EB-2008-0346

ONTARIO ENERGY BOARD

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

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

SUBMISSIONS ON THE STAFF DISCUSSION PAPER AND REVISED DRAFT GUIDELINES FROM THE SCHOOL ENERGY COALITION

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1 OVERVIEW

1.1 *Background*

1.1.1 On October 31, 2008 the Board initiated a consultation process to assist it in developing Guidelines for the next generation of DSM plans from gas utilities. After having meetings with stakeholders, and receiving input from some parties, Board Staff prepared a Staff Report with Draft Guidelines.

1.1.2 After additional submissions by many parties on the Draft Guidelines, the Board retained two consultants, Concentric Energy Advisors ("Concentric") and Pacific Economics Group ("PEG"), to review aspects of Gas DSM in Ontario. The reports of Concentric (the "Concentric Report") and PEG (the "PEG Report") were released by the Board on March 19, 2010, and many parties provided input on those reports.

1.1.3 Board Staff has on January 21, 2011 released a report (the "Staff Discussion Paper") along with amendments to the Draft Guidelines (the "Revised Draft Guidelines"). These are the submissions of the School Energy Coalition with respect to the Staff Discussion Paper and the Revised Draft Guidelines.

1.1.4 We note that SEC has provided submissions on these issues on December 8, 2008. February 20, 2009, and June 7, 2010. SEC was also actively involved in the EB-2006-0021 proceeding which established the existing DSM Framework for Union and Enbridge, and has been an active member of the Stakeholder Consultatives for those utilities, including several periods as a ratepayer representative on their Evaluation and Audit Committees.

1.1.5 Many of the issues dealt with below have been raised previously, although of course SEC's views on the issues have, like those of others including Board Staff, benefitted from the review process to date. Where issues continue to be a concern in the current Staff Discussion Paper and Revised Draft Guidelines, we have attempted to highlight them here rather than referring back to previous submissions.

1.1.6 The submissions below have been organized using the same numbering and headings as the Revised Draft Guidelines for ease of reference. In a number of places, SEC makes no submissions. No inference should be taken that we agree with the Staff Discussion Paper or the Revised Draft Guidelines. In a number of cases we simply do not have a position on the issue. In others, we are aware of other stakeholders who will be providing detailed submissions on the issue, so we have nothing of value to add. In addition, in this consultation there is only limited time available to deal with the issues, so we have tried to focus on those issues where we feel we can be of most assistance to the Board.

1.2 *The Board's Long Term Strategy*

1.2.1 ***Philosophical Approach.*** When the existing DSM Framework was implemented, the gas utilities were far and away the biggest utility players in promoting conservation in Ontario. While the LDCs had third tranche money to spend, they were new to the activity, and their impact was nothing like the impact of the gas utilities.

1.2.2 Times have changed, and the market is now crowded with organizations, including utilities, spending ratepayer (or taxpayer) funds in the pursuit of cost-effective conservation. This is not a bad thing, by any means, but it should, in our view, have a material impact on how this Board views DSM by gas utilities going forward. For example, it appears clear that the electricity distributors will spend at least $1.7 billion over the 2011-2014 period pursuing CDM benefits for their customers, i.e. more than $400 million per year. The gas utilities are no longer a lone voice. In fact, there are now many voices, and the Board must, in our view, ensure that going forward all of those voices can be heard.

1.2.3 In our submission, there are essentially three ways the Board can view the future role of regulated gas utilities in ratepayer-funded conservation:

(a) ***Expanded Role.*** In keeping with the government's focus on cost-effective conservation, the Board could expand the role of the gas utilities to match that of the largest LDCs, and perhaps even to go beyond that given their experience in the field.

(b) ***Status Quo Role.*** The gas utilities can continue to promote the conservation of natural gas, and try to distinguish their message from the increasingly loud voices of other players including particularly the electricity distributors and OPA.

(c) ***Phase-Out Role.*** The Board could recognize that much of the easier gas DSM has already been achieved, and start to wind down the role of the gas utilities in seeking further savings. In this respect, the Board may conclude that, with all the attention being paid to electricity conservation, continuing gas conservation will arise naturally as, essentially, a kind of spillover effect.

1.2.4 The Board has not asked parties to provide input at this philosophical level, and it may be that these questions are premature. However, in our submission this choice of direction is, as a long term matter, the context of most of the policy decisions implicit in the Revised Draft Guidelines**.**

1.2.5 ***Budgets.*** By way of example, what is the appropriate budget level for gas utilities over the next several years?

1.2.6 The Staff Discussion Paper assumes an enormous expansion of budgets which is really only consistent with the first of the three future roles above. Whether or not Staff expressly adopt that role the choice of two budget options with massive increases, one (apparently reluctant) option that is a spending freeze, and no wind-down options, means a choice has been made to expand the utilities' roles.

1.2.7 SEC is very concerned that the Staff Discussion Paper does not appear to face the question of the long-term utility role head on. In our view, the Board should set budgets for this activity based, conceptually, on what role the Board sees the gas utilities playing over the next several years.

1.2.8 ***Incentives.*** Incentives are an even more pointed example. Staff, in proposing a jump from the current levels to $9.5 million, are essentially telling the gas utilities to treat DSM as a more and more important part of their business.

1.2.9 If the Board wants the utilities to increase their reliance on DSM profits, and thus get more firmly entrenched in the DSM business over the long term, then this is a sensible approach. However, it should be done consciously, not by accident. In our view, the choice of incentive plan should be based on where the Board sees the utilities going in this area over the next several years.

1.2.10 ***Commitment of the Board's Resources – Prioritization.*** In addition to the impact on the approach of the utilities, the choice of direction affects how the Board uses its own resources.

1.2.11 The Staff Discussion Paper is based on a foundation of much more detail in planning and review, and many times the level of Board involvement in the process. If the Staff approach is adopted totally, the Board would become far more hands on in its oversight of the gas utilities, reviewing each individual program and assessing how they will be screened, prioritized, implemented, and evaluated (much like the OPA for electricity). This may make sense if the role of the gas utilities is being expanded for the long term. If it is not (and maybe even if it is), this would not appear to us to be a good use of the Board's limited resources.

