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BY EMAIL and RESS

December 8, 2008
Our File No. 2060109

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

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2008-0346 – Gas DSM Consultation

At the Board's meetings on November 24 and 26, 2008, Board Staff invited parties to provide input into the process and the issues in this matter. This letter is sent on behalf of the School Energy Coalition to provide input to assist the Board.

We have attempted to cover most of the issues set out in the Board Staff presentations to stakeholders, but we have had to group them differently in light of the nature of our submissions.

General Considerations

1. ***Extent of Review.*** Board Staff appears to be starting from an initial premise that the current system for dealing with natural gas DSM programs was developed after a thorough review, and should not be altered in any radical ways. In our view, this assumption is incorrect.
2. The current system was the result of extensive multi-party negotiations. As one of the most active participants in those negotiations, SEC can safely say that we and other ratepayer groups did not negotiate a good framework. The result has been excessive incentive payouts to the utilities, increased rather than reduced wrangling over the evaluation and audit process, and program planning and design that has not sufficiently improved in the intervening years. Further, incentives have been paid on the basis of results that, at the time they are finalized, are known to be incorrect. The current framework is, in our respectful submission, a failure.

3. We therefore believe that in 2009 the Board should fundamentally rethink not only how DSM is measured and incented, but the role of the gas distribution companies in program development and delivery.
4. ***Relationship to CDM Rules.*** The suggestion has been made that the gas DSM framework should be changed – if at all - to match more closely the framework for electricity CDM. This is not a good idea, for several important reasons, including:
 - a. Gas utilities have been involved in DSM activities for a lot longer than electricity distributors, and so can have a more mature framework that reflects their experience and the lower level of “low hanging fruit”.
 - b. Gas utilities are doing DSM at the same time as they are actively engaged in load building, whether in response to industrial development or load shifting from electricity. By contrast, electricity distribution includes a negligible amount of load building, and virtually no load shifting from gas. While in the future electricity distributors may need to build off-peak load, and perhaps use load shifting from conventional transportation fuels to do so, currently electric LDCs are more focused on pure conservation activities.
 - c. Gas utilities are large companies with sufficient infrastructure to take on complex activities like DSM, and they can handle thorough reporting, management, stakeholder involvement, and other regulatory requirements. The same is not true of most electricity distributors, who do not have the resources for program design, extensive reporting, and stakeholdering. Their programs will thus necessarily be very different from those of the gas utilities.
 - d. Ontarians are, with few exceptions, price-takers when it comes to natural gas, which means that Ontario consumption has little or no impact on the price of the commodity. In electricity, we generally supply all of our own electricity, and the price is responsive to load changes within the province. Thus, electricity CDM much more heavily influences local price impacts compared to gas DSM, and this affects program design and policy goals.
5. It is therefore our view that the framework for gas DSM should be developed to best promote and manage that activity, and should not be developed with a view to consistency with CDM.
6. ***Role of the Utility.*** The conventional wisdom is that gas DSM should be spearheaded by the gas distribution companies because they are close to the customers, and have their trust. They are therefore best positioned to carry this out.
7. The allocation of this role to the utilities made sense years ago, when the conservation sector was sparsely populated. Today that is no longer the case. The conservation sector has several layers of government, plus utilities of all types, plus NGOs, plus many private companies, all vying for the attention of the consumer. The need for the gas utilities to take the lead on gas DSM may have been reduced, or modified.

8. The Board should therefore, in our view, reconsider whether and how the gas utilities should be involved in DSM. In that regard, it is important for the Board to assess the primary goals of involving the gas utilities, so that any framework developed is expressly directed at achieving those goals.

Process and Timing

9. The proposal of Board Staff is that they will prepare draft guidelines, without any significant consultation on the issues (the short meetings in late November lacking the thoroughness to be really useful), and put them out for comments. The announced deadline for final guidelines is the end of February.
10. In our view, the timing and nature of the proposed process is insufficient given the seriousness of the issues that need to be considered. That “seriousness” can be measured in two ways:
 - a. In 2008, the two utilities will receive more than \$17 million in incentive payments, and \$40 million in budget, relating to DSM. Over the three year period of the existing framework, the total budget and incentives will be more than \$170 million. In any new planning period based on the same model, the three year total will be \$200 million or more.
 - b. The current system is not working well, as evidenced by the concerns expressed in this letter and by the comments of a number of stakeholders at the Board Staff meetings in November.
11. To do a thorough review, in our view it is appropriate to consider bringing in an outside expert on behalf of Board Staff (the current expert is not suitable for this contemplated purpose, in our view), then have a consultation or working group to provide input to Board staff. That could be followed by a Board Staff proposal, submissions (including intervenor experts where required), and if necessary a hearing or technical conference to deal with the most difficult issues. This would likely be completed by June, 2009. Of course, this is but one example. There are many ways of dealing with these issues, but we believe the Board’s approach should maintain this level of thoroughness, in keeping with the materiality and contentiousness of the issues.
12. This is not a situation in which an ADR is appropriate. It is self-evident that the ADR last time on this subject did not succeed in producing a workable framework. More important, though, we believe that there are overriding policy issues on which the Board should provide its independently derived view and guidance.

