

May 19, 2016

**BY EMAIL**

Kirsten Walli  
Ontario Energy Board  
2300 Yonge Street, 27th Floor  
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: EB-2015-0276 – Union Gas 2014 DSM Deferrals**

We are counsel for Union Gas Limited in the above-noted matter.

Pursuant to Procedural Order No. 3, attached please find Union's Reply Argument. Should you have any questions or concerns, please do not hesitate to contact the undersigned.

Yours truly,



Alex Smith

AS/af

Attachment

**ONTARIO ENERGY BOARD**

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

**AND IN THE MATTER OF** an Application by Union Gas Limited for an order or orders clearing certain non-commodity related deferral accounts;

**REPLY ARGUMENT OF UNION GAS LIMITED**

**A. Overview**

1. This is Union Gas Limited's ("Union's") reply argument in its application for approval to dispose of its 2014 balances in its Demand Side Management ("DSM") deferral and variance accounts (the "Balances"). In accordance with the Board's third procedural order, this reply argument responds to the arguments of those who filed written submissions on Union's application: Board staff, the School Energy Coalition ("SEC"), the Association of Power Producers of Ontario ("APPrO"), the Industrial Gas Users Association ("IGUA"), the London Property Management Association ("LPMA") and the Ontario Greenhouse Vegetable Growers ("OGVG").

2. The Balances at issue in this application relate to the final year of:

- (a) Union's multi-year DSM plan for 2012-2014, which was the subject of EB-2011-0327, and
- (b) Union's 2013-2014 DSM plan for large volume customers, which was the subject of EB-2012-0337 (together, the "2012-2014 Plan Period").

Since this application was commenced, the Board has released its Decision and Order on Union's new DSM plan for 2015-2020 (the "2015-2020 Plan Period") in EB-2015-0029. As a result, in this application Union is seeking approval to dispose of the last of the balances from the 2012-2014 Plan Period, albeit after a decision has been rendered by the Board with respect to the 2015-2020 Plan Period.

3. Board staff and most of the intervenors who have responded to this application (together, the “Respondents”) primarily take issue with one of the Balances: the Lost Revenue Adjustment Mechanism Variance Account (the “LRAMVA”). They do so despite the fact that all of the Balances—including the balance for the LRAMVA—were determined through the verification and audit process of the audit committee for Union’s DSM activities (the “AC”). As they did in EB-2014-0273, which was Union’s application to dispose of its 2013 balances in the DSM deferral and variance accounts, Board staff’s submissions again downplay the significance of the extensive AC process, which is described at pages 4 through 6 of Exhibit A, Tab 2.

4. Instead of giving due regard to the AC process, the Respondents once again reargue the question of the appropriate free ridership rate. This has been a perennial issue throughout the 2012-2014 Plan Period, and most recently in EB-2014-0273. In doing so, many of the Respondents again advance the proposition that all projects with a payback period of less than one year should be deemed free riders, even though that proposition was specifically rejected by the Board in EB-2015-0029 four months ago. The Board should once again reject this flawed reasoning and approve Union’s application as filed.

5. The arguments of each of the Respondents are addressed in further detail below.

**B. Board staff**

6. Board staff supports the approval of Union’s application as filed, with the sole exception of the the LRAMVA.

***Free ridership and payback periods***

7. Board staff “continues to have a concern” with Union’s commercial/industrial custom projects and large volume projects with payback periods of less than one year.<sup>1</sup> As Board staff again puts the argument,

If Union cannot provide evidence indicating that the financial incentive it provided actually influenced the customer’s decision to participate in the program, all

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<sup>1</sup> Board staff submission, p. 3.

projects with a payback of one year or less, and those with extremely long paybacks of almost 50 years, should be considered free riders.<sup>2</sup>

8. This argument was before the Board in EB-2015-0029. As the Board observed four months ago in its decision and order in that case, “SEC and Board staff proposed that incentives not be given to custom projects with payback periods below 2 and 1.5 years respectively.”<sup>3</sup> In response to that argument, Union explained “that payback period is only one of the many factors affecting a customer’s decision to proceed with a project, and that equating low payback periods with free ridership was not appropriate.”<sup>4</sup> Having heard those arguments the Board decided that it “will not require the utilities to change the program selection criteria to require all participants to have a payback of at least one year as suggested by some parties.”<sup>5</sup> Instead, the Board found that:

implementing a payback threshold of greater than one year may exclude some free riders but does not fully address this issue. The OEB agrees with the testimony of the expert witness, Mr. Neme, who indicated that it is preferable to improve program design and target the proper customers in order to screen out free riders at the outset, rather than later in the process, after investing considerable utility time and effort. For the mid-term review, the OEB directs Enbridge and Union to provide evidence showing how it has lowered the free ridership rates in these programs.<sup>6</sup>

9. While Board staff does not propose adjustments to savings associated with Union’s commercial/industrial custom projects in this proceeding,<sup>7</sup> Board staff does propose adjustments to the Large Volume Program based on the same underlying rationale. Board staff submits that Union’s LRAMVA balance should be recalculated “with its Large Volume program results being reduced by an additional 30% to the 54% reduction already used in the calculation of net savings

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<sup>2</sup> Board staff submission, p. 5.