1.2.12 ***Conclusion.*** In our submission, the Board should look at each of the issues that arises in the Revised Draft Guidelines through the prism of the utility role that is implied. The Guidelines adopted by the Board should take a consistent approach, and thus propose and promote a role for the utilities that is an expression of the Board's long-term vision. Each aspect of the Guidelines should feed that vision.

1.3 *Overview of SEC Submissions*

1.3.1 ***General.*** SEC has not commented on all issues that arise out of the Staff Discussion Paper or the Revised Draft Guidelines. The highlights of the submissions we have

made are the following.

1.3.2 ***Term.*** SEC believes that a longer term is more practical, and recommends a term that commences January 1, 2012 and ends December 31, 2017. The end would therefore likely coincide with the IRM terms of Union and Enbridge.

1.3.3 ***Adjustment Factors***. SEC continues to be concerned with the proposed inclusion of spillover in the results for which incentives are paid. We are unable to see how paying incentives for unintended results is consistent with the basic concept of an incentive.

1.3.4 ***Budgets, Metrics, Targets and Incentives.*** SEC believes that the Staff proposals have two main problems.

1.3.5 First, the proposals move, not to a simpler and more elegant system, but to one that relies even more heavily on bottom-up calculations at an increasingly detailed level. In our view, the scorecard approach proposed by Staff is unworkable for the utilities, the stakeholders, and the Board. Instead, we believe that the Board should be moving <u>away</u> from the kind of system that keeps everyone bogged down in details.

1.3.6 Second, Staff clearly is pushing for dramatically higher budgets, in an environment in which ratepayers are already funding much more conservation than they did in the past. No evidence has been given, except the clearly suspect Concentric Report, to support the appropriateness of these massive budget increases in the Ontario context.

1.3.7 In the end SEC proposes "Option 5", which would set budgets based not on an a priori assessment of how much should be spent, but on the basis of the results the utilities achieve. In our model, described in detail in Section 8.3 of these submissions, the ratepayers "procure" cost-effective DSM at a reasonable cost, which includes the costs of the utilities to achieve their results, and their incentives (profit levels) for doing so. As proposed, the utilities can achieve as much DSM as they want, but they are paid (including program costs, administrative costs, incentive payments, and shareholder incentives) based on their actual results. It would, if accepted by the Board, be a significant shift to increased accountability.

1.3.8 ***Program Evaluation and Stakeholder Input.*** SEC believes that the current system is working quite well, but proposes that the Board take the final step of formalizing the current practice of requiring stakeholder approval of auditor selection.

2 TERM

2.1 *Staff Proposal*

2.1.1 The Staff Discussion Paper proposes a three year term for Multi-Year DSM Plans. It also contemplates the possible extension of the plans, much like has happened with the existing DSM Framework.

2.2 *Alternative Approach*

2.2.1 There appear to us to be two problems with the three year plan, one a matter of policy and the other more practical.

2.2.2 On the policy side, we believe that utilities with a five year IRM should have a similar term for the DSM part of their business as well. In fact, the simplest approach would be to have the DSM Framework end at the same time as the next IRM period ends. If the IRM period will end December 31, 2017, then the DSM Framework should end at the same time.

2.2.3 The more compelling argument, though, is the practical one. The current DSM Framework started in 2007, and will end up going for five years. The reason for that is that putting in place a new framework, including learning from the old one, takes some time. The Board found, not surprisingly, that it was not really practical to have a new plan in place for 2010.

2.2.4 A look at the future dates shows why that is true. If a DSM Framework is announced in April 2011, new plans will be filed and will start January 1, 2012. Even if they are delayed somewhat, they will still commence early in 2012.

2.2.5 Given that starting point, what is the critical path to get to a new (or even refreshed) DSM Framework to start January 1, 2015? Of course, the new framework would have to be in place early in 2014, so that the utilities could develop their plans. To achieve that, the Board would have to have a consultation process, which presumably could start as late as the fall of 2013. That normally should follow, or be based on, a review of the experience under the existing framework. Depending on how extensive that review is, it probably has to start in the spring of 2013. But, at that time the utilities will not even have completed their audit process for their first year under the new DSM Framework. There will be nothing to learn.

2.2.6 In our submission, the new DSM Framework should be designed to cover the period January 1, 2012 to December 31, 2017, a six year period. The Board should, each time it receives the annual filing from the utilities, seek input from all parties on how it's going, and whether any modifications are indicated. Unless it is significantly off track,

however, it should be allowed to continue for the full six year period, and thus end at the same time as the next IRM period for the gas utilities.

2.2.7 We note that our term proposal means that the "learnings" from the framework are being gathered along the way. At the time the Board has to start the process of developing the next multi-year framework, in the spring or summer of 2016, it will already have three years of information, and a fourth coming soon.

3 PROGRAM AND PORTFOLIO DESIGN

3.1 *General*

3.1.1 We have commented on the complexity of the Staff proposals in Section 8.3, below. We have no additional comments.

4 PROGRAM TYPES

4.1 *General*

4.1.1 For the most part, SEC will leave comments in this area to others. However, we do wish to make two specific comments.

4.1.2 First, with respect to resource acquisition programs, the Revised Draft Guidelines at page 5 limit this category to programs that "involve the installation of energy efficient equipment". While we understand that most resource acquisition programs do have an equipment component, we do not think they can be so limited. In our view a program that seeks to incent a permanent or sustained change in energy use, in any form, is a resource acquisition program.

4.1.3 Second, the description of market transformation programs at page 10 of the Revised Draft Guidelines misses what we think is the main point of such programs. A successful market transformation program must have an exit, i.e. a point in time at which the market has been transformed, and intervention of any sort is no longer required. That exit should be part of the initial plan.

5 SCREENING AND PRIORITIZATION

5.1 *Staff Proposals*

5.1.1 ***Screening.*** The Staff Discussion Paper proposes that the screening of DSM programs use a modified TRC test, in which the conventional TRC test is augmented with a carbon value, initially $15/tonne.