Calculation of Results/Incentive Structure

13. ***The TRC Test.*** The most conflict and difficulty in the area of DSM has arisen because of the total resource cost test. It drives the calculation of DSM success, and thus incentive payments, and through them drives the ongoing battles over evaluation and audit of programs. Most of the regulatory complications, and the flaws in successive DSM frameworks, have been almost exclusively caused by this calculation system.

14. The TRC Test is problematic because it is a bottom up approach to evaluating the success of DSM programs. It does not measure the actual benefits created by those programs. Instead, it makes a series of assumptions about what will happen in the future, human behaviour, and causation, to forecast through a complex and controversial calculation the expected benefits from a program. The calculation is highly sensitive to several of the most controversial assumptions. Those forecasts are then accepted as if they were real, and utilities are paid incentive amounts on that basis. At no time are the actual benefits of the programs measured in an empirical way.
15. What we have learned in gas DSM in Ontario is that using an artificial construct to calculate results and incentives has four predictable disadvantages:
 - a. An enormous amount of time, effort and money is spent on the calculation of, and debating of, these artificial numbers. Because they have so many component parts, because there is no way of testing to see whether any proposed answer is right, and because so much money is riding on the outcome, thousands of hours of the time of stakeholders, consultants, utility personnel, and Board personnel are spent trying to find the right answer. This multi-million annual activity may be wasting significant dollars.
 - b. The complexity promotes – even incents – game playing on the part of the utility (and perhaps even on the part of other stakeholders). How you measure and calculate becomes more important, in a dollar sense, than whether you actually reduce gas use. In fact, you can't even measure the reduction in gas use, so this approach motivates parties to focus on the calculation methods and details, rather than on the best programs. We have seen this in the stakeholdering activities, where stakeholders spend 20 hours a year at most on program analysis and input, but 50-200 hours a year debating results.
 - c. Because the framework is focused on calculations, there are ongoing debates, and that engenders distrust and animosity between utility and its stakeholders. This is particularly bad since this is an area in which utility and stakeholders should be working together constructively, and there is no reason for them to be fighting.
 - d. On the other side, the fact that the benefits to ratepayers are not “real” has, year in and year out, been the primary reason why many ratepayers have less support for utility programs than makes sense. The TRC Test has, in effect, made ratepayers cynical about DSM activity. Ask anyone involved over the last few years how often they have heard terms like “boondoggle” used to describe utility DSM programs.
16. It is also important to note that these difficulties are getting worse, not better. Although we may be learning more about how to calculate benefits artificially, we are also in an increasingly crowded conservation sector, where the multiplicity of programs and players wreaks havoc with any estimate of causation. Issues such as free ridership, spillover, free drivership, net to gross ratios, and even market transformation programs, are all becoming almost impossible to deal with due to the number of players in the market today.
17. ***An Alternative Approach.*** The Board has been a leader in using statistical modelling to calculate rate-relevant figures from historical data. In both electricity and natural gas

ratemaking, the Board has relied on external experts to review past cost increase data, letting that data, suitably analysed, tell the Board what is a reasonable level of rate increase for a utility.

18. In our view, the purpose of gas DSM programs is to reduce the quantity of gas used for a given energy function. There are many ways a gas utility could do this, of which incentive programs (the basis for the current DSM budgets) are only one, and not in every case the best one. We believe that that Board should investigate whether directly measuring reduced gas intensity would:
 - a. Provide an empirical test of the success of utility activities; and
 - b. Measure not just incentive program-related activities, but other utility activities that can be used to achieve this goal.
19. There are many ways such a measurement approach could be established. Just as one example, it may be possible to identify the key components of normalized average use in any given year using a formula approach derived from statistical modelling of past data. If it is possible through available measurement methods to calculate, for example, the impacts on gas intensity in a given year of price elasticity, economic factors, fuel switching programs, and customer growth, that could create a baseline. From comparing that to actual results, it is likely that an approximation of the effects of conservation activities can be derived. Whether this will be a robust number can only be determined by experimentation and analysis.
20. This is not an easy thing to design or implement, which may be why to the best of our knowledge there is no entirely empirical DSM measurement system yet in place in any jurisdiction. However, in our view it is appropriate for the Board to consider whether an empirical measurement system can be established.
21. We are aware that there is work going on right now in a number of jurisdictions dealing with measuring actual conservation program impacts. We believe the Board should consider retaining experts familiar with the field, who can review what other jurisdictions are doing, and assess whether a different measurement approach is viable in Ontario.
22. **Incentives.** If it proved possible to measure the actual achievement of the goal of reducing gas intensity, then the design of an incentive becomes much easier. In the simplest of all possible worlds, the saved volume each year (relative to a base line) would be compensated at the same level as sold volume (as is the case of LRAM today), plus a bonus percentage reflecting the fact that saved cubic meters are more valuable to society than sold ones.
23. We note that not only would this make the incentives simpler, but it would also remove the need for the bottom-up debates, particularly when it comes to causation. It is in the interests of the utility to maximize saved cubic meters, which are more valuable to it than sold cubic meters, and it will find the best ways to influence that result without regard to whether it gets credit for it.

