

2006 Electricity Distribution Rates
(RP-2004-0188)

Reply Submission

From:



CANADIAN
Energy Efficiency Alliance

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1. Background

The Canadian Energy Efficiency Alliance (“Alliance”) reply submission consists of three main components:

- **A summary of our submission of 14 February 2005.** After reviewing the submissions of other parties the Alliance has concerns that some of our positions may not have been accurately stated.
- **A clarification of elements of our position.** Based on our review of the comments by other participants, the Alliance appreciates the opportunity to clarify and elaborate on our position concerning a number of issues.
- **Comments on selected submissions of other parties.** Some participants have raised issues that were not previously addressed in the working group, or directly during the hearing.

2. Summary of the position of the Canadian Energy Efficiency Alliance

The major components of the Alliance’s position in this case relate exclusively to Conservation and Demand Management (CDM), and include:

The context of conservation and demand management

- The Rate Handbook should include a definition of Conservation and Demand Management (CDM) that is based on the local distribution company (LDC) activities authorized by the *Ontario Energy Board Act* and the *Electricity Act*, and as elaborated upon in the Minister’s letter to LDCs of May 31, 2004. The Alliance suggests that the definition of CDM should include energy efficiency, load management and distributed generation, but for post third-tranche spending should exclude smart meters, which are being addressed through a separate initiative. CDM should also include LDC initiatives to reduce distribution losses; to reduce electricity use by customers behind their meters; and to reduce electricity use within its own operations, as a consumer of electricity.
- The Board has an affirmative obligation to actively encourage LDCs to undertake CDM activities, and should expressly state in the Rate Handbook that the Board expects each LDC, as part of its core business, to engage in CDM activities that are aggressive. This is consistent with the Board’s

approach to encourage aggressive and cost effective gas DSM since E.B.O. 169-III.

Regulating CDM

- The Board can encourage LDCs to undertake CDM in 2006 by committing to: ensuring that the regulatory burden does not impede action, innovation or experimentation; by developing a *Conservation Manual* that will provide methodologies and data the LDCs can rely on¹; and by establishing the necessary deferral or variance accounts for CDM in the Accounting Procedures Handbook and the Uniform System of Accounts.
- The Board should facilitate open and transparent processes in order to encourage: continued cooperation and sharing of information among utilities; innovation and learning about energy use and energy saving opportunities; and on-going consultation with technical experts, and local stakeholders. Some specific suggestions for realizing these are presented in the Alliance Argument of 14 February 2005.

The CDM filing

- A CDM filing should be part of the normal rates application and not a separate process. Setting out the specific CDM filing requirements in the *Conservation Manual* will increase the overall efficiency of the CDM approval process by assisting LDCs in the preparation of their applications, and reducing the Board's own burden in reviewing these applications. Some specific suggestions for what the CDM filing should include are provided in the Alliance Argument of 14 February, 2005 (p.6).
- In addition to reporting on individual programs, the CDM filing should address how the CDM portfolio was selected, taking into account a range of design criteria, including: cost effectiveness (i.e. TRC where appropriate), distribution of programs across customer classes, local needs, partnership opportunities, a mix of long and short term measures, low income and other hard to reach consumers, and a mix of distributed generation, load management, and energy efficiency measures. The filing should also indicate the nature and extent of public notice and consultation.
- LDCs should only be required to advise the Board where there are material and substantial deviations from the program outlined in the approved rate application, and no interim filings should be required.

¹ The VECC submission of 14 February 2005 indicates that the Alliance proposes standardization for measure life and savings. In fact, the Alliance sees these as only two of many input data that would be addressed by the *Conservation Manual* (see p.16 of the Alliance Argument of 14 February 2005).

- The full rate application, including the CDM plan, should be readily available to any party who may wish to intervene. This may best be achieved by publishing it on the World Wide Web, and including the URL in public notices. No special notification provisions for CDM beyond those that are provided in the rate application ought to be required.

