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Dear Ms Walli

**Demand Side Management Guidelines for Natural Gas Distributors and
Review of Demand Side Management (DSM) Framework for Natural Gas Distributors**
Board File Nos.: EB-2008-0346 / EB-2008-0150
Our File No.: 339583-000030

I am writing on behalf of Canadian Manufacturers & Exporters (“CME”) to provide comments on a report entitled *Review of Demand Side Management (DSM) Framework for Natural Gas Distributors* prepared by Concentric Energy Advisors (the “Concentric Report”) and a report entitled “*Top Down*” *Estimation of DSM Program Impacts on Natural Gas Usage* prepared by Pacific Economics Group Research (the “PEG Report”).

It is CME’s understanding that after reviewing comments on the Concentric Report and the PEG Report, Board Staff will prepare a Discussion Paper that will be subject to a further comment process. It is within this context that CME has prepared its comments.

THE CHANGING LANDSCAPE OF CONSERVATION AND ENERGY EFFICIENCY IN ONTARIO

In its submissions of February 20, 2009 on the Draft DSM Guidelines for Natural Gas Distributors (EB-2008-0346), CME urged the Board consider the pace at which the landscape of conservation and energy efficiency in Ontario has changed since the Board’s Decision in the DSM Generic Hearing (EB-2006-0021). At that time, CME noted that since the existing DSM Framework was approved by the Board:

- (a) There has been an increase in the number of parties that deliver energy efficiency initiatives or other conservation activities, some of which overlap with natural gas distributor sponsored DSM programs;
- (b) The Federal Government and Ontario Government have become increasingly active in conservation activities;
- (c) The Ontario Power Authority has increasingly undertaken a variety of energy efficiency initiatives;
- (d) Electricity LDCs increasingly deliver CDM;

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- (e) Municipalities, such as the City of Toronto, offer conservation and energy efficiency programs (see for instance Exhibit L, Tab 5, Schedule 1 from the IPSP proceeding [EB-2007-0707]); and
- (f) Industry associations have become more involved with the delivery of conservation activities. For instance, CME itself administered funding through its “SMART Program”, to help small and medium sized manufacturers improve their productivity so that they can compete more effectively in the global economy.

Since that time, there have been other significant changes. Most notably, the enactment of the *Green Energy Act*, including implementation of resulting steps. This includes the introduction of the “Special Purpose Charge”. The Concentric Report takes into consideration many of these changes. To this end, page 17 of the Concentric Report confirms that its suggested direction among the various options is based upon its understanding and interpretation of Ontario’s provincial policies on energy and the environment. These policies on energy and the environment include the *Green Energy Act*, Ontario’s 2007 Action Plan on Climate Change, and the Environmental Commissioner of Ontario’s December 2009 report entitled “Annual Greenhouse Gas Progress Report 2008/2009.”

At page 22, the Concentric Report also confirms that the Board’s objective to promote energy efficiency and gas conservation must be balanced with regard for the economic circumstances of provincial energy customers, highlighting the importance of participant costs and rate increases associated with efficiency programs. When asked how this should be achieved, Concentric confirmed that its report provides a series of recommendations that offer the Board a menu of options for measuring cost effectiveness, developing and monitoring input assumptions, determining adjustment factors, designing DSM programs, establishing DSM budgets, measuring DSM program success, accounting for lost revenues associated with DSM programs, and granting shareholder incentives for achievement of program objectives. However, the ultimate decision on how to design a DSM framework that balances the objectives set forth in the *Green Energy Act* with the economic circumstances of provincial energy customers rests with the Board.

CME urges Board Staff to explicitly address the need to balance the costs of DSM with the need to maintain rate affordability. Such an assessment should not be limited to an isolated assessment of only the rate impact of DSM on the natural gas distributors. Rather, the costs should be considered in a broader analysis by the Board of the costs of all conservation activities that impact customers of both electricity and gas. Such an analysis would permit the Board to ensure that the global costs for DSM and CDM in Ontario are appropriate.