<sup>3</sup> Decision and Order, EB-2015-0029/EB-2015-0049, January 20, 2016, p. 20.

<sup>4</sup> Decision and Order, EB-2015-0029/EB-2015-0049, January 20, 2016, p. 20. See also Exhibit C.SEC.15(b) Supplemental in this proceeding, where Union gave evidence that “Union’s incentives enable Large Volume customers, who were the subject of this CPSV process, to prioritize their maintenance and capital equipment projects among many other competing priorities.”

<sup>5</sup> Decision and Order, EB-2015-0029/EB-2015-0049, January 20, 2016, p. 21.

<sup>6</sup> Decision and Order, EB-2015-0029/EB-2015-0049, January 20, 2016, p. 21.

<sup>7</sup> Board staff submission, p. 4.

in this program in order to more accurately reflect the number of free riders who participated in the program.”<sup>8</sup>

10. The argument for this proposed reduction is as follows:

Based on the sample results, 68% (15 projects) of the large volume projects audited (or 82% of the savings) had a payback of one year or less with some projects identified in the sample above having payback periods as short as just a few months. In addition, there are two projects with payback periods around 50 years which could also be considered free riders.

If all the projects with a short payback period of one year or less and those with an extremely long payback of about 50 years are considered free riders, then 83% of the large volume savings could have happened on their own without the utility's financial incentive. Based on this assessment, the 54% free ridership adjustment used by Union does not sufficiently adjust the gross savings amounts to appropriately reflect the free ridership level of the large volume program.

OEB Staff submits that Union should increase its free ridership adjustment factor by about 30% (i.e., from 54% to 83%) and reduce the savings from its large volume gas customers accordingly. [Emphasis added.]<sup>9</sup>

11. This argument simply assumes that “all the projects with a short payback period of one year or less” are free riders. That assumption is at odds with Mr. Neme’s evidence and the Board’s decision in EB-2015-0029, which is quoted above at paragraph 8, and ignores the fact that Union’s 54% free ridership rate is applied at the portfolio level and is not customer-specific. The rate is applied consistently to all customers and all claimed DSM savings across Union’s entire custom DSM portfolio, regardless of customer sophistication and whether clearly demonstrated influence for a savings claim is made apparent by the utility.<sup>10</sup>

12. The Board should reject these recycled free ridership arguments from Board staff, again, in this application.

***The Auditor's recommendations on steam leaks***

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<sup>8</sup> Board staff submission, p. 2.

<sup>9</sup> Board staff submission, pp. 5-6.

<sup>10</sup> Exhibit A, Tab 2, Appendix A, p. 6.

13. Board staff references recommendations #6 and #8 of Evergreen Economics (the “Auditor”) in its *Independent Audit of 2014 DSM Program Results* (the “Audit”) and argues that in light of these recommendations Union should improve the design of its commercial/industrial and large volume programs to screen out potential free riders at the outset.<sup>11</sup> Board staff fails to mention, however, the extent to which this is happening, as acknowledged by the AC in its resolution in response to recommendations #6 and #8:

The AC agrees with the Auditor’s recommendation that savings from projects that are obvious safety hazards should not be eligible for incentives. The AC also agrees that if classes of projects – including projects below a certain payback threshold – are to be made ineligible that this policy should be established in advance.

Starting in 2014, Union no longer provided incentives for gas leak projects. As of 2016, it will no longer be incenting projects classified as O&M Repair. O&M repair projects are those in which a customer has completed a repair (i.e. maintenance) to improve energy performance, as opposed to continuing to operate less efficiently. The most common types of projects would be steam leak and steam trap repairs. It would also encompass descaling and heat exchanger cleaning projects. [Emphasis added.]<sup>12</sup>

#### ***Base case reductions***

14. The Auditor recommended that the net cumulative natural gas savings for certain commercial/industrial projects should be reduced by 50% due to a lack of documentation of customer standard maintenance procedures. This recommendation was based on the Auditor’s professional judgment, as contemplated by the request for proposal (“RFP”) to which the Auditor was responding. (The RFP was developed and endorsed by stakeholders, including SEC.) While Board staff acknowledges that this recommendation was based on the Auditor’s professional judgment, they also submit that the proposed reduction was arbitrary.<sup>13</sup> Recommendations based on professional judgment are, by definition, not arbitrary. Board staff’s submission on this point should be rejected.

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<sup>11</sup> Board staff submission, pp. 5-6; Exhibit B, Tab 2, pp. 13 and 30.