CDM financing issues

- LDCs that have completed spending of their third-tranche funds for CDM should be able to apply for additional funds for CDM activities. The Board should not set a minimum or maximum amount to be spent on CDM. Rather, the Board should set a guideline on total spending in 2006, including any remaining third-tranche funds allocated to customer-side programs, of between 0.5% and 3% of gross revenues for customer-side programs. LDCs may apply for values outside this range, but would be expected to explain why their spending ought to be outside this range.
- Customer-side CDM spending should be treated as an expense for rate making purposes, not capitalized. Other CDM spending (i.e. utility-side CDM and in-house programs) should be treated in the same manner as other utility expenditures.
- The CDM revenue requirement should be allocated among all rate classes and be recovered in rates in the same manner as other expenditures that apply to all rate classes.²
- A lost revenue adjustment mechanism (LRAM) should be put in place. LDCs should be encouraged to quantify forecasted load reductions based on their proposed CDM activities and these forecasted load reductions should be used in determining applicable rates for the test year.
- For the 2006 test year, an incentive of 5% of total net TRC benefits would be appropriate for customer-side CDM programs.
- The Board should require LDCs to evaluate their programs and to undertake a third-party audit of LRAM or incentive claims. The Board should provide guidance in the *Conservation Manual* on an appropriate audit protocol.

² The VECC submission suggests that the Alliance favours 'split savings'.

The application of the financing recommendations to the three types of CDM activities is summarized in the following table:

	Customer-side programs	Utility system programs	In-house utility conservation
Recovered through rates beyond 3 rd tranche	Yes	Yes	Yes
Part of 0.5 – 3% budget guideline	Yes	No	No
LRAM	Yes	No	No
Incentive	Yes	No	No
Reporting on results	Yes	Yes	Yes
Capitalized/expensed	Expensed	C/E according to normal accounting practices	C/E according to normal accounting practices

The Conservation Manual

- The development of the *Conservation Manual* is a priority task and should be a Board-driven process, coordinated by a consultant familiar with the Ontario market, in consultation with a small group of technical experts and representatives.
- The Board should provide direction and guidance on the content and format of the *Conservation Manual*.
- LDCs may use data or methodologies other than those set out in the *Conservation Manual* if they provide a rationale for their alternatives. The *Manual* should be revised and enhanced on a regular basis over time as additional or better data become available.

The appropriate role for consultation, including in developing the *Conservation Manual* is discussed below.

3. Clarification of elements of our position based on submissions of others

Role of the Board

At the hearing, and in their submissions, a number of participants advocated a cautious approach to CDM. In particular, concern was raised over the relative inexperience of electricity LDCs, and the uncertainty of the role of the Ontario Power Authority (OPA), in general, and the Conservation Bureau, in particular.

The Alliance would like to stress that it has always advocated, and the government has accepted, a hybrid model for implementing CDM measures. This has been indicated in a number of ways:

- Section 1 of the *Ontario Energy Board Act, 1998*, (The “OEB” Act) has been amended to provide that in carrying out its responsibilities the Board shall be guided by the objective to promote economic efficiency in not only the generation, transmission, distribution, and sale of electricity, but also in the demand management of electricity. Demand management is now a specific, enunciated objective for the Board.
- The previous concern as to whether LDCs had the authority to carry out CDM initiatives has been clarified with the addition of subsection 71(2) of the *OEB Act*, which provides that a transmitter or distributor may provide services that would assist the Government of Ontario in achieving its goals in electricity conservation, including services related to the promotion of electricity conservation and the efficient use of electricity.
- The hybrid nature of the regulatory scheme is also reflected in subsection 29.1(1) of the *Electricity Act*, which provides that a transmitter, distributor or the OPA may provide services that would assist the Government of Ontario in achieving its goals in electricity conservation, including services related to the promotion of electricity conservation and the efficient use of electricity.

It is clear that transmitters, distributors and the OPA each have a significant role to play in providing CDM services. In this regard, the role of electricity distributors is parallel with, and complementary to, the role of the OPA, but not subservient to the OPA.

Need to act now

The Alliance is concerned that in the past uncertainty has led to inaction.