CME believes that this approach would be consistent with recent statements by the Chair and Vice-Chair of the Board in which they recognize the importance of considering “affordability”. For instance, in a speech to the Electricity Distributors Association Annual General Meeting on March 29, 2010, Board Chair, Mr. Wetston, stated:

“Finally, we are also thinking about the total bill and where it is going or, as Minister Duguid referred in his speech to the Ontario Energy Association on Wednesday last week, rate affordability. In an environment where all costs are increasing, we need to think about the various regulatory approaches to address the rate affordability issue.”
[emphasis added]

A broader analysis of DSM and CDM costs would also ensure that the Board considers all direct and indirect costs that relate to conservation activities. To this end, page 22 of the Concentric

Report refers to Section 6 of Schedule D of the *Green Energy Act* which relates to the assessment of expenses incurred and expenditures made by the Ministry of Energy and Infrastructure for energy conservation and renewable energy programs. In balancing conservation objectives with rate affordability, it is imperative that the Board also consider such charges. In this regard, Concentric confirmed that if \$50 million were collected by gas distributors for spending on energy conservation and renewable energy programs, then the portion of the \$50 million attributable to gas DSM programs should be included in the recommended 4-6% budget calculation and should be considered in terms of overall rate impact.

For these reasons, CME urges Board Staff to ensure that any proposed Guidelines remain sufficiently flexible to permit the natural gas distributors the ability to quickly respond to changing economic conditions, and to provide the Board with the ability to balance rate affordability with the objectives of cost-effective conservation activities.

SHORTCOMINGS OF THE EXISTING DSM FRAMEWORK

When Board Staff issued its Draft DSM Guidelines for Natural Gas Distributors in EB-2008-0346, it identified a number of disadvantages with the existing DSM Framework. In particular:

- (a) It requires an enormous amount of time, effort and money on the calculation of, and debating of numbers;
- (b) Is quite complex and the complexity promotes game playing on the part of the utility and stakeholders;
- (c) It can, under certain circumstances, create unnecessary distrust or animosity between utilities and stakeholders; and
- (d) At certain times, it may make ratepayers cynical about DSM activities.

At that time, CME agreed with Board staff that these were shortcomings of the existing DSM Framework. CME believes that these challenges remain today. For this reason, in preparing its next DSM Discussion Paper, CME urges Board Staff to continue to consider how these challenges can be overcome when developing the next-generation of DSM for the natural gas distributors.

CME also urges Board Staff to resist implementing new elements into the DSM Framework unless the new approach offers a clear advantage over elements of the existing DSM Framework. CME is concerned that some of the recommendations in the Concentric Report fall into this category.

THE DSM COST EFFECTIVENESS TEST

Board Staff's Draft DSM Guidelines for Natural Gas Distributors in EB-2008-0346 continued to rely upon the Total Resource Cost ("TRC") test. CME supports Board Staff's original proposal that the TRC test continue to be the required screening tool for proposed DSM measures and programs.

In contrast, Concentric has recommended use of the Societal Cost Test ("SCT"). The SCT differs from the TRC test in that it includes the effects of externalities (such as environmental, GHG



emissions, national security) and uses a different (societal) discount rate. Concentric proposes the use of the SCT for two reasons. First, it includes the impacts of externalities, the most important of which is carbon. Second, it incorporates a lower discount rate, the societal discount rate, which Concentric suggests is appropriate given the societal benefits of DSM programs.

At some point in the future, it may be more appropriate to use the SCT than the TRC test. To do so now, however, would be premature. In its response to Question #20, Concentric confirmed that the appropriate mechanism for handling societal costs is the existing methodology for DSM plan input assumptions: these costs are estimated by distributors, reviewed by the Board, with opportunity for stakeholder input, and updated every three years. In doing so, the Board would need to prioritize the externalities that should be quantified, and in particular, determine the starting parameter values (e.g., \$/ton for carbon). CME questions the appropriateness of the Board determining externalities such as the value to be ascribed to carbon. Such a determination would likely be better determined by the Government.