<sup>12</sup> Exhibit B, Tab 3, pp. 5, 6. This resolution predates the Board’s decision in EB-2015-0029 to continue the Large Volume program (contrary to Union’s proposal to discontinue it). As a result of that decision by the Board, there will likely be some O&M Repair completed through the Large Volume program in 2016, though with required supporting documentation.

<sup>13</sup> Board staff submission, p. 7.

### C. SEC

15. SEC's submissions present a quantitative analysis of Union's Large Volume custom projects, but the underlying criticism is similar to that of Board staff. SEC acknowledges that many of its criticisms have been "discussed at length in the past" and that positions on these issues are familiar "from past discussions".<sup>14</sup> As it did in in EB-2015-0029, SEC focuses on projects with a payback of 2 years or less.<sup>15</sup> Though SEC has required Union to provide additional data through the interrogatory process and has generated new calculations based on that data, SEC's underlying complaint remains the same. While SEC acknowledges that "[p]ayback is only one criterion, of course", SEC ultimately submits—purely on the basis of its payback calculations—that Large Volume savings should be reduced to zero for the purposes of the LRAMVA balance.<sup>16</sup> This analysis is not credible and should be rejected.

16. SEC also presents a "straw man" version of Union's responses to SEC's criticisms, which SEC suggests are known from previous proceedings in which these very issues were considered.<sup>17</sup> In doing so, SEC ignores Union's response to SEC's own interrogatory on this point, which addresses how "Union's incentives enable Large Volume customers, who were the subject of this CPSV process, to prioritize their maintenance and capital equipment projects among many other competing priorities."<sup>18</sup> As Union has already submitted in this proceeding,

Union's guidance and incentives help customers to prioritize energy efficiency projects against their own internal competing factors (such as those activities which are deemed more business critical) and demonstrate the competitive advantage customers can gain through efficiency upgrades. The savings claims are subsequently assessed through Union's internal quality assurance/quality control process to validate the project results.<sup>19</sup>

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<sup>14</sup> SEC submission, p. 3.

<sup>15</sup> SEC submission, p. 2. SEC also makes reference to the 1 year payback threshold championed by Board staff: "What is most striking is the project economics. 84% of the savings come from the 71% of the projects having a payback of 2.0 years or less. Even more astonishing, 77% of the savings come from the 49% of the projects with a payback of 1.0 year or less."

<sup>16</sup> SEC submission, pp. 2, 5.

<sup>17</sup> SEC submission, pp. 3-4.

<sup>18</sup> Exhibit C.SEC.15(b) Supplemental.

<sup>19</sup> Exhibit A, Tab 2, Appendix A, p. 9.

17. SEC suggests that “there is a baseline issue” with the Large Volume program that reflects Union’s assumption that steam leaks and similar repairs would be left unrepaired for 20 years but for Union’s intervention. This radically oversimplifies the issue. In fact, Union establishes base case by considering a number of factors, including legacy equipment, market availability of new equipment, estimated gas usage, existing manufacturing levels and operating conditions for existing processes.<sup>20</sup> SEC’s submissions on this point also oversimplify the related concept of effective useful life, which also involves a range of factors.<sup>21</sup> SEC’s criticisms in this regard are simplistic, unfair and misleading.

18. Notwithstanding the fact the Board recently had a three-week hearing on Union’s DSM programs during the 2015-2020 Plan Period in EB-2015-0029, which involved over 3,000 pages of evidence, SEC goes on to suggest that the Board order a “value-for-money audit of the Union Gas DSM programs”.<sup>22</sup> This suggestion is duplicative and disproportionate.

19. Finally, SEC raises concerns about the sampling methodology employed in the CPSV audit process.<sup>23</sup> The issues identified by SEC on this point are the natural consequence of the sampling methodology which, it is acknowledged, was approved by SEC’s counsel.

#### **D. APPrO**

20. APPrO’s sole submission is that the LRAMVA balance should be adjusted down to completely eliminate any savings associated with steam leak repairs.<sup>24</sup> APPrO acknowledges that this is contrary to the Auditor’s recommendation of a 50% reduction, which was approved by the AC. APPrO submits that this is appropriate because:

- (a) the importance of establishing baseline information about customer’s maintenance practices was raised in previous audits during the 2012-2014 Plan Period and Union has a financial disincentive to collect and bring before the Board such information;

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<sup>20</sup> Exhibit A, Tab 2, Appendix A, p. 3.

<sup>21</sup> Exhibit A, Tab 2, Appendix A, pp. 4-5.

<sup>22</sup> SEC submission, p. 5.

<sup>23</sup> SEC submission, p. 4.

<sup>24</sup> APPrO submission, pp. 2-3.



