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BY COURIER (2 COPIES) AND EMAIL

Ms. Kirsten Walli
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Dear Ms. Walli:

Re: Pollution Probe – Written Comments in Reply to Board's Letter dated March 29, 2011
EB-2008-0346 – DSM Guidelines for Natural Gas Distributors

We write to provide Pollution Probe's written comments in response to the Board's letter dated March 29, 2011 for the above noted matter.

Summary

Pollution Probe believes that the Ontario Energy Board's decision in its March 29th letter to freeze Enbridge's and Union's aggregate demand-side management ("DSM") budgets at $55 million per year for the next three years is contrary to the public interest. As a result of this decision as part of the DSM "Guidelines", the Board has now denied consumers' approximately $870 million of bill reductions without a proper public hearing.[1]

Gas DSM has provided greater financial benefits to Ontario's gas consumers than any other Board-regulated initiative during the past 15 years. Specifically, as a result of Enbridge's and Union's DSM programs for 1995-2009, customers' bills have been reduced by $3.1 billion at a

[1] Board Staff had proposed that Enbridge's and Union's DSM budgets be increased by a total of $61 million and $28 million respectively between 2012 and 2014. In 2009, for every dollar that Enbridge spent on DSM, its customers' bills were reduced by $8.50. In 2010 for every dollar that Union spent on DSM, its customers' bills were reduced by $12.70. Therefore, if the Board had approved Board Staff's budget proposal, customers' bills would have been reduced in aggregate by about an additional $870 million (i.e. ($61 million x $8.50) + ($28 million x $12.70)).

cost to utility ratepayers of only $191 million. It is thus very unfortunate that the Board has decided to now freeze these DSM budgets and thereby deny customers additional bill savings.

This decision appears to be based on faulty assumptions as well as a limited understanding of the beneficial public interest impacts of DSM. These issues are discussed in more detail below.

The Faulty Assumptions

The Board's decision to "limit the ratepayer funded portion of the natural gas DSM budgets to their current levels" appears to be based on the following four faulty assumptions.

1. As a result of the success of gas DSM to date, there is little remaining cost-effective DSM potential.

2. Achieving significant additional DSM savings would require large cross-subsidies.

3. An unduly limited view of Enbridge's and Union's core business in relation to the distribution of natural gas that restricts DSM.

4. There are more appropriate alternative sources of funding for DSM.

Each of these faulty assumptions are dealt with in turn below.

Faulty Assumption #1: There is little remaining cost-effective DSM potential

Pollution Probe submits that there is no or little evidence to support the Board's apparent assumption that there is little remaining cost-effective DSM potential in Ontario. In fact, the evidence actually indicates that we still have a very large untapped DSM potential. For example,

1. According to a report by Marbek Resource Consultants for Enbridge, cost-effective energy efficiency measures could reduce natural gas consumption in Enbridge's franchise areas by 26% by 2017.[2]

2. According to another Marbek report for Union Gas, cost-effective energy efficiency measures could reduce natural gas consumption in Union's franchise areas by 30% by 2017.[3]

3. According to a report by the Canadian Manufacturers & Exporters, cost-effective energy efficiency measures could reduce industrial energy consumption by 29% by

[2] Marbek Resource Consultants Ltd., *Natural Gas Energy Efficiency Potential: Update 2008: Residential, Commercial and Industrial Sectors Synthesis Report* (September 2009), pp. 10.
[3] Marbek Resource Consultants Ltd., *Natural Gas Energy Efficiency Potential: Residential, Commercial and Industrial Sectors Summary Report* (March 24, 2009), p. 9.

2030.[4] Further, according to this study, 50% of the industrial energy savings would be with respect to natural gas.[5]

Pollution Probe thus submits that the evidence does not support this apparent assumption.

Faulty Assumption #2: Achieving significant additional DSM savings would require large cross-subsidies

Pollution Probe submits that this assumption about large cross-subsidies is faulty for two reasons.

First, there are still many cost-effective energy efficiency measures which are low cost and have short pay-back periods. For example, many such measures are noted in the Marbek and CME studies , and, given their nature, these measures would not require large cross-subsidies.

Second, it is not necessary to provide large cross-subsidies to persuade consumers to implement DSM measures that have a long pay-back time. Utilities can instead help consumers overcome the often high upfront capital cost barrier to long pay-back measures through other methods. These methods include offering on-bill financing at a low-interest rate, or implementing rental programs for new energy saving appliances and equipment. For clarity, such methods are also not novel. For example, Manitoba Hydro provides on-bill financing for loans of up to $20,000 at an interest rate of only 4.9%, and these loans can be repaid over a term up to 15 years.[6]

Accordingly, in co-operation with a financial institution, a utility can provide low-interest loans, which result in no cross subsidies. Further, utilities can reduce default risk by being able to deny gas service to consumers that fail to pay their loans, which is currently a right that both Enbridge and Union have.

Faulty Assumption #3: An unduly limited view of what Enbridge's and Union's core business is in relation to the distribution of natural gas that restricts DSM

Pollution Probe submits the Board has taken an unduly limited view of what the gas utilities' core business is. Enbridge's and Union's core business is related to the distribution of natural gas, but this needs to be examined within the context of the Board's statutory objectives regarding natural gas. Specifically, the *Ontario Energy Board Act* was amended to make the promotion of energy conservation and efficiency explicitly one of the guiding objectives of the Board's natural gas regulation. DSM is thus an appropriate part of the core businesses of Enbridge and Union.