5.1.2 ***Prioritization.*** Conversely, Staff proposes that once the menu of available programs has been established using the modified TRC test, the prioritization within the portfolio (choice of programs that will be undertaken, allocation of budget and other resources, etc.) should be carried out using a range of considerations. These include the "four objectives", stakeholder consultation, PAC test, modified TRC test, etc.

5.2 *Commentary*

5.2.1 ***Screening.*** SEC has been vocal in the past about the complexities of the TRC test, and we continue to believe that a bottom-up approach like TRC will tend to overstate savings and cause high administrative and regulatory costs relative to results. While this is less true when it is used for screening than when it is used for evaluation, as we note below that distinction is largely irrelevant in practice.

5.2.2 Notwithstanding our concern about TRC, at this time we believe that Board has no realistic alternative, particularly for screening. The addition of a carbon value is a useful improvement, but on balance there is no other comprehensive method currently available that can be used to predict the probable conservation impacts of utility activities in any useful way.

5.2.3 Therefore, subject to our comments below we believe that the modified TRC test is the best approach for the next period of gas utility DSM.

5.2.4 ***Prioritization***. On the other hand, the Staff proposal on prioritization is not, in our view, suitable, or even possible.

5.2.5 Staff starts from the premise that the Board can give general guidance to the utilities as to their prioritization of programs within their portfolios. In our view, the Board can only influence prioritization in two ways:

(a) Through the design of the incentive method; and

(b) By requiring a mandatory and formulaic ranking of programs.

5.2.6 With respect to the second approach, we do not agree that the Board should be so

involved in the management of the utilities' DSM programs that it mandates which programs should go ahead, and how resources should be allocated. There may be broad criteria, but establishing a program selection formula, for example, appears to us to be well beyond the Board's appropriate role.

5.2.7 In any case, the Board has the most powerful tool in its hands when it establishes the incentive mechanism.

5.2.8 The point of an incentive is to motivate the person or company to act to achieve the goals inherent in the incentive. If the incentive is based on TRC, for example, the utility will prioritize programs and allocate resources to maximize TRC. If, as proposed by Staff, the incentive is based on program-specific scorecards, the utility will carry out prioritization and resource allocation to maximize the scores on those scorecards.

5.2.9 It is true that the Board can place restrictions on prioritization and resource allocation. For example, budgets can be split between regular programs and low income programs. Utilities can be required to have pre-determined percentages of program dollars spent on programs for particular rate classes. The Board can, and to some extent does, set the environment within which prioritization and resource allocation operates.

5.2.10 But aside from those general restrictions, in our view the Board has no ability to cause prioritization and resource allocation to take place in any way different from that which is incented by the Board-determined incentive mechanism. People will act as they are incented to act. Even if the Board could cause utilities to act any differently, which it can't, why would it? That would just undermine the incentive mechanism itself.

5.2.11 SEC is, later in these submissions, critical of the proposed scorecard approach to incentives. However, no matter what incentive metric is ultimately chosen, in our view that is completely determinative of the utilities' prioritization and resource allocation actions.

5.2.12 ***Impact on Screening.*** In addition, we note that the incentive mechanism may have an influence on screening as well. While it is true that a mechanistic approach like TRC testing seems to be beyond the judgment of the utilities, in fact the programs that are selected for screening are entirely within the discretion of the utilities.

5.2.13 It is inevitable, it appears to us, that if utilities are incented on the basis of scorecard metrics, the programs they present for screening in the first place will be ones for which they feel they can establish and achieve high scorecard results.

6 ASSUMPTIONS

6.1 *Input Assumptions*

6.1.1 SEC agrees with Section 6.1 of the Revised Draft Guidelines dealing with the base case and updates to the input assumptions. We have nothing further to add.

6.2 *Avoided Costs*

6.2.1 ***Avoided Gas Costs.*** No submissions.

6.2.2 ***Carbon Value.*** No submissions.

6.2.3 ***Discount Rate.*** SEC has in the past expressed its concern about the use of low discount rates in TRC calculations.

6.2.4 Staff has not recommended a discount rate, but has expressed the view that a lower discount rate should be used, as it would put a greater value on savings that arise further into the future.

6.2.5 SEC disagrees with this approach, for two reasons. First, the future value is that of the customers, and therefore a discount rate that relates to their time value of money is more appropriate than one related to the time value of money for the utility. In those circumstances, a higher rate is in order. Second, future savings are also those that are more uncertain. The TRC test does not insert an uncertainty factor, to reflect the fact that savings are less likely to occur as they are further into the future. Perhaps it should, but it does not. In the absence of any such adjustment, a discount rate that ascribes a lower value to more remote savings is appropriate.

6.2.6 The current discount rates used by Enbridge and Union are appropriately high. If the Board wishes to establish an external benchmark, the one that is the most rigorous, and the most applicable to the current situation, is the Treasury Board rate of 8% plus inflation. The rate used by Peter Spiro – the acknowledged expert on social discount rates in Canada – is also well supported, but in our view it is more conservative than is appropriate for gas DSM programs.

7 ADJUSTMENT FACTORS

7.1 *General*

7.1.1 Staff have proposed a move in the direction of net to gross ratios, recognizing spillover as an impact that should be incented. Aside from this change, Staff continues the past approach of trying to tease out causal connections between utility actions and incentable results.

7.1.2 As we have stated in the past, the problem of causal connections between utility actions and results is getting worse, not better, as more players are active in the field, and the "conservation culture" becomes more entrenched. In our submission the Board's goal should be to reduce its reliance on causation debates in getting to final numbers.

7.1.3 That having been said, we do not believe the Board is now in a position where it can substitute some form of top-down metric that obviates the need for free ridership and attribution considerations.

7.2 *Free Ridership*

7.2.1 No additional submissions. We understand that other parties will be providing input on this issue.

7.3 *Spillover*

7.3.1 SEC continues to be concerned about the push by the utilities to include spillover in the results for which they claim incentives. We have asked the question before, and we continue to ask it: "Why would we pay the utilities incentives for results they did not intend to achieve? How is that an "incentive"?"

