWh, peak kW and peak kVa saved, as a percentage of the utility's total kWh delivered, peak kW and peak kVa respectively, broken-out according to major customer segments (e.g., residential, commercial/institutional, industrial);
- Conservation expenditures;
- Conservation expenditures per kWh delivered, peak kW and peak kVa, broken-out by major customer segments;
- Net present value of TRC benefits, broken-out by major customer segment;

The CWG has also recommended that the OEB's independent auditor should compile the above statistics, on a post-audit basis, for each utility. [Ex. D7.3, Tab 4, CWG Recommendation #6]

Pollution Probe agrees with the CWG's recommendations and it is Pollution Probe's submission that the OEB should require the filing and publishing of all of the above-noted statistics on an annual basis.

Distribution System Losses

In 2002 Ontario's transmission and distribution line losses were equivalent to 30% of Ontario's total coal-fired electricity generation. [Transcript Volume 7, para. 839, 840] Any significant potential savings in line losses might therefore substantially contribute to the major government goal of phasing out coal-fired generation.

According to Messrs. White and Chernick, electric distribution companies can implement a wide variety of options to reduce distribution losses, including:

1. increase the voltage of their distribution lines;
2. purchase more energy-efficient transformers;
3. encourage their customers to shift some of their loads from peak to off-peak periods;
4. reduce electricity theft;
5. install capacitors;
6. bill on a kVa basis;
7. feeder phase balancing; and
8. optimizing open point locations between feeders. [Transcript Volume 7, para. 846 to 895; and Transcript Volume 10, para. 225, 226]

However, at the present, distribution system losses are a "pass-through" item for Ontario's electric utilities. As a result, the utilities do not have a direct financial incentive to reduce line losses. [Transcript Volume 7, para. 898 to 904]

The draft *2006 Electricity Distribution Rate Handbook*, (10 January 2005) contains two alternative ratemaking options with respect to distribution system line losses. Alternative #1 is the status quo option where line losses are a pass-through item and the utilities have no direct financial incentive to reduce line losses. Under Alternative #2, any variance between a utility's actual and budgeted kWh line losses are no longer a pass-through item. As a consequence, if Alternative #2 is adopted by the OEB, the utilities will have a direct financial incentive to reduce line losses.

Mr. White appears to be opposed to Alternative #2 on the grounds that, if it is adopted, the electric utilities' profits could be affected by factors outside of their control.

The validity and importance of this concern, Pollution Probe respectfully submits, is open to serious doubt. In his evidence Mr. White provides an analysis of the potential impact of Alternative #2 on an electric utility's profits if a large customer or an electricity generator is added to or subtracted from a utility's distribution system. However, Mr. White's examples are very extreme. In his examples the large customer and the electricity generator are responsible for 13% and 28% of the utility's total load respectively. [Transcript Volume 7, para. 1014, 1015, 1057, 1058] With the possible exception of some very small electric utilities, none of Ontario's electric utilities will experience a 13 to 28% change in their distribution volumes in 2006. Furthermore, according to section 10.5 of the draft *Rate Handbook*, if a utility expects that its loss factor will change, due to the gain or loss of a large customer, it can adjust its loss factor accordingly. Therefore an anticipated change in a utility's loss factor due to the gain or loss of a large customer will have no impact on a utility's profits.

Furthermore the impact of random unexpected customer gains or losses can either increase or decrease a utility's profits and therefore, over time, these random events will have no net impact on the utility's expected profits. Moreover, within any given rate year the adverse profit impact of random increases in system losses may be offset by other random factors (e.g., increased delivery volumes due to a hot summer).

Finally, it is important to note that the potential negative or positive impact on the utility's profits due to a change in its total distribution losses as a result of a loss of a large customer will be trivial compared to the impact of the loss of a large customer on its total distribution revenues and hence profits. [Transcript Volume 9, para. 355, 356]

Pollution Probe therefore respectfully suggests that Mr. White's concern about electric utilities' profits being unfairly affected by factors outside of their control if Alternative #2 is adopted is not well-founded.

Pollution Probe therefore respectively submits that the OEB should adopt Alternative #2 since it will lead to lower electricity rates and it will make Ontario more energy efficient.

If Alternative #2 is adopted, it will provide the electric utilities with a direct financial incentive to reduce their line losses as aggressively and cost-effectively as possible. As a consequence, over time, the utilities' rates will fall as their line loss costs decline. Second, since a reduction in line losses will reduce the need for new, relatively high-cost natural gas-fired power plants, Ontario's average electricity generation costs will decline (or rise less steeply).

It is also Pollution Probe's submission that the OEB should permit the utilities to rate base their capital expenditures to reduce line losses.

If due to factors beyond its control, a utility's profits are unacceptably low because of this change, it should be permitted to apply to the OEB for a special rate adjustment.

Costs

Pollution Probe submits that its participation in this hearing has been responsibly conducted and has, it believes, contributed to the Board's consideration of the issues. Pollution Probe therefore requests its costs of this proceeding in accordance with the Board's rules.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Murray Klippenstein
Counsel, Pollution Probe