Because of the pressures on the Board in 1999 in opening the electricity market and unbundling rates, Chapter 8 of the Electricity Distribution Rate Handbook, dealing with Demand Side Management, was essentially a placeholder for first generation PBR and DSM issues were expressly not examined. There was also the uncertainty, which has now been resolved, concerning whether LDCs had the legislative authority to conduct DSM programs. Parties were assured that “appropriate consideration of DSM” will be included in the review for second generation PBR. As a result most LDCs were reluctant to undertake CDM initiatives

in part, because, during first generation PBR, the costs of CDM programs were not directly recoverable in rates and had to fit within the price caps.

Since that time the legislation has been amended to make it clear that CDM is an important objective of the government, and the Minister has continually stressed in letters and in public presentations that LDCs have a significant role to play in CDM for their customers. There is no reason for the Board to wait for further clarification of the role of the OPA and the Conservation Bureau.

Now is the time for the Board to show firm and aggressive leadership in fulfilling its statutory objective to promote economic efficiency and cost effectiveness in demand management.

LDCs need to be encouraged

As the presiding member indicated in the hearing, government has set very aggressive conservation targets (5% reduction by 2007) and wants to encourage a “conservation culture”. It is clear that the Minister expects electricity LDCs to play an important role in reaching these goals. However, as the presiding member also alluded to during the hearing, many LDCs are, by their nature, fiscally conservative and risk averse. They want assurances that costs they incur for CDM initiatives will not be disallowed and will be recoverable in rates.

The Alliance is concerned that one of the overriding themes in many of the submissions was that the Board should be wary that LDCs will waste ratepayers’ money on CDM activities and benefit from “insipid” results. There is nothing, either from the record of this proceeding or the past actions of LDCs, to indicate that this would be the case.

Merely because many LDCs do not have direct experience in delivering CDM services does not mean that expertise is not readily available to assist LDCs in developing a balanced CDM portfolio and delivering economically efficient and cost effective programs. In addition, the Board should encourage LDCs to minimize the possibility of “insipid” results by sharing CDM program information and best practices with other LDCs, taking advantage of partnership opportunities, making it easy for LDCs to get CDM programs approved and running, and by setting an incentive that is sufficiently large that LDC shareholders and management will want to realize big benefits for their customers.

The Board needs to take a leadership role and send a clear message that all LDCs are expected, as part of their core businesses, to engage in CDM activities appropriate for their service territories, and that, in the absence of negligence or abuse, they should have reasonable assurance and comfort that the costs of these activities will be recovered in rates.

Prospective or retrospective LRAM

In its evidence and earlier Argument, the Alliance recommended that LDCs should be encouraged to calculate the lost revenue adjustment mechanism (LRAM) on a prospective basis, building anticipated load losses into their rate application. Some parties have indicated this would be difficult for a number of possible reasons, including:

- They lack detailed load forecasts; and
- They are unable to estimate the uptake of proposed CDM programs with a high level of accuracy.

The Alliance does not see either of these factors as an impediment to a prospective LRAM. Even in the absence of detailed load forecasts for the overall system, the LDC should be able to estimate the impact of their CDM programs on load, possibly drawing on data provided in the *Conservation Manual* on potential savings, net-to-gross ratios, equipment lifetimes, and other determinants of savings and then to subtract the anticipated reduction in revenues associated with these losses to the revenue requirement on Schedule 8-1 of the Rate Handbook (revised as recommended in the Alliance Argument of 14 February 2005, p.19).

Similarly, the LDCs should be encouraged to estimate participant uptake. Even an inaccurate estimate is likely to be better than an assumption that the uptake will be zero (which is what is implied by a retrospective LRAM). While accuracy is desirable, it is not essential since there ultimately will be a true up once the data are available.

An incentive based on TRC or kilowatt-hours

The Alliance Evidence and Argument of 14 February 2005 indicated that an incentive based on TRC or one based on physical units – kilowatt-hours or kilowatts – are both acceptable to the Alliance.