7.3.2 In our submission, until that question is answered there is no rational basis to include spillover in the results of DSM programs for incentive purposes. Measure the spillover effects, by all means, but don't try to incent someone to do something that, by definition, they don't intend to do.

7.4 *Attribution*

7.4.1 We are very concerned that attribution will become an increasingly difficult problem for the Board in the next few years. The Staff proposal does nothing, it appears to us, to address that.

7.4.2 Although there is a lot that could be said about this, for the most part we will leave it to

others. The one exception is the proposal to allow rate-regulated and non-rate-regulated entities to form partnerships and make an agreement as to how the savings from the programs will be attributed. In our view, this is an impractical and dangerous proposal.

7.4.3 A simple example shows the problem. A trade association is planning to deliver a DSM program for its members, funded $1 million a year by the federal government. The program will generate $10 million a year in TRC, which creates no financial benefit for the trade association. The association approaches Enbridge, asking them to contribute $300,000 per year for the program, in return for which Enbridge will get all of the TRC attributed to them. Enbridge agrees, since it will increase its DSM incentive payment by $600,000, all of which will be paid by the ratepayers, at no risk to the utility. The net effect is to increase the cost of the program by 60% for no incremental benefit. The association and Enbridge effectively share the extra $600,000 paid by the ratepayers.

7.4.4 In our submission, if entities that cannot benefit from TRC can make deals with utilities who can, they will always be motivated to maximize the available incentives in the pot at the expense of the ratepayers. This example is one of many that will arise if this proposal is allowed.

7.4.5 We note, in passing, that our concern is precisely the concern that some taxpayers expressed, in November 1983, when the federal government proposed the original SRTC (scientific research tax credit) program. Before that program was finally stopped only 17 months later (after an initial attempt to stop it in June 1984 failed), more than $2 billion of tax dollars had been wasted on transactions structured exactly like the one described above. It was, and still is, the costliest tax policy blunder in Canadian history.

7.5 ***Persistence***

7.5.1 We will leave this area to others to provide input to the Board.

8 BUDGETS

8.1 *Staff Proposal*

8.1.1 Staff have proposed three budget alternatives, and one of them is a budget freeze. However, the other two are both very substantial increases. The first would have the Enbridge 2014 budget increase by 171% and the Union budget increase by 130%. The second would have the Enbridge budget increase by 121% and the Union budget increase by 56%.

8.1.2 In real terms (i.e. after taking into account inflation), the proposals are somewhat less, but the lowest increase is still 46% in real dollars, ranging up to a high of 156%.

8.1.3 By contrast, the "freeze" option is in fact a decrease in real terms of about $1.7 million a year for each utility by 2014, or about 6%.

8.1.4 What is surprising is that the most obvious two options: status quo and measured wind-down, were not considered. A status quo option, in which the increases track inflation, would leave Enbridge at $29.7 million and Union at $28.7 million in 2014. A wind-down over ten years, for example, would leave Enbridge at about $19 million and Union at about $18 million in 2014. Staff does not explain why options such as these were not considered.

8.2 *Commentary*

8.2.1 In reading the Staff Discussion Paper, one cannot help but conclude that the "freeze" option is nothing more than a straw man, designed to be rejected so that only the options with large increases are left on the table. The fact that the freeze option is effectively a reduction over time, plus the many negative comments made by Staff about this option, suggest that it is not being presented for serious consideration by stakeholders.

8.2.2 ***Deep Savings.*** This leaves two budgets with large increases. It would appear that Staff's main rationale for this is the need to pursue "deep savings", meaning savings that arise out of more fundamental and lasting changes to Ontario infrastructure.

8.2.3 What is a little surprising in this regard is the example given by Staff. The gas utilities, they say [at page 38] could fill the gap left by the federal government exiting the ecoEnergy Retrofit program, and the provincial government exiting the Ontario Home Energy Savings Program. This is, in our view, nothing short of breathtaking. Both the federal and provincial government have decided to exit a particular type of incentive, presumably for some reason. That reason may be spending priorities, or it may be that they have decided the program is not a top policy priority right now.

8.2.4 What Staff propose is that the gas utilities, at the urging of the Board, rush into the void and fill it. This is not obvious to us. On the contrary, we would have thought that the Board would be more cautious in considering a program that both levels of government had exited, and would not be quick to inject its own contrary conclusion into the situation.

8.2.5 This is not to say that building envelope programs are a bad idea, or that this particular example means that deep savings are a bad idea in general. We believe deep savings are generally a good idea, and note that schools have been in the forefront of ensuring that their building plans try to avoid allowing these types of things to become lost opportunities.

8.2.6 ***Diminishing Returns.*** What this example does show, however, is the type of program gas utilities would have to consider if they are to spend the vastly increased budgets being proposed by Staff. The gas utilities are already having some difficulty getting from new programs the same level of TRC benefits they have enjoyed from their early programs. A law of diminishing returns kicks in, or, as the gas utilities have said numerous times over the last couple of years, they have skimmed the cream, and now the savings are harder to come by.

8.2.7 Of course, if the budgets are increased, the savings will be harder to come by still. This is not difficult to see. In the early programs, things like water heater efficiency delivered the biggest savings. As time went on, the higher efficiency water heaters became the standard, and it is simply no longer possible to incent someone to switch out a low efficiency water heater for a high efficiency one. The high efficiency water heaters are the only ones on the market. The same is true, to a lesser extent, with furnaces and many other types of equipment.

8.2.8 There are still opportunities like drain water heat recovery, but all of the more recent opportunities require spending more to get less.

8.2.9 This situation is exacerbated (but probably in a good way) by the other activity in the conservation marketplace. Greater insulation improves heating efficiency, but also cooling efficiency. Electricity distributors going after the latter will of course leave fewer opportunities for the gas utilities. Programmable thermostats work for both heating and cooling. At the commercial or institutional level, energy monitoring systems typically manage all energy use, not just electricity and not just gas.

