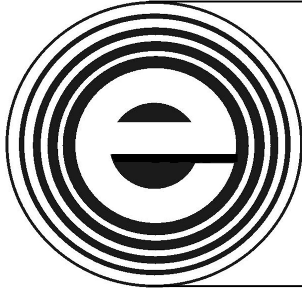

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February 15, 2011

BY EMAIL & BY COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Dear Ms. Walli:

Board File No. EB-2008-0346
Demand Side Management Guidelines for Natural Gas Distributors
Comments of Energy Probe

Pursuant to the Board's letter, issued January 21, 2011, please find attached the Comments of Energy Probe Research Foundation (Energy Probe) for the Board's consideration.

Energy Probe apologizes for submitting its Comments a day past the Board's filing date. A processing problem occurred in respect of Mr. Rubin's email system.

Should you have any questions or require additional information, please contact me.

Yours truly,

Original signed by

David S. MacIntosh
Case Manager

cc. Norm Rubin, Consultant to Energy Probe (By email)
Interested Parties (By email)

Energy Probe Research Foundation 225 BRUNSWICK AVE., TORONTO, ONTARIO M5S 2M6

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EB-2008-0346

Ontario Energy Board

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

AND IN THE MATTER OF a Consultation by the Ontario Energy Board with respect to Guidelines for Demand Side Management by Natural Gas Distributors.

Submissions on the Staff Discussion Paper and Revised Draft DSM Guidelines from Energy Probe Research Foundation

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February 15, 2011

Demand Side Management ("DSM") Guidelines for Natural Gas Distributors

Submissions On Behalf Of

Energy Probe Research Foundation

Our references to the documents will generally be to the Staff Discussion Paper, unless specifically noted otherwise. Energy Probe will be restricting its comments to a subset of the topics considered, in the interest of saving time and resources.

PART ONE: ENERGY PROBE'S GENERAL, OVER-ARCHING CONCERNS

First over-arching concern: The disconnect between desired results, direct metrics, and incentives:

Energy Probe has long been concerned that the expenses and artificiality of Utility DSM programs have not produced demonstrated improvements in real-world metrics, like decreases in natural-gas consumption, or emissions -- much less done so in an economically efficient or cost-effective manner. Indeed, the conclusions of the OEB-sponsored "PEG Report" -- that no decreases at all in normalized average natural-gas use per customer ("NAUC") can be attributed to Enbridge and Union's DSM programs by PEG's most careful and imaginative analysis and modeling -- may have surprised Board Staff and other Stakeholders more than it surprised Energy Probe. In fact, we have presented evidence in the past indicating that per-customer natural-gas consumption has declined <u>more slowly</u> in Enbridge's territory, during a time of unusually aggressive DSM activities, than in neighbouring or regional Utilities with less aggressive DSM activities.

These findings raise more questions than answers, but they do not lead logically to Board Staff's conclusion that DSM activities, and their budgets, should be dramatically ramped upwards, in order to increase Ontario's economic or ecological well-being. (We also do not find much support for this proposal in the generally unimpressive Concentric report.) Rather, they suggest to Energy Probe that Utility Shareholder Incentives should be more closely aligned to a fundamentally desirable metric, like lowered NAUC, rather than to more abstract or more indirect metrics like TRC savings. We note that our recommended (and previously recommended) alignment of Utility Incentives with decreases in NAUC is the basis of SEC's "Option 6", outlined in its Comments, pp. 20f, and we endorse that recommendation.

Ironically, Board Staff seems to read the evidence from the PEG report almost diametrically opposite to the way Energy Probe reads the same evidence:

> "With respect to using NAUC metric, staff is concerned with the difficulty and controversy that may surround this measure in light of the findings in the PEG report." [**3.8.1, Resource Acquisition Programs [Metrics]**, p. 56]

Again, if the current approach has not produced the desired verifiable reductions in NAUC, rational responses include phasing out that approach, and/or **directly promoting the desired verifiable reductions in NAUC.**

In the alternative, if we cannot use NAUC as the key metric in 2012 and beyond, Energy Probe would recommend another alternative to complex, regulatory-intensive, and "gaming-intensive" schemes -- an integrated TRC-based approach in which Utilities set their own budgets, choose their own programs and measures, risk their own funds, and collect payments based on their results. Although Energy Probe has proposed versions of this integrated approach once or twice in the past, we would defer in this proceeding to the admirably clear outline in **SEC's Comments, pp. 18-20, where it appears as "Option 5". We endorse SEC's presentation of the option, and its recommendation that it**

be adopted -- thereby simultaneously resolving the issues of Budgets, Metrics, Incentives, and several others.