Setting Targets

24. **Existing System.** The current target-setting formula is not viable over the long term, for a number of reasons:
- a. It doesn't reflect the loss of major programs due to saturation, code changes, or the like. In some cases this can cause utilities to either keep programs that should be cancelled (because they need the TRC), or lose motivation when it is clear that they can't meet an unrealistic target.
 - b. It doesn't reflect new technologies and other new opportunities that can be achieved with minimal effort.
 - c. It cannot properly address market transformation activities.
 - d. Changes in the input assumptions are not properly reflected throughout.
 - e. It incents gaming by all parties.
25. **Alternatives.** In our view, the best system would be one in which targets are not required. The approach we outlined in para. 22 above is one way of doing it. This implies that the utilities will be incented for poor performance as well as good performance, of course. It is worthwhile for the Board to explore whether there are other ways of dealing with that issue.
26. If a target setting system is to be retained, then it seems clear that the existing system must be revised to more closely track what is achievable in any given year. We do not know of a method of doing this, but during the Board's process this should be looked at closely to see whether there are alternatives that have not yet been considered.

Evaluation and Audit

27. **Existing System.** The 2006 process took an important step forward in tightening up evaluation and audit, both on timelines and on quality. During 2007 and 2008 the utilities and intervenors, working together, have introduced further refinements, such as the agreement in principle that there should be an audit "opinion" from an independent auditor, much like an audit opinion on financial statements.
28. But the existing system has many problems. In our Notice of Intervention in this proceeding, we attached a memo prepared by the 2007 Enbridge Audit Committee intervenor members, setting out a number of issues that arose, and how they were resolved. We will not repeat those details here, but do suggest that it should be considered by the Board.
29. More fundamentally, the problems with evaluation and audit are mostly driven by the structure of the TRC test and the many assumptions that must be made. We try to pretend that the evaluation and audit process produces real data on which the parties and the Board can rely, but of course that is a fiction. As noted earlier, the TRC approach is inherently artificial, and no amount of tough evaluation and audit can turn imaginary numbers into empirical data.

30. ***Changes to Consider.*** We therefore believe that the Board should consider how the method of calculating savings can be simplified and empiricized (as discussed earlier). In addition, for whatever method is employed, the Board should consider whether auditors employed by the utilities will ever be sufficiently independent to provide a reliable review. If doubt exists about that, then the Board should consider whether adding a DSM audit capability at the Board, or retaining third party experts on behalf of the Board to review DSM data, would be a better approach.

Lost Revenue Compensation

31. There seems to be general agreement that some form of compensation for revenue lost through DSM program activity is appropriate. However, as there are more and more players driving this result, utilities could reasonably ask whether all of the factors driving down their average use are being captured, or should be. The recent insistence by Enbridge on a price cap per customer approach to IRM, and Union's price cap with a NAC adjustment, are examples of the increasing sensitivity to this problem.
32. This is part and parcel of the issue of "revenue decoupling", which the Board will certainly be dealing with at a higher level over the next few years. It is reasonable to ask how LRAM and revenue decoupling should be integrated, and the extent to which lost revenue compensation should be included in the current consultation.

Planning

33. We have been disappointed with the level of collaboration taking place in utility DSM planning. It is far better on the gas side than with the electric LDCs, but the 2006 framework was going to enhance collaborative planning, and it didn't.
34. That having been said, we believe that the way to improve this is not through making it mandatory, but through getting the calculations and incentives right. Utilities will increase their consultation and work more closely with their stakeholders if they believe it will improve their results.
35. One aspect of this that we believe should be considered is longer term plans. The experiment with three years plans has been an improvement, but we believe that at the very least making the DSM plans co-terminous with the IRM periods would be better. This is an issue that should be considered in more detail in this consultation.

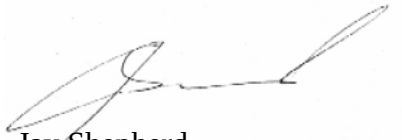
Conclusions

36. We thank the Board for considering our input, and hope it will prove useful.

All of which is respectfully submitted.

Yours very truly,

SHIBLEY RIGHTON LLP



Jay Shepherd

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