8.2.10 ***The Concentric Report.*** We have commented previously on the Concentric Report, and in particular on the obvious lack of expertise of the report writers. Staff's heavy reliance on this report in the budgeting area, clearly targeting the range proposed in the Concentric Report, is problematic. Concentric's conclusions are not based on sufficient expertise or even research to carry weight on their own, without looking

behind those conclusions to the data on which they are based. Staff does not appear to have reviewed these conclusions with a sufficiently critical eye.

8.2.11 The most obvious example, of many, is the fact that the Concentric Report assumes that DSM best practices are revealed by the utilities that spend the most money on DSM. This is not a connection that most people would accept. Test DSM best practices against those utilities who have the best results or, even better, who have the greatest benefits achieved for each dollar of budget spent. That would make some sense. To say that the more you spend, the better your program, is not likely to be correct.

8.2.12 Another example is the reliance by Concentric on a study by the American Gas Association. The AGA asked utility personnel how much residential consumers were reducing their consumption as a result of utility DSM programs. The results showed that the programs, run by those very same utility personnel, were a success. No empirical review took place. It was an opinion survey. Concentric treated it as hard evidence. It was evidence of nothing other than that utility personnel running DSM programs think they are making a difference.

8.2.13 In our view, Staff's reliance on the Concentric Report is a significant flaw in every aspect of the Staff Discussion Paper in which it arises, including particularly the Budgets section.

8.2.14 SEC believes that the budget options proposed by Staff do not provide sufficient scope for the Board to make reasonable decisions about budgets going forward. Clearly directed only at large increases, the Staff proposals are too narrow to be useful. Not only do they fail to consider budget trajectories (such as status quo) that obviously should have been considered, but they consider no options that are tied to results, to incentives, or to other conservation metrics.

8.2.15 ***Union vs. Enbridge.*** One other comment is appropriate in this analysis of the Staff Discussion Paper. Staff assumes throughout that the old split between Union and Enbridge, in which Union would have a substantially lower DSM budget than Enbridge, should be re-introduced. The apparent reason for this is that a budget tied to distribution revenues is inherently better than budgets that are closer to equal.

8.2.16 In the EB-2006-0021 proceeding, the parties, with the Board's approval, consciously chose to narrow the budget gap between Union and Enbridge, structuring the budget formulae so that Union would, over time, catch up with Enbridge. The reason for this was that, while there is a difference in distribution revenues, there is much less difference in throughput, and the parties concluded that Union could spend DSM dollars as efficiently as Enbridge, and at the same levels.

8.2.17 Staff's proposal to reverse this, without dealing with the reason why it was

implemented in the first place, seems inexplicable to us. At the very least, if Staff felt that the equalization approach was wrong, it should have gone back to the analysis that drove it, and argued why it is not appropriate. In fact, SEC believes that the policy was correct, and that Staff's proposed reversal of this policy is unsupportable.

8.3 *Alternative Approaches*

8.3.1 SEC wishes to propose three additional budget options, which we label Options 4, 5 and 6 (after the first three from Staff).

8.3.2 ***Option 4 – Status Quo.*** One option that should be considered is a true status quo, in which DSM spending increases at a level to keep pace with other utility spending. This could be through an inflation escalator (such as GDPIPPI), or through tying the DSM spending increases to increases in distribution rates.

8.3.3 While SEC would prefer to see a more creative approach to budgeting going forward, in our view escalating the current budgets to rate increases would be a reasonable transitional approach for the next few years. Option 4 is, in our submission, much better at least than any of options 1 through 3.

8.3.4 ***Option 5 – TRC-Based Budgeting***. If the gas utilities feel that they can spend incremental DSM dollars in a cost effective manner, one way to give them that option is to shift more of the risk of that expansion from the ratepayers – who generally don't want it – to the gas utilities, who do. There are many ways to do this. Option 5 is just one approach.

8.3.5 In the last three years for which data is available (2007 through 2009), Union and Enbridge have spent the following dollars for the following TRC results:

Year	*Program Costs*	*Shldr Incentive*	*Ratepayer Cost*	*TRC*	*Cost per $TRC*
Enbridge Gas Distribution					
2007	$20,742	$8,248	$28,990	$166,940	$0.1737
2008	$23,027	$5,803	$28,830	$177,178	$0.1627
2009	$25,420	$5,364	$30,784	$205,381	$0.1499
Union Gas Limited					
2007	$16,131	$6,941	$23,072	$189,254	$0.1219
2008	$20,259	$7,943	$28,202	$230,336	$0.1224
2009	$22,222	$8,751	$30,973	$269,635	$0.1149

[In preparing the above table, SEC used TRC for the LRAM case consistent with the proposed new DSM Framework. That data was not available for Union for 2007 and 2008, so we used the same ratio as the ratio between SSM and LRAM cases for the

2009 TRC, taken directly from the final audit report. We note that all of the above numbers except the last column are '000s omitted.]

8.3.6 While the above is not a sufficient statistical sample, it does indicate the range of cost per dollar of TRC over the past three years of the expanded DSM Framework (from EB-2006-0021). Union appears to be able to achieve TRC dollars at a cost, including their own incentive, of around $0.12 per dollar of TRC. Enbridge has had a somewhat higher cost, and that cost has dropped as Enbridge's incentive level has dropped over the same period. Based solely on spending, Enbridge has in fact stayed roughly level.

8.3.7 There is an obvious difference between Union and Enbridge, but all parties have in the past acknowledged that Union is able to achieve higher levels of TRC for the same dollars due to their much higher industrial customer base. We do not have sufficient data to do the above calculations for each customer type, but if we did we suspect that the cost per dollar of TRC, including incentives, for each of Enbridge and Union is similar for each customer group.

8.3.8 This analysis leads to the obvious possibility that the Board would not set budgets at all. Instead, the Board could invite the utilities to seek as much cost-effective DSM as they feel they can achieve, on the basis that whatever they get, they will recover a fixed percentage from the ratepayers.