We do concede that time and effort and care will have to be spent in choosing the percentage of demonstrated TRC savings to be "shared" to implement this integrated approach -- 12% in SEC's example for Union Gas. But we believe that this process will be less onerous than that of the last generic DSM hearing, will stand up well to multi-year implementation (with or without built-in "ratcheting"), and will produce significant benefits in simplicity and enhanced accountability.

Second over-arching concern: These incentives will not achieve "depth".

Energy Probe notes that many Stakeholders, and OEB Staff, find fault with the existing TRC-based metrics and SSM incentives for DSM. Unfortunately, we do not believe that the proposed changes, as we understand them and envision their operation, eliminate or even diminish those faults. For example, the Staff Discussion Paper repeatedly favours "deep" DSM programs to replace "shallow" ones, and attributes the current allegedly "shallow" approach to the TRC-based SSM incentive. The draft documents would substitute a scorecard-based incentive for the TRC-based SSM incentive, especially for Resource Acquisition programs. [Cf. **3.8.1, Resource Acquisition Programs [Metrics]**, p. 57] Unfortunately, we believe that rewarding Utility shareholders on the basis of the first two (of three) metrics on that scorecard -- Cubic meters (m3) of natural gas saved and $ spent per m3 of natural gas saved -- would actually encourage "shallow" DSM programs, at least as much as the current TRC-based SSM incentive!

That first metric is clearly and purely pro-"cream-skimming", because each "deeper" measure in the "stack" generally saves less gas than the one before. The second metric is also clearly and purely pro-"cream-skimming", because each "deeper" measure in the "stack" generally costs more per m3 of gas saved. In general, these are exactly the characteristics that made these "deeper"

measures less attractive in the past and at present, when Utilities have fixed budgets to spend to save TRC$ and earn a TRC-based Incentive. (That's how the "stack" is ordered, or "stacked"!) We are uncertain of the effect (on "shallowness" or "cream-skimming") of the third proposed scorecard metric -- Number of participants that receive at least one deep measure. Giving an incentive for "Number of participants" obviously tends to promote "shallowness" or "cream-skimming", since one can generally reach more participants by offering less to each one. But including "at least one deep measure" as a criterion ensures that participants will tend to receive one (or more) so-called "deep measure" each, which will tend to compensate for the "pro-shallow bias" of the first half of that proposed scorecard metric.

In summary, it appears that roughly 2.5 out of 3 proposed scorecard metrics, applied to an Incentive scorecard, will promote a search for "shallow" or "cream-skimming" DSM savings. The other 0.5 out of 3 metrics does not fundamentally promote or "incent" a deep approach, although it will promote the provision of one qualifying "deep measure" to each participant. **If a preference for "shallow" DSM instead of "deep" is indeed a serious problem, this proposed "solution" will not solve it, in Energy Probe's opinion.**

PART TWO: ENERGY PROBE'S COMMENTS ON SPECIFIC TOPICS

3.10 Incentive Payments:

> "Staff proposes that the maximum annual incentive amount available to market transformation programs be set at 5% of the Annual Cap, which would provide continuity and consistency with the amount available under the current DSM framework. Staff suggests that the remaining 95% of the Annual Cap be allocated between resource acquisition and low-income programs based on their approved DSM budget shares." [p. 62]

We note that Stakeholders are divided about the future role of Market Transformation programs in the future DSM "mix" -- specifically, whether they will increase or decrease in relative importance. In that context, we do not understand the benefit of an arbitrary and non-negotiable "cap" of 5% of total [SSM] incentive available for MT programs. It seems to eliminate all flexibility of the Stakeholders to increase the importance of MT in the "mix", even if we reach consensus on the wisdom of doing so.

3.5.1.2 Use of Input Assumptions;
3.5.2 Avoided Costs; and
3.5.2.1 Updating of Avoided Costs:

Energy Probe supports the proposed use of the best available information, including the use of best available information for the calculation of incentive benefits. However, we recommend that **Avoided Costs should continue to be an exception to that rule, and continue to be "frozen" at the level projected and approved in advance, at the approval of the current year's DSM budget.** We further recommend that this treatment of Avoided Costs be specified explicitly.

For example, we note that **3.5.2.1, Updating of Avoided Costs** (and the corresponding **Section 6.2.1** of the Revised Draft DSM Guidelines, "**Updating of Avoided Costs**"), calls for natural-gas commodity costs to be updated annually. In conjunction with the proposed use of the best available information for the calculation of incentive benefits -- and given the fact that the calculations of *post hoc* results from the DSM year occur months after the year is concluded (i.e., more than a year after the year is begun) -- that could readily be interpreted to mean that brand-new, current Avoided Cost estimates should be used in that calculation.