The introduction of the SCT would also result in the need to develop a Program Administrator Test ("PAT"). Because the SCT screen may result in an increase of accepted DSM program measures over those currently screened through the TRC test, Concentric recommends introduction of the PAT to prioritize which programs get funded first until such time as eventual program expenditures would catch up to all those that are justified by the SCT. The result would be that the SCT is the primary screen, and the PAT would serve as a governor, determining the prioritization of program funding when annual budget limits are reached. Again, from CME's perspective the use of SCT and PAT introduces incremental complexity that is not needed.

In summary, CME is concerned that to move from the TRC test to the SCT, at this time, would unnecessarily create complexity. The existing DSM Framework is already overly complex. The goal should be to simply that Framework – not to make it more contentious.

INPUT ASSUMPTIONS AND PARAMETERS AND SHARED SAVINGS MECHANISM ("SSM")

At page 61 of its Report, Concentric recommends that the Board continue to update input assumptions to reflect the best available information based on the Evaluation Reports. Further, at page 119, in the context of addressing Shareholder Incentive Mechanisms, Concentric confirms that when input assumptions are updated, it is appropriate to use best available information for purposes of calculating the financial incentive payment.

In its answer to Question 52, Concentric clarified that its intention was that DSM input assumptions will be updated for the current and subsequent program years as a result of the annual Evaluation Reports for purposes of SSM. They would not, however, be adjusted retrospectively for the prior program year that the Evaluation Report covered.

Board Staff's Draft DSM Guidelines for Natural Gas Distributors in EB-2008-0346 proposed that the calculation of SSM be based on the best available information at the time of the evaluation. As pointed out by Board Staff at that time, this would remove the need for estimating and having locked-in freeriders and technology savings assumptions from the prior year. This should also result in distributors receiving incentives only for savings that are actually achieved. CME notes that Concentric confirmed its belief that distributors should only receive shareholder incentive payments for achieving established program targets caused by their DSM programs.



In 2009, CME supported Board Staff's Draft Guidelines on this issue, and it still does. CME recognizes that when input assumptions which form the basis of SSM incentive earnings are subject to change, it may become difficult for utilities to treat the financial incentives as a predictable stream of shareholder earnings. That said, the value of predictable earnings must be balanced with the goal that utilities only be rewarded for savings that are actually achieved. CME is concerned that to do otherwise could result in ratepayers bearing the cost of incentive payments for savings that did not actually occur.

Furthermore, CME believes that the SSM reward structure should be proposed by distributors in the same rate proceeding that DSM budgets, TRC targets, and market transformation targets are all considered. Budgets, targets and SSM reward structures are inextricably intertwined and cannot be considered in isolation. In reviewing the SSM, parties should be entitled to challenge not only the proposed formula, but also the anticipated quantum available to the natural gas distributors.

The Concentric Report recommends, amongst other things, that:

- (a) the financial incentive mechanism be primarily tied to the success of the gas distributor in achieving pre-determined market penetration levels for each DSM technology;
- (b) the Board set metrics and targets for gas distributors so that they are incented to pursue DSM measures that provide deep energy savings; and
- (c) the Board develop an incentive formula that considers the magnitude by which the gas distributor exceeds certain metrics or targets, including market penetration, reduction in gas consumption, and/or contributions toward reductions in carbon emissions.

While all of these recommendations should be considered by Board Staff, CME is concerned that the "devil is in the details". In order to properly assess any of these recommendations, CME would need to have more information on exactly how these different elements would operate with the DSM Framework.

CME also notes that the Concentric Report made no recommendations on how the Board should determine the appropriate level of financial incentives. What is, or is not, an adequate financial incentive is a key determination that must be addressed in any DSM Framework. CME urges Board Staff to explicitly address this issue in their forthcoming Discussion Paper.