8.3.9 For example, it appears quite clear that Union can achieve TRC for a budget of roughly 12% of their TRC results. There is really no reason for the Board to limit the utility. Instead, the Board could say "Set your budget and target at whatever levels you think you can achieve. At the end of the year, we will calculate and audit your TRC, and you will be able to recover 12% of that amount in rates. If you spend less, you will have an incentive. If you spent more, you will have lost money."

8.3.10 What this approach would do is allow Union, in this example, to decide how much risk they want to take in determining DSM budget, and how high a profit they want to achieve on the activity. For the ratepayers, it would be self-correcting. If the utility spends too much money, it will fact experience diminishing returns, and its incentive will automatically be reduced. On the other hand, if the utilities are right and they can deliver cost-effective DSM with much higher budgets, the ratepayers will "procure" more of that cost-effective DSM at a cost, in this example 12%, that the ratepayers already believe is a reasonable one.

8.3.11 Of course, as with many things "the devil is in the details", and certainly in this case a simple formula is likely not going to be enough. At the very least, it is likely that a separate formula should be established for each customer group – residential, commercial/institutional, and industrial. Past history demonstrates that the cost to get DSM from these three groups is different, and we agree with the Board's past policy that all customer groups should benefit from utility DSM programs.

8.3.12 However, subject to making the concept more detailed, we believe that the issues of budget, incentives, and targets can all be dealt with through a formula in which the ratepayers, through their rates, procure cost-effective DSM delivered by the utilities within pre-determined cost parameters.

8.3.13 As a practical matter, in our view any such system should include an amount included in rates at the outset (a forecast cost, in effect), and a variance account to track the actual cost when known. This is not really different from the commodity cost accounts, and would have the added advantage of giving the Board visibility on the utilities' plans in advance, while retaining the higher degree of accountability that this approach delivers.

8.3.14 In our view, Option 5 is significantly better over the next five or six years than any of options 1 through 4.

8.3.15 ***Option 6 – Utility Double Savings.*** At this stage, it is our view that the sixth option, set out below, is probably premature. However, we are including it to suggest to the Board one of the various exit mechanisms that may be available if the Board wishes to work towards a gas utility exit from the rate-supported DSM business.

8.3.16 Option 6 is based on the electricity programs – both OPA and Hydro One have them - that incent customers to reduce their demand by paying them a multiple of their demand charge savings. If a customer can drop their peak kW by, say, 100 kW, and thus save $500 a month in distribution costs (in addition to the commodity cost savings also likely), the program will pay them a further $500 or even $1,000 a month on top of that. The effect is that the normal market price signal is enhanced.

8.3.17 While the PEG Report did not show a measurable correlation between utility DSM programs and normalized average use per customer, everyone believes that DSM programs are driving down NAUC. Under Option 6, utilities would be incented to achieve that result.

8.3.18 There are a number of ways of doing this, and detailed planning would be important, but the concept is that the utilities would measure their reduction in NAUC for the year, much like they do now for IRM purposes. Whatever that shortfall is, they would receive double that, to incent them to achieve that result. As is currently the case, the shortfall would be built into the rates for the subsequent year. However, an additional amount equal to that shortfall would be paid out over the year as an incentive.

8.3.19 In this scenario, there would be no ratepayer-funded budget for DSM, nor would there be any targets or incentives. The utility could spend a lot, or nothing. They would be compensated based solely on the long-term result that all agree is the goal of DSM programs – reductions in use.

8.3.20 We note that in many respects this is exactly like the employee incentive compensation programs that both Union and Enbridge employ today. Employees have individual goals, to be sure, but for senior employees the overriding metric for their incentive is the profit line. It is irrelevant whether they actually caused the profit line to be better. The theory is that if you incent the right goal, everyone will do their part to achieve that goal, and it will be achieved.

8.3.21 The Board must be, as we are, unhappy with the results of the PEG Report. With all the tens of millions of ratepayer dollars spent in Ontario over the last ten years on DSM, and the hundreds of millions of claimed – and incented – savings, it is disheartening to find that there is no measurable result of all that activity. In our submission, one of the Board's goals in DSM going forward should be to change that, i.e. to ensure that activities in the future do produce a result that is empirically demonstrated.

8.3.22 Finally, on Option 6, while we believe it is too early to recommend it at this time, we do believe that it is worth considering having a component of budgets and incentives established this way. Just as the Board did with benchmarking of electricity distributors, taking a small step in the 3rd Generation IRM regime, so too it may be worthwhile to include a small step toward empirical accountability in the new DSM Framework.

8.3.23 ***Conclusion***. In our submission, the three budget options proposed by Staff should be rejected. In keeping with our view that higher levels of utility accountability should be part of the new DSM Framework, we recommend consideration of our Option 5, an integrated budgeting, targeting, and incentive system that would protect the ratepayers while providing the gas utilities with increased scope and freedom to pursue cost-effective DSM.

9 METRICS

9.1 *Staff Proposals*

9.1.1 The Staff Discussion Paper proposes that the results for all DSM programs be measured using a scorecard approach. Each program would have a scorecard, proposed by the utility and including at least the following metrics:

(a) Cubic meters of gas saved;
(b) Cost in dollars per cubic meter saved;
(c) Number of participants receiving at least one deep measure.

In addition, the utilities could propose other metrics. For each metric, there would be a target (100%) level proposed, a 50% floor, and a 150% ceiling.

9.1.2 We are not able to determine, based on the Staff Discussion Paper or the Revised Draft Guidelines, how the trajectory of the target levels for each program, and the incentives themselves, would integrate. On page 34 of the Revised Draft Guidelines, for example, Staff says that 40% of the incentive should be available at the 100% level, but then gives an example in which 50% of the target is 40, 100% of the target is 60, and 150% of the target is 70. Then, even more difficult to follow, the incentive in the example for 50 units is $200,000, but the incentive for 60 units appears to be $400,000, and for 65 units appears to be $700,000.

