

Ontario Energy Board
EB-2006-0266

Report of the Board

on the Regulatory Framework for Conservation and
Demand Management by Ontario Electricity Distributors in
2007 and Beyond

March 2, 2007

3.0 THE ROLE OF THE DISTRIBUTOR

3.1 2005 to 2007

In 2004 the Government permitted distributors to apply to the Board for an increase in their 2005 rates as part of the third instalment of their MARR. As a result, distributors prepared, and submitted CDM plans to the Board.

Distributors delivering CDM programs currently funded through distribution rates are responsible for the full life-cycle management (i.e. planning, design, delivery, evaluation and reporting) of CDM programs implemented in their service areas. Distributors must obtain Board approval of CDM plans and budgets and provide regular reports to the Board on the progress of the CDM programs.

Under the current model, the Board is responsible for approving the funding of CDM programs through distribution rates, with a focus on reviewing the prudence of CDM expenditures. To that end, the Board developed processes for distributors to apply for third tranche funding through 2005 distribution rates and for additional funding through 2006 and 2007 distribution rates. Funding through 2007 distribution rates is discussed in more detail in section 4.1.1 of this Report.

The current model includes review and approval of spending levels and proposed programs within distributors' CDM plans, reporting requirements, and evaluation. In order to assist distributors with performing a cost-benefit analysis of programs, the Board developed a Total Resource Cost ("TRC") Guide, which was released in September 2005.

With regard to reporting, approval of third tranche funding was conditional upon distributors submitting quarterly and annual reports. For 2006 incremental funding, only annual reports are required.

3.2 2007 to 2010

Once the Distributor CDM Fund is up and running, it is expected that funding for, and delivery of, the majority of distributor CDM activities will be coordinated by the OPA. The Directive sets out the respective roles and responsibilities of the OPA and distributors. According to the Directive, responsibility for the design of standard programs will lie with the OPA. These standard programs may include consumer awareness and education programs, market capacity building, and market transformation programs. Distributors may also design custom programs and apply to the OPA for funding of these programs.

Pursuant to the Directive, the OPA will be responsible for ensuring that all areas of the province have access to an appropriate set of CDM programs. This means that where a distributor has not entered into a contract with the OPA or where the OPA sees a need to deliver one or more specific CDM programs not being implemented by the

distributor, the OPA may either directly, or through a third party, deliver the CDM programs to consumers in the distributor's service area.

The Directive also states that the OPA will be responsible for implementing an accountability framework and for reviewing the activity and results achieved by distributors against that framework.

Under the model laid out in the Directive, distributors will contract with the OPA for delivery of CDM programs. Distributors will be important delivery agents of OPA-funded CDM programs.

As set out in section 4.1.1 of this Report, distributors would also be able to apply to the Board for funding through distribution rates for certain CDM programs. ||

3.3 2010 and Beyond

The July 13, 2006 Directive is silent on the role of distributors in, and the source of funding for, CDM beyond 2010. As evidenced by the Government's long term conservation targets set out in the Supply Mix Directive, the Board assumes that the Government intends that CDM resources will be necessary beyond 2010.

The development of specific distributor CDM funding indicates that the Government considers distributors to be important delivery agents in the near-term (2007-2010), and that funding through the commodity cost, as part of the Global Adjustment Mechanism is the appropriate funding vehicle. The Distributor CDM Fund is, however, an interim measure to provide funding to distributors for CDM activities, until the implementation of the IPSP and associated procurement processes. It is expected that the OPA will, in the IPSP, identify the costs and funding needs associated with its planned conservation and supply resources.

In addition, as the conservation culture develops and market signals become clearer, a competitive energy services market may drive conservation without additional funding through distribution rates or from the OPA.

The framework outlined in this Report is not limited to addressing distributor use of OPA funding associated with the Distributor CDM Fund; it also addresses the regulatory treatment of funding for distributors from other OPA CDM procurement processes, and from distribution rates.

4.0 THE REGULATORY FRAMEWORK

The Board assumes that once the Distributor CDM Fund is up and running, there will be two streams of funding available to distributors for the delivery of CDM programs: funding from the OPA, and funding through distribution rates. The ratemaking implications of each funding stream are different. In developing this regulatory framework, the Board has been guided by its December 10, 2004 decision in the

conservation and demand management proceeding (RP-2003-0203) and the Report of the Board on the 2006 Electricity Distribution Rate ("EDR") Handbook, which together set out the current treatment of CDM activities funded through distribution rates.

This section begins with an overview of the sources of funding available to distributors for CDM, and then moves to a discussion of the regulatory framework as it applies to each funding stream.

4.1 Program Planning

4.1.1 CDM Funding

OPA Funding

The OPA has a number of mechanisms available to it for funding CDM activities, including: the recently announced Distributor CDM Fund; the Conservation Fund; the Technology Development Fund; and OPA procurement processes needed to implement the IPSP and any other Ministerial Directives.

OEB Funding

Upon implementation by the OPA of the Distributor CDM Fund, most CDM funding for distributors will be provided by the OPA, either through the Fund or other OPA procurement processes. The Board is mindful, however, that to successfully meet the Government's CDM targets, continued funding of CDM activities through distribution rates may be necessary, and the continued availability of this funding stream is not precluded by the Directive or otherwise.