We do not support that interpretation, and we do not recommend that practice. Avoided Costs of natural gas -- both current costs and projections of future costs -- have been known to fluctuate significantly within a single year, and may well do so again. These fluctuations are generally completely exogenous to the Utility and its DSM programs, out of the Utility's control, and therefore completely inappropriate as an influence on the incentives paid by ratepayers to the Utility in return for excellence in the pursuit of its DSM programs. But these fluctuations, if included in the calculations of benefits and incentives, generally have a very large effect on those calculations, and on those calculated benefits.

For that reason, it is appropriate that the calculations be done using prior, "frozen" Avoided Cost estimates, rather than newer, "best available" estimates. And we recommend that this interpretation be expressly specified in the Guidelines, as we believe they are not so specified at present.

3.5.2.3 Discount Rate --

The Staff Discussion Paper proposes to use a below-market Social Discount rate, in order to encourage deeper measures, specifically less cost-effective measures and programs, which are more reliant on longer gas-saving life expectancies for their cost-effectiveness. But this "back-end-loading" approach also exacerbates many of the weaknesses in past implementation of the TRC calculations and the TRC-based SSM, and creates larger incentive cash flows from methodological errors like (*e.g.*) the widespread failure to reflect "delayed Free Riders" in the calculation of results. Furthermore, that approach would constitute a kind of "double-counting", since the proposed addition of a value on CO2e emissions already constitutes a kind of "back-end-loading" -- generally incurring current ratepayer costs in return for avoiding climate-change costs which are currently zero or even negative for most Ontario customers of natural gas.

We note that in this draft proposal, Discount Rate would still influence the TRC as a screening tool, but DR & TRC would apparently no longer influence Utility Incentives, which would instead be determined by scorecards.

3.7.2 Budget for Resource Acquisition Programs
3.7.4 Budget for Market Transformation Programs

Occasionally, it can occur to the Utility and other Stakeholders (perhaps first the EAC) that there would be advantages to reallocating DSM programs from Resource Acquisition to Market Transformation, or vice versa. The rigidity of a firm budget allocation of these two (and Low Income) for ONE year would be mildly restrictive. But having that rigidity for a multi-year program seems brutally restrictive and inflexible, especially if virtually all the Stakeholders support a reallocation. Even if the new Guidelines are going to specify separate budgets for each of these categories, it would be useful to have some kind of mid-term "off ramp" to allow reallocation among the categories.

3.7.4 Budget for Market Transformation Programs:

Energy Probe would like to highlight and endorse one sentence in particular: "Moreover, staff recommends that market transformation programs be focused on lost opportunities and be outcome-based (e.g., selected and designed to achieve measurable impacts on the market) as opposed to output-based (e.g., delivering a given number of workshops)." Indeed, in our position on the Enbridge EAC for 2009 and 2010, we have successfully argued for the elimination of "output-based" metrics for MT programs, in favour of a heavier weighting of the remaining, "outcome-based" metrics. We do see a continued role for true Market Transformation Programs -- perhaps one that's more significant than these draft documents see -- but we agree that MT metrics and incentives should be based on results, and not on effort, as much as possible.

3.8.1 Resource Acquisition Programs [Metrics]
3.8.2 Low-Income Programs

We frankly do not understand how the volume-based metrics, and incentive, are defined, or how they are supposed to work. For example, 2 out of 3 "grades" in the proposed resource-acquisition and Low-Income scorecards contain volume-based metrics, as in the following passage from p. 57 and the similar one from p. 58:

> . . Staff proposes to use a scorecard approach for resource acquisition programs that would include:
> - Cubic meters (m 3) of natural gas saved;
> - $ spent per m3 of natural gas saved; and
> - Number of participants that receive at least one deep measure.

Traditionally, all volumetric DSM metrics -- *e.g.*, those that have been discussed during negotiations over DSM budgets and targets -- have only measured first-year savings. But the intent here may be to measure multi-year savings, over the estimated life of the DSM measures. If so, will future-year savings be discounted, the way they are in TRC calculations? If so, using what discount rate? Financial-market and "financial-social" discount rates don't necessarily seem relevant or appropriate. (And as discussed in our preliminary section, “**Second over-arching concern: These incentives will not achieve “depth”.**”, we also believe that these scorecard incentives will not accomplish what is perhaps their main stated objective, to achieve “deeper” DSM savings.)

Energy Probe thanks the OEB and OEB Staff, for this opportunity to comment on these documents.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Norman Rubin

Energy Probe Research Foundation