9.1.3 For each of the metrics, and each level, for each of the programs, Staff proposes that each utility should be required to provide an analysis of the challenges they would face in meeting that level for that metric.

9.2 *Commentary*

9.2.1 ***Scorecard Approach.*** The Staff proposal seeks to bring in as many variables as possible, but in our view it is completely unworkable. Establishing multiple targets for multiple metrics for each program, and then assessing how hard each target is to achieve, is a massive undertaking for the utilities, the intervenors and the Board.

9.2.2 The utilities and the intervenors have already seen the complexity involved in program specific scorecards in dealing with the market transformation programs. A single program (Drain Water Heat Recovery) took many hours of discussions, proposals and counterproposals, and negotiation. Further, that was the "shortcut" approach. If the same assessment had to be made in a contested proceeding in front of the Board, the time involved would be much greater.

9.2.3 What Staff appear to be proposing is that this time-consuming process be replicated for each and every program offered by each utility. The steps involved in doing so would

be at least the following (roughly in chronological order):

(a) The utility must identify a program, including measures, incentives, and delivery methods.

(b) All input assumptions have to be determined, and TRC calculations done.

(c) All adjustment factors (e.g. free ridership, persistence) have to be determined in the context of the particular program implementation plan.

(d) At least three metric levels have to be determined (cubic meters, dollars per cubic meter, and participants with deep measures), and for each one three achievement levels have to be identified.

(e) Any other metrics, and their levels, have to be identified.

(f) The weighting of the metrics on the scorecard has to be determined.

(g) The interaction of the incentive levels to the metrics has to be determined, as per our discussion above.

(h) The impacts of each program on other programs has to be established, and the metrics for each program assessed given those relationships.

(i) The same process must be repeated for twenty to fifty programs, to build the portfolio for the year.

(j) Various scenarios have to be tested to determine how the combined metrics will be expressed in real world situations. In particular, since the scorecards are the primary driver of incentives, the parties must model what behaviour is being incented by these specific scorecards, and whether that behaviour is consistent with the policy goals gas DSM is supposed to achieve. For example, if the scorecards produce too much short term savings, or end up prioritizing programs with the lowest levels of cost-effectiveness, or result in a lot of non-quantitative results being incented, they will have to be adjusted. The process is iterative in that respect.

9.2.4 For each of the above steps, either the utilities and their stakeholders must agree, or they must appear before the Board to debate the appropriateness of the individual scorecards or even the individual scorecard metrics.

9.2.5 In our view, it is not reasonable to ask the Board to get into this much detail on utility DSM plans, nor is it reasonable to ask the utilities and the stakeholders to get into this much detail in order to set targets and, in effect, determine the availability of future

incentives.

9.2.6 Alternatively, the Board could designate an independent third party to determine the metrics and the scorecards**.** This would, in effect, result in the Board delegating its responsibility to set targets, and establish incentive levels of tens of millions of dollars, for the gas utilities. This is not an appropriate delegation of the Board's responsibilities.

9.2.7 ***Modified TRC.*** We have said in the past that the TRC test, using a bottom-up approach, is not the best solution for DSM measurement. That having been said, moving to another bottom-up approach that is even more detailed, requires more wasted activity, and has more room for gaming and argument, is not the right answer.

9.2.8 At this point in time, and in light of the PEG Report, SEC believes that the TRC test, as modified to include a carbon value, must be retained for the next DSM Framework. The Staff proposal is worse, not better, and we have not seen a viable alternative proposed by anyone over the consultations from 2009 until now.

10 DSM TARGETS

10.1 *Staff Proposals*

10.1.1 Staff has proposed that targets be set on a program by program basis, as discussed in Section 9 above.

10.2 *Commentary*

10.2.1 For the reasons set out in Section 9, we believe that setting multiple targets for multiple metrics on a program by program basis is entirely unworkable.

10.2.2 In Section 8.3 of these Submissions, SEC has proposed a budget-setting approach that would also set targets and incentives in an integrated way. It would provide the gas utilities with increased scope and freedom to achieve cost-effective DSM, while at the same time increasing their accountability based on results.

10.2.3 We note that, while Staff in their proposals are moving in the direction of more detailed review of programs, metrics, targets, and incentives, SEC is proposing to move in the opposite direction. In our view, the Board should be seeking more sophisticated approaches to DSM that require less Board supervision, and build in both greater flexibility and greater responsibility to deliver results.

11 INCENTIVE PAYMENTS

11.1 *Staff Proposals*

11.1.1 Staff have proposed that the incentive payments be based on scorecard performance for all programs.

11.1.2 Staff have further proposed that the initial cap on incentives be set at $9.5 million per annum for each utility, with escalation annually using Ontario CPI. In the event that the utilities have a smaller budget than Staff has proposed, they believe that the cap on the incentive should be reduced pro rate with the budget reduction.

11.2 *Commentary*

11.2.1 SEC has described in Section 8.3 (Option 5) a combined budget, target and incentive approach that we believe properly integrates the three. Our approach is fundamentally inconsistent with the Staff approach.

11.2.2 However, we will raise a number of the key issues with the Staff approach.

11.2.3 ***Complexity.*** In our discussion of the metrics in Section 9, we have described the impracticality of the program by program scorecard approach.

11.2.4 ***Initial Cap.*** The Staff Discussion Paper does not, as we read it, contain an explanation for why the cap should increase so substantially to $9.5 million per year. In our view, the current incentive levels are already very generous, and in the case of Union should be reduced, not increased.

11.2.5 ***Escalator***. Staff proposes Ontario CPI as the escalator. We do not know how that could possibly relate to compensation to a utility. The Board uses GDPIPPI when dealing with costs, having reviewed various inflation measures and concluded that is the most appropriate. If the intent is to keep the dollars whole (i.e. make the cap "real" dollars rather than nominal dollars), then we would have thought a national measure, or even several other inflation measures, would work better. The last inflation measure that we would consider would be Ontario CPI, which relates to what Ontario consumers pay for a typical basket of goods, very few of which are applicable to a gas utility.