- (b) companies do not require financial incentives from Union to perform economically prudent maintenance; and
- (c) other maintenance activities that have been funded through DSM have not been adjusted downward in the manner that the Auditor downwardly adjusted savings from steam leak repairs.

21. APPrO's first argument falls short of imputing bad faith to Union, though APPrO suggests a penalty worthy of an actual finding of bad faith based on evidence. APPrO's second argument is familiar from previous proceedings in which that argument has not been accepted by the Board. APPrO's third argument second guesses the Audit, the Auditor and the AC without providing any evidentiary basis for doing so. As the Auditor made clear in the Audit, "in general it appears that Union Gas has robust DSM programs that are being implemented effectively".<sup>25</sup> All three arguments should be rejected in favour of the recommendation of the Auditor, which was approved by the AC.

#### **E. IGUA**

22. IGUA endorses Board staff's submission that Union's Large Volume program results should be reduced by an additional 30% over the existing 54% free ridership reduction. IGUA submits that in this proceeding Union has "offered no evidence whatsoever" that projects with a short payback period should qualify for DSM incentives. With respect, this is not the case: Union has produced the evidence of the Audit, as approved by the AC.

23. While IGUA's arguments are for the most part similar to those of other Respondents, an argument advanced by IGUA alone in this proceeding is that it cannot be necessary to provide DSM funding to the same large volume customer for two energy efficiency initiatives that are "clearly economic projects".<sup>26</sup> This argument assumes that if a particular customer is alerted to one economic energy efficiency project then there will be no need to help that customer—and more particularly energy efficiency advocates *within* that customer—to prioritize energy efficiency projects against their own internal competing factors. This assumption is not correct.

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<sup>25</sup> Exhibit B Tab 2, p. iv.

<sup>26</sup> IGUA submission, p. 3, para. 13(a).

**F. LPMA**

24. LPMA accepts the disposition period proposed by Union and takes no issue with the application as filed.

**G. OGVG**

25. OGVG submits that the forthcoming net-to-gross (free ridership) study should apply to Union's 2015 DSM results.<sup>27</sup> While that is an argument for another day, Union notes—as it did in EB-2015-0029—that targets, budgets and results need to be calculated on the same basis in order to avoid incoherence and unintended and possibly unfair outcomes. The Board has already approved Union's targets and budgets for 2015. Results should not be evaluated in light of a different set of underlying assumptions.

26. Subject to constraints of proportionality and commercial reasonableness, Union does not object to customers having the right to pay, over time, DSM amounts owing due to the clearance of DSM-related accounts.

27. While OGVG invites Union make further arguments about saturation in this reply, Union's view is that market opportunity was considered in the development of Union's DSM programs during the 2015-2020 Plan Period in EB-2015-0029, which was the subject of a recent exhaustive three-week hearing.

28. Finally, OGVG articulates a concern about "possible double recovery" from customers who fall below their contracted-for minimum annual volumes ("MAVs").<sup>28</sup> OGVG's concern appears to be that Union recovers charges from customers when they consume below the rate of their contracted-for MAVs and also recovers for these "reduced volumes" through the LRAM. This concern is misplaced.

29. Union has outlined the reasons why customers contract for MAVs: either because it is a requirement to qualify for a rate class, or because they are contracting for a negotiated rate, or in lieu of an aid-to-construct payment as the customer's commitment toward the economics of a

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<sup>27</sup> OGVG submission, p. 3.

<sup>28</sup> OGVG submission, p. 5.

capital project.<sup>29</sup> In other words, in each case where customers elect to contract for a MAV they obtain a bargained-for benefit for doing so. In this sense, a MAV is akin to a bargained-for minimum requirement for a volume discount.

30. Most MAVs are negotiated on an annual basis with customers upon contract renewal, and at that time the customer and sales representative can review past activity and expected upcoming DSM to adjust MAVs for the upcoming contract period. For longer term MAVs related to aid-to-construct, as Union has explained recently in response to concerns raised by OGVG in a different context,

Union is willing to work with customers, if necessary, to assign their contracts or to amend the term and volume of those contracts. This assistance would be provided on a “best efforts” basis. To be fair to Union and other ratepayers, assistance would have to be revenue neutral; that is, the customer’s share of the Project costs would still have to be recovered either from the new customer or the existing customer, over time.<sup>30</sup>

31. Given the very different functions of MAV and LRAM there is no double counting. In any event, OGVG’s proposal would allow customers who bargained for a MAV to retain the bargained-for benefit while relieving them of the corresponding bargained-for consumption obligation. The result would be an unjustified windfall for such customers.

#### **H. Conclusion**

32. Union requests that the Board disregard in their entirety the submissions of the Respondents and approve its application as filed.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED**

[Original Signed by]

Alex Smith

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<sup>29</sup> Exhibit C.OGVG.3(b)

<sup>30</sup> Reply Argument of Union Gas, EB-2016-0013, p. 6, para. 26.

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