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[4] Canadian Manufacturers & Exporters, *Advancing Opportunities in Energy Management in Ontario Industrial and Manufacturing Sector* (March 17, 2010), p. iii.

[5] *Ibid.*

[6] See Manitoba Hydro's website online at http://www.hydro.mb.ca/earthpower/loan.shtml.

Faulty Assumption #4: There are more appropriate alternative sources of funding for DSM

Pollution Probe submits that gas delivery charges are actually the most appropriate option to finance gas DSM. From an economic perspective, raising the gas delivery charge brings the price of natural gas service closer to its full cost (i.e. including externalities) – which is consistent with the "polluter pays principle". The use of the gas delivery charge to pay for DSM also allows the cost of gas DSM programs to be recovered from the consumers who directly benefit from gas DSM (although their net bills will be less overall). Pollution Probe thus submits that any alternative sources of funding would not be more appropriate.

Why the promotion of the wise and efficient use of natural gas by Enbridge and Union is in the public interest

Pollution Probe submits that the promotion of wise and efficient natural gas use (such as through DSM programs) has significant public interest benefits and impacts. These benefits and impacts are detailed further here.

According to general economic theory, a competitive market will lead to an efficient allocation of resources only if all of the following conditions are met:

a) all consumers have perfect information;
b) capital markets are perfect; and
c) the prices of all goods and services equal their marginal costs.

However, the reality is that these conditions are unfortunately not met in Ontario's current energy market.

First, most consumers have limited information about the full range of their cost-effective energy efficiency options. They also have limited information about the honesty, quality and reliability of their potential energy solutions suppliers.

Second, most consumers also lack access to sufficient capital to invest in all of their cost-effective energy options. As a result, residential, commercial and industrial customers typically demand very short (i.e. 1 to 5 year) payback periods for energy efficiency investments. This is despite the fact that these investments can continue to generate savings for decades. As a result, many energy efficiency investments that are cost-effective over their overall life-cycle (but not within the shorter payback period) are not pursued. In contrast, natural gas distribution companies (i.e. the supply-side of the equation) are willing to recover their capital costs over 30 years or more.

Finally, the market price of natural gas is less than its marginal cost. This is because the costs of the related greenhouse gas emissions have not been internalized by a carbon tax (i.e. there are externalities that are not accounted for by the market).

However, each of these issues related to the promotion of wise and efficient use of natural gas can be overcome with the assistance of Enbridge and Union. This is because they have unique abilities to help consumers overcome the above-noted market barriers to energy efficiency.

First, Enbridge and Union are viewed by their customers as very trusted and knowledgeable sources of information. As a result, they have a unique ability to help their customers overcome information limitations and barriers to energy efficiency.

Second, Enbridge and Union have access to capital at a much lower cost than most of their customers. As a result, the utilities can assist their customers overcome high upfront capital cost barriers to energy savings investments through appropriate programs. For example, such investments include energy conserving windows, tankless water heaters, high-efficiency gas boilers, hybrid solar/gas water heaters, geothermal heat pumps. Further, such beneficial investments can be financed through appliance and equipment rental programs and/or on-bill financing programs. Moreover, since the gas utilities have the right to deny gas service to customers who don't pay their bills (including any portions related to financing), the utilities' risk of potential defaults is much lower than that of conventional lenders. As a result, they have the potential to provide their customers with on-bill financing at very low rates.[7]

Third, as a result of their local monopolies related to the distribution of natural gas, Enbridge and Union can raise their rates to reduce externalities by providing targeted financial incentives to encourage their customers to purchase high-efficiency appliances and equipment. According to general economic theory, such incentives are necessary to increase economic efficiency as long as the price of natural gas is below its true marginal cost.[8]

In light of all of the above, Pollution Probe submits that there are important and significant public interest benefits and impacts as a result of promoting the wise and effective use of natural gas (such as through DSM programs). The benefits and impacts should not now be limited by a Board decision inappropriately restricting the utilities' DSM budgets.

Conclusion

Pollution Probe submits that the Board's decision to freeze Enbridge's and Union's DSM budgets at a total of $55 million for the next three years is contrary to the principles of natural justice and prudent public utility regulation. In particular, the Board had not yet heard any evidence or submissions from the two gas utilities or intervenors with respect to the utilities' proposed DSM programs, budgets and targets. It was thus premature and inappropriate for the Board to make the finding that it made.

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[7] Unfortunately, in EB-2010-0280 matter regarding "Customer Service Standards for Natural Gas Distributors", the Board is considering changing the customer disconnection rules so that Enbridge and Union will no longer be able to deny gas service to customers who default on their equipment rental or on-bill financing payments. However, Pollution Probe submits that this proposal is not logical if the Board wishes to minimize the need for DSM cross-subsidies.

[8] Richard Lipsey and Kelvin Lancaster, "The General Theory of Second Best", *Review of Economic Studies*, Vol. 24, No. 1 (1956-57), pp. 11-32.

Pollution Probe thus submits that the Board should make such decisions based instead on evidence that is tested in a public hearing. Accordingly, Pollution Probe submits that the Board should invite Enbridge and Union to submit, for Board-approval, the DSM programs and budgets that they believe are in the best interests of their customers instead of subject to the limitations that the Board has now imposed through this process.

We trust that these detailed submissions are of assistance, and please do not hesitate to contact the undersigned if you wish to discuss any of this further.

Yours truly,

Basil Alexander

BA/ba