11.2.6 ***Adjustment.*** The proposal for a pro rata adjustment in cap based on spending is ill-conceived. Just as Concentric was wrong in thinking that the high spending gas distributors must be the ones exhibiting best practices, so too Staff is wrong in saying that utilities that <u>spend</u> less should get less incentive. In fact, utilities that <u>achieve</u> less should get less incentive, and utilities that <u>spend more for the same achievement</u> should get less incentive. There does not appear to us to be a circumstance in which

higher spending should, by itself, result in a higher incentive.

11.2.7 ***What is Being Incented?*** In the end, the Board must ask what it is incenting with any given proposal. At the superficial level, the Staff proposal appears to incent cubic meters, efficiency in achieving those cubic meters, deep savings, and other items that depend on additional metrics proposed. The relative weights are not clear, and must also be proposed.

11.2.8 In our view, the real activities being incented by the Staff proposal are regulatory in nature. Utilities are being incented to spend time crafting good scorecards, and planning easily achievable metrics at all levels. This proposal seems to be a recipe for gaming.

11.2.9 SEC is uncomfortable moving in that direction. Now is the time, it seems to us, to move away from "regulatory churn" in DSM, and start to map out a future in which utilities are given their heads to deliver results as aggressively and creatively as they possibly can, and they are compensated if they do deliver those results.

12 LRAM

No submissions.

13 ACCOUNTING TREATMENT

13.1 *General*

13.1.1 SEC is in general leaving comments in this area to others.

13.1.2 However, we note that our proposal for setting budgets, outlined in Section 8.3 of these submissions, would mean the following from an accounting point of view:

(a) No DSMVA would be required, as the budget would be self-adjusting based on results.

(b) No SSMVA would be required, as incentives to the shareholder would be included in the budget adjustment.

(c) An LRAMVA would still be required, because it would still be necessary to make the utility whole for lost revenues associated with its DSM programs.

(d) A new variance account, to track the final budget/incentive results to the amount provisionally included in rates, would be required. It would operate like a commodity variance account, i.e. clearing the difference between forecast and actual budget/incentive, on an annual basis.

13.1.3 While SEC's proposal is inconsistent with the Staff proposals, we do note that, for the DSMVA, the Staff Proposal is to use pre-audited results to determine their 15% level. It is unclear to us why unaudited figures would be used**.**

14 DISPOSITION OF VARIANCE ACCOUNTS

No submissions

15 PROGRAM EVALUATION

15.1 *Staff Proposals*

15.1.1 The proposals put forward by Staff appear to be fully consistent with the current evaluation and audit process, with two exceptions.

15.1.2 First, Staff have not adopted the financial audit model that is slowly becoming the norm for Enbridge and Union.

15.1.3 Second, Staff propose that a member of Board Staff attend all consultative and EAC meetings. The former is already the case, but attendance at EAC meetings would be a departure from current practice.

15.2 *Commentary*

15.2.1 SEC has been an active participant in both Enbridge and Union evaluation and audit processes over the last few years. In our view, the processes work well, largely because the utilities and the intervenors work together to achieve a consensus result. To achieve this, the intervenor groups in turn regularly select EAC representatives that not only represent a range of interests, but also bring a range of expertise and approach to the table. In general, the three intervenor representatives will include at least one who has strong on-the-ground DSM experience, one who will ask detailed questions, and one who will ask big-picture questions. This balance has proven very effective.

15.2.2 Given our experience, we believe that the current model is working and should be retained largely intact. We therefore have comments only on the two components referred to above.

15.2.3 ***Financial Audit Model.*** Staff say, in the Revised Draft Guidelines (page 44) "The third party auditor, although hired by the natural gas utility, should be independent and ultimately serve to protect the interests of the ratepayers." This is a direct analogy to the financial audit process, but Staff then fails to go the next step and propose the same protections as financial audits contain.

15.2.4 In a financial audit, the auditor is retained by the shareholders, not the company, although the company pays the cost. The auditor is typically instructed by a committee of the Board of Directors, which must include a majority of members independent of management. In fact, it is generally considered mandatory that the audit committee of the Board of Directors meet with the auditors at least once, and usually more than once, in the absence of management to ensure that the auditors' independent views are being heard.

15.2.5 At the end of the process in a financial audit, the auditor provides an opinion on the financial claims of the company. That opinion is not to the company, but to the shareholders, whose interests the auditor is hired to protect. The audit report is delivered directly to the shareholders, and the auditor normally attends a shareholders' meeting in person to answer questions and assure the shareholders that the results are sound.

15.2.6 The reason for all this structure is that the drafters of the corporation acts, which stipulate the process, recognized the difficulty in maintaining auditor independence. The auditors spend most of their time meeting with company representatives, have their access to information controlled by the company, and get their paycheque from the company. It is thus a challenge to ensure that the result of the audit is truly independent.

15.2.7 In our submission, the importance of the audit of DSM results requires that the same kinds of protections be implemented. The EACs of the two utilities have done that, first by formalizing the audit opinion process so that now the auditors give a specific opinion on the key results after the audit, and second by operating the EAC much like an audit committee of a corporation. The utilities have also accepted in practice that they will not retain an auditor that the intervenor members of the EAC do not support, although both utilities still maintain their right to do so at any time.

15.2.8 The next step, which flows from the paradigm, is to provide that the stakeholders (or their committee) select the auditor, since the auditor is ultimately there to represent their interests. Staff has, instead, sought to maintain the "advisory capacity only" role of the EAC.

15.2.9 It is submitted that the value of the DSM audit would be improved if the selection of the auditor was with the express consent of the stakeholders, either in the consultative or, more practically, through their EAC representatives. This would formalize the current practice, and reflect the auditor's true responsibility.

15.2.10 ***Staff Attendance.*** There are two reasons why we believe Staff should not as a matter of practice attend EAC meetings.

15.2.11 First, human nature being what it is the presence of staff may make the meetings more adversarial, with parties seeking to put their point of view forward to the "objective" third party, Board Staff. One of the reasons why EAC meetings work is that there rarely is any posturing. The people around the table know each other