On another SSM issue, at page 119 of the Report, Concentric recommends that gas distributors not be eligible to receive financial incentive payments unless they exceed established DSM metrics and targets for each program. To this end, Concentric also recommends that the Board develop an incentive formula that considers the magnitude by which the gas distributor exceeds certain metrics or targets including market penetration, reductions in gas consumption and/or contributions toward reductions in carbon emissions. Presumably, this combination of metrics and targets would be used to establish the 100% incentive level for each individual DSM program.

CME does not oppose the proposition that utilities should only receive an incentive if they exceed 100% of the target. The difficulty will be in establishing targets that are not "too low" or "too

high". In CME's experience, the establishment of such targets is extremely difficult, and in most cases, highly contentious.

ADJUSTMENT FACTORS

Concentric recommends that program attribution should be determined primarily by the program partners' contributions to the program budget. In coming to this conclusion, Concentric recognized that determining attribution for joint DSM programs is a difficult question. Concentric's recommendation was nevertheless based on the premise that the percentage of total dollars spent on designing, developing and delivering joint DSM programs is the most readily observed factor. While there may be other factors that could be considered in determining attribution, Concentric's opinion is that percentage of financial contribution is an equitable default. CME supports this approach. If accepted by the Board, it would establish a easy means to determine attribution.

That said, CME would also not oppose allowing distributors the opportunity to provide evidence supporting a different percentage. If this were permitted, there would be a rebuttable presumption that attribution is based on total dollars spent.

DEVELOPMENT OF DSM BUDGETS, TRC NET SAVINGS TARGETS AND MARKET TRANSFORMATION TARGETS

Concentric recommends that DSM Budgets be in a range of 4.0% to 6.0% of utility revenues less the purchased cost of gas. In this regard, Concentric notes that the average Canadian gas distributor spent approximately 2.0% of distribution revenues on DSM programs. If accepted, Concentric's percentage range would be 2-3 times greater than the Canadian average.

CME is opposed to establishing DSM budgets as a percentage of total distribution revenue. Particularly in light of the rapidly changing energy efficiency landscape in Ontario, the establishment of DSM budgets through a percentage formula would be arbitrary and not reflective of market conditions, customer needs or rate affordability.

In CME's view, distributors should propose as part of their DSM plans separate budgets and targets for resource acquisition and for market transformation. The proposed budgets and targets should be justified on the basis of historic results of DSM programs in conjunction with market potential studies, and also be consistent with the most recent government policies on conservation. Proposed budgets and targets should also take into consideration economic conditions, rate affordability, and the availability of other energy efficiency programs being delivered by governments, utilities, municipalities and/or industry associations.

DSM CONSERVATION IMPACT EVALUATION

CME has been a member of Union's Evaluation and Audit Committee ("EAC") for the past few years. CME's experience with the Union EAC leads it to conclude that, while not perfect, the EAC increases transparency and allows for increased cooperation between Union and its stakeholders. For this reason, CME is of the view that the EAC should continue to provide advice and maintain transparency.

That said, CME also remains of the view that value could be achieved by the Board developing its own audit capability or retaining third party experts to review the DSM data provided by



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distributors. This is consistent with Concentric's recommendations. CME urges Board Staff to assess whether there are alternative ways to complete evaluation and audit of the natural gas distributors' DSM programs which are directed, organized and managed by the Board.

THE PEG REPORT

CME notes that PEG's conclusion was that its research did not provide any evidence that is definitive enough to substitute a "top-down" approach for the "bottom-up" methodology currently being used in Ontario's gas DSM programs. In light of this conclusion, CME sees no basis for the Board, at this time, to take further steps in the establishment of a "top-down" estimation of gas DSM savings.

CONCLUSION

CME is grateful for the opportunity to provide these comments. It looks forward to reviewing the Discussion Paper to be prepared by Board Staff, and to provide further comments at that time.

If you have questions or concerns, please do not hesitate to contact me at your convenience.

Yours very truly

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- c. All Interested Parties
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