In their submissions, Pollution Probe and GEC argued against the use of an incentive based on physical units for the following reasons:

- A kWh incentive would give the utilities an equal incentive to save electricity during peak and off-peak times
- A kWh incentive could give a utility a conservation profit bonus even if the actual costs of its conservation program are greater than its benefits
- A kWh incentive would not place higher value on longer-lived measures and would not favour more cost-effective measures and programs
- Once tweaked to capture factors (such as measure life) they are in effect the same as the TRC and there is little difference in simplicity.

In Pollution Probe's submission, which presents the first two of these points, it also argued that such an incentive based on physical units is directly contrary to the OEB's legislative mandate to promote "cost effectiveness" (p.6).

It is the Alliance's position that, in practice, these concerns are unfounded for a number of reasons:

- Neither TRC nor kWh is likely to be perfectly correlated with total societal costs; however either test may be a reasonable proxy. Their greater simplicity may offset the loss of precision in measuring total net societal benefits.
- This is particularly true where, as has been suggested by the Alliance, there should be other constraints on the CDM portfolio such as program screening, the expectation of programs for all major customer classes, a mix of short- and long-term savings measures, and a mix of energy efficiency and demand response (focused on peak savings) programs.
- No reasonable LDC manager would specifically design a program to save electricity primarily during off-peak time, even though the incentive would be the same as for savings realized at peak times.
- Since the Alliance is suggesting there should be a screening process (using TRC), only cost-effective programs would be included in the CDM portfolio so there would not be a conservation bonus for programs that cost more than they benefit, and the portfolio would not be shifted only to programs with a shorter life.

Other participants in their evidence and argument have advised the Board of the advantages of using the TRC model. The Alliance feels that the Board should also be aware of some of its limitations such as:

- It requires an elaborate set of input data (or assumptions)
- It does not necessarily provide the LDC with a clear and easily understandable connection for the program delivery agent between the agent's actions and the results for the LDC.
- It is based on total program costs, not just utility costs. Consequently it (like the method based on kWh) rewards equally a program paid for entirely by the utility and one in which the utility gets the customer to share in the costs of the program. As such, neither method attaches the priority the Minister did in his letter to LDCs of 31 May 2004 to programs that leverage funds, as a basis for providing the incentive.³

A portfolio designed according to the criteria suggested by the Alliance, coupled with an incentive based on a rate (e.g. 0.0025 \$/kWh) multiplied by annual electricity savings multiplied by the life of the measure has a number of benefits including that it:

³ Where the utility has a fixed budget, it will naturally be incented to minimize utility costs to maximize savings or TRC benefits.

- Is subject to fewer disputes over assumptions in calculating the incentive.
- Encourages longer term measures by accounting for future savings and not discounting them.
- Makes it clearer to those responsible for delivering the program how their efforts in reducing load would translate into an incentive for the LDC.
- Provides incentives for results measured in a way consistent with the Minister's broad policy goals (e.g. the Minister's target to reduce electricity use by 5% by 2007).

The Alliance Evidence and Argument indicated that either an incentive based on TRC or load reduction would be acceptable (particularly if the *Conservation Manual* identifies key input variables such as avoided cost and discount rate, and provides the calculation framework). Prior to making its determination, the Board should be aware of the advantages and disadvantages of each approach.

4. Comments on arguments of others

An incentive based on the median performance level

The School Energy Coalition (SEC), in its submission of 14 February 2005, has set out a proposed alternative incentive mechanism that would only reward LDCs whose CDM results, as measured by TRC benefits and percentage of volume saved, were greater than the median for all provincial utilities. LDCs whose performance was substantially better than the median would be given an enhanced incentive. Although not proposed for 2006, it also suggests in the future there could be a penalty for performance below the median.

While the Alliance appreciates the creativity behind this proposal, it is not appropriate for a number of reasons:

- The ability of an LDC to realize substantial net benefits may relate to factors beyond its control, such as its geographic location, its size, the nature of its customer base (e.g. residential/commercial split), and the age and income structure of its customers.
- LDCs operate regulated monopolies in exclusive service territories and are not in direct competition with one another. The Board should not approve an incentive mechanism which pits one utility against another. As previously discussed, it is important to encourage LDCs to share information and best practices, but an incentive that by design can only be realized by half of the LDCs is likely to encourage information hoarding, rather than sharing.