Board staff proposed that funding through distribution rates be restricted to initiatives targeted to consumers within the distributor's licensed service area, and to initiatives that neither the OPA nor any other entity is already delivering within the distributor's service area. Such targeted initiatives might include, for example, a load control program that is triggered by conditions on the distributor's local system, rather than solely on province-wide market conditions, or a distribution system improvement initiative to reduce line losses.

Submissions of Parties

Parties were generally supportive of a dual funding model, but requested further details as to division of responsibilities between the Board and the OPA, and the application process for distributors. Some parties suggested that the Board make it a requirement that distributors first apply for funding from the OPA before making any application to the Board. Other parties suggested that the Board should encourage distributors to apply to the OPA first, but not necessarily make it a requirement.

In its submission, the OPA reported that it would not be in a position to fund distributor designed programs by October 1, 2007, as previously reported to the Board. The OPA further advised that funding would only be available for five standard programs³. The OPA requested that the Board encourage distributors to apply to the Board for funding through distribution rates for all other programs through to the end of the 2007 rate year, which ends April 30, 2008.

Conclusions

The Board considers it important that distributors be able to continue to deliver cost effective CDM programs. The Board originally expected that funding from the OPA would become available in October 2007, and that incremental funding through distribution rates would only be required for the period from May 1, 2007 to September 30, 2007. However, as indicated by the OPA's submission in this process, this potential funding gap will be longer than expected. The Board has experience in reviewing and approving CDM program proposals, and is thus in a position to ensure funding is available for CDM programs during this interim period. **As a result, the Board has determined that it is necessary to provide an extension of incremental funding for programs originally funded through third tranche funding, until such time as OPA funding for these programs becomes available.**

New programs or existing third tranche programs that are the same as the five soon to be offered by the OPA are not eligible for distribution rate funding.

Filing requirements for the extension of incremental funding for third tranche programs are outlined in the letter issued by the Board on March 1, 2007.

The Board will continue to receive applications for funding through distribution rates for programs designed to address local reliability or system improvement situations.

As funding from the OPA becomes available for all other types of programs, the Board expects that distributors will apply to the OPA for funding. However, where funding is not available from the OPA at the time of application, distributors may apply to the Board for funding through distribution rates. The Board will coordinate with the OPA to ensure that there is no duplication of funding.

In all cases, programs funded through distribution rates must be targeted to consumers within the distributor's licensed service area.

Filing requirements for new CDM programs will be the same as those outlined in the Board's Filing Requirements for Transmission and Distribution Applications, issued November 14, 2006.

³ The OPA has advised that these five programs are: Business Incentive Program, 10/10, Residential Demand Response, Appliance Retirement, and Small Commercial Direct Install.
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The Board believes that this funding framework recognizes the OPA's primary responsibility for funding CDM programs in the province, and encourages participation in the OPA's CDM processes, while providing CDM funding continuity and preventing the cross-subsidization of one distributor's ratepayers by the ratepayers of another.

4.1.2 Revenue Protection

Background

Unforecasted CDM results can have the effect of eroding distributor revenues due to lower than forecast throughput. Distributors recover fixed distribution costs through both a fixed and a variable rate, which is set based on a forecast of consumption. If actual consumption is less than the forecasted amount used for rate-setting purposes, the distributor earns less revenue than it otherwise would have, all things being equal. Since the intention and effect of CDM activities is to reduce capacity and energy use, it also has the effect of reducing throughput and associated distributor revenues, which can result in a disincentive for distributors to deliver CDM programs.

A mechanism to compensate for distributor-induced lost revenues is intended to remove the disincentive for a distributor to implement CDM programs.

In its December 10, 2004 decision in proceeding RP-2004-0203, the Board concluded that a lost revenue adjustment mechanism ("LRAM") was appropriate for electricity distributors, and that it should apply to CDM expenditures relating to the third instalment of distributors' MARR. The Board provided such a mechanism as part the 2006 EDR process. This LRAM is also available for approved CDM activities funded in 2006 and 2007 through distribution rates.

LRAM is a retrospective adjustment, which is designed to recover revenues lost from CDM activities in a prior year. It is designed to compensate a distributor only for unforecasted lost revenues associated with CDM activities undertaken by the distributor within its licensed service area.

On November 2, 2006 the Board issued a letter inviting stakeholder comment on a proposal from the Electricity Distributors Association ("EDA") regarding a revenue stabilization mechanism for distributors. The proposal is outlined in a report entitled, *Designing an Appropriate Lost Revenue Adjustment Mechanism (LRAM) for Electricity CDM Programs in Ontario*, developed for the EDA by Elenchus Research Associates ("EDA Proposal"). The EDA Proposal sets out a comprehensive revenue stabilization adjustment mechanism ("RSAM") that uses the variance between forecast and actual consumption as the basis for a lost revenue adjustment. Since the RSAM would eliminate the impact of all variances from forecast in electricity demand, it would not only address the impact from all CDM programs, regardless of whether implemented by the distributor, but also any other factors that might affect electricity demand (e.g. the economy, weather and customer growth).