

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

**AND IN THE MATTER OF** the preparation of a handbook  
for electricity distribution rate applications

**REPLY EVIDENCE OF HYDRO ONE INC. REGARDING  
CONSERVATION AND DEMAND MANAGEMENT EVIDENCE FILINGS**

**January 18, 2005**



## **Introduction**

As discussed in the evidence of Pollution Probe, the Green Energy Coalition and the Ontario Energy Board staff,<sup>1,2</sup> utilities are a key delivery mechanism for Conservation and Demand Management (CDM); yet before they will be in a position to deliver the required results, three issues must be addressed:

- recovery of costs associated with CDM activity,
- lost revenues resulting from reduced electricity and
- incentives to shift scarce resources to CDM from other activities.

Hydro One also submits that the determination of utility funding levels for CDM activities is another issue which requires attention. We believe that CDM funding levels should follow the Government's policy and that each utility should assess its funding levels and portfolio of programs based on appropriateness to its customer base and overall cost-effectiveness. This submission briefly addresses this issue after a discussion of the above three items.

## **Recovery of Costs Associated with CDM Activity**

Without assured cost recovery of program expenditures and administrative effort, utilities will be tentative in their CDM activities. Costs, which are relegated to deferral accounts to be cleared at some future time and subject to an unknown cost recovery method, become an uncontrollable risk for utilities. Risks of this nature will be minimized by the utilities resulting in tentative CDM activities. The preferred utility mechanism for cost recovery is one that collects revenue during the same period as costs are being incurred.

## **Lost Revenue Resulting from Reduced Sales**

The above noted evidence recognizes the need to compensate utilities for revenue lost as a result of undertaking CDM activities. Hydro One agrees with the position put forward by the Green Energy Coalition and Pollution Probe, that, for at least the short term, it is advisable to adopt the approach suggested by the RP-2004-0188 Conservation Working Group of using pre-approved input assumptions for calculating revenues lost to CDM effort, for which the utility will be compensated. This provides utilities with an assured mechanism for assessing programs and for recouping lost revenues.

Hydro One believes that even in the longer term, adjustments to input assumptions (and to funding) should be done prospectively, not retroactively. Retroactive adjustment of input assumptions and the effort required by each utility to defend them, serve only to distract utilities from program delivery and to focus their attention predominantly on regulatory processes and preparation for them. We believe that, rather than requiring each utility to undertake an extensive audit and report on each of its programs, a review of only a small sample of similar programs should be necessary to verify and/or re-calibrate the relevant common input assumptions on a prospective basis. Only in those cases where a utility has a unique program, typically for a large commercial or industrial customer, should there be a need for utility-specific information.

## **Incentives to Shift Scarce Resources to CDM from Other Activities**

Hydro One agrees with evidence submitted by all of the above parties, which recognizes the need for incentives to encourage utilities to assign their limited resources from more traditional utility operations to CDM activities. We, however, do not agree with the contention by some that utility-side CDM activities differ from customer-side CDM in their need for incentives.

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<sup>1</sup> These were "A Lost Revenue Adjustment Mechanism and a Shared Savings Mechanism for Ontario's Electric Utilities," submitted by Pollution Probe, December 20, 2004; "Cost Recovery for Conservation and Demand Management for Ontario Electric-Distribution Utilities," submitted by the Green Energy Coalition, December 20, 2004; "Overview of C&DM Practices in North America and Potential Alternatives for Ontario," submitted by Board staff, December 20, 2004.

<sup>2</sup> Hydro One acknowledges the evidence submitted by ECMI Coalition addressing incentives which deal with electrical losses.

A MW of commodity demand reduction on the utility side of the meter is indistinguishable from a MW of commodity demand reduction on the customer side of the meter. Similarly a MWh commodity consumption reduction on the utility side of the meter is indistinguishable from a MWh of commodity consumption reduction on the customer side of the meter. These reductions provide benefits to all customers. As such, incentives should apply equally to any equivalent demand or consumption reduction.

For example, should a utility-oriented initiative and a customer-oriented initiative have the same capital and operating costs and the same effect on demand and consumption, the utility initiative would comprise the "correct" societal choice as it incurs no lost revenue needing recovery and therefore it would achieve the same result with a lower overall cost. In this case, an incentive for customer initiatives only would tend to encourage the utility to direct its expenditures toward the more expensive customer-side initiative in order to earn the incentive payments. Incentives which are also directed toward utility-oriented CDM initiatives will help the utility to develop the right balance of cost-effective initiatives.

Hydro One agrees with Pollution Probe that the approach suggested by the RP-2004-0188 Conservation Working Group of using pre-approved input assumptions for calculating incentive payments would provide utilities with the information they need to confidently assess and deliver CDM programs. The effort would be directed away from protracted regulatory processes and towards program delivery.

#### **Determination of CDM Funding Levels**

Hydro One is concerned with the discussion of funding levels and comparisons with other jurisdictions with very different commodity price levels, pricing structures and customer composition. Higher commodity prices in other jurisdictions would imply higher avoided costs and a commensurate increase in initiatives that would be cost-effective. In addition, other jurisdictions may have a composition of customers and related end uses, which are significantly different from those experienced in Hydro One's service territory. Hydro One Networks has a very low density service territory, which increases our cost of program delivery and therefore, further reduces the scope of CDM initiatives that will be cost-effective versus those of higher-priced jurisdictions. Hydro One believes that the CDM funding level for utilities should follow Government policy and that each utility should establish a funding level and develop a portfolio of programs based on their appropriateness to its customer base and overall cost-effectiveness. We do not believe that appropriate funding levels can be achieved by applying a simple formula across all utilities.

#### **Other Matters**

Hydro One wishes to raise two additional matters:

- In developing mechanisms for the Ontario electricity industry, it is necessary to keep in mind the differences versus the gas industry. Electricity cannot readily be stored. The electricity industry requires instantaneous supply to match peak demand, which creates peak supply issues in both the summer and winter that are not experienced in the gas industry. Furthermore, there are approximately 90 electric utilities versus two gas utilities, a difference in industry structure which requires a simplified regulatory process if CDM is to be successfully implemented in the electricity industry.
- Considerable weight has been given by some entities to an avoided cost study in which Hydro One Networks is participating. Hydro One wishes to make clear that this study is predominantly focussed on approaches taken to estimate avoided costs and whether or not the approaches taken in the gas industry can be applied to the electricity industry. Hydro One does not have any knowledge of or involvement with commodity based avoided costs, which are by far the largest component to be considered in the implementation of CDM initiatives. The study in which Hydro One is participating will not derive commodity based avoided costs. The OEB, the OPA or some other entity will need to develop these commodity based avoided costs, for use by electric utilities.