- LDCs that rank low in the initial ranking, are likely to be discouraged, and may do less or give up entirely, rather than do more if they don't consider it likely that they can overtake the early 'winners'.

The Board should be putting in place a system that encourages all LDCs to succeed in realizing economically efficient and cost effective DSM programs.

Consultation

Conservation Manual

The development of the *Conservation Manual* is a critical step in facilitating the implementation of CDM initiatives and should be a critical priority for the Board. It should be a Board-facilitated initiative and the Board should give guidance and direction as to its contents.

As indicated in the Alliance Argument of 14 February 2005, the Alliance envisages that the *Conservation Manual* will be very technical in nature, and convening a large multi-stakeholder consultation group to develop the manual will be unproductive in the initial stages. In order to be effective, the *Conservation Manual* should be developed by an expert knowledgeable in the area, with practical experience in the Ontario market. The consultant should be encouraged to discuss its contents with and seek input from appropriate stakeholders, which may form an *ad hoc* technical working group. For example, if the proposed contents will have an impact on the LDC delivering the CDM program, then the consultant should be encouraged to discuss the implications with appropriate LDCs.

Once the initial draft of the *Conservation Manual* has been prepared, the Board should publish and circulate it for comment. Once there has been sufficient time for comments, the comments should be reviewed and the *Manual* amended, if appropriate. There should be only one more round of comments. Once the *Conservation Manual* has been finalized, it should be adopted by the Board and incorporated by reference into the Rate Handbook.

The Alliance anticipates that the evolution of the *Conservation Manual* will be an ongoing process. As LDCs and other stakeholders gain experience, the assumptions, processes, methodologies and protocols can be refined, improved and updated, based on the experience in Ontario.

Development of the CDM Portfolio

The Alliance anticipates that at least initially, most of the CDM measures that electricity LDCs will engage in will be of a local nature. LDCs should be actively encouraged to solicit meaningful input into their proposed CDM measures that is appropriate for the particular program. For example, if the LDC is considering a CDM program targeted at schools in the service territory, the LDC should be encouraged to consult with the appropriate school boards. Likewise for a program targeted at low income households, the LDC should be encouraged to consult, partner, or both with local community-based agencies.

The Board should also be aware of the nature and scope of the consultation engaged in by the utility. The Alliance has suggested that any annual rate filings made to the Board with respect to CDM programs should require that LDCs indicate the nature and scope of the consultation on a project-by-project basis. In order to provide flexibility, the utility should not be required to engage in a specific consultation process. If the Board, after receiving the application, has concerns regarding the nature or extent of the consultation engaged in by a particular utility, the Board can address those concerns on a utility-specific basis.

The Alliance also suggests that the CDM program should be specifically mentioned in any notice of rate application published in local newspapers and that, as with other aspects of the rate application, the details of the proposed CDM initiatives should be available for inspection at the utility offices, posted on the LDC's web site, and posted on the Board's web site.

CDM programs should not be treated differently than any other LDC activity or expenditure. As long as the CDM portfolio meets the filing and screening requirements in the *Conservation Manual*, the LDC should not be required to engage in a pre-approval consultation process.

If stakeholders have meaningful concerns regarding the LDC's proposal, either because of the nature of the proposed program or the extent of the proposed expenditures, then they can intervene in the process in the same manner as with any other issue in a rates case.

In the subsequent rates case to clear any applicable variance and/or deferral accounts, the LDC should be required to report on the results of each program and file the applicable information, set out in the *Conservation Manual*, similar to the type of information that would be required to be filed to clear any other variance/deferral account. If this process is followed, there should be no need for any further stakeholder consultation or approval process.

As the Board, LDCs and stakeholders gain experience with CDM programs in Ontario in general, and specific utilities in particular, the results can be tracked,

concerns about unsuccessful programs can be raised, and successful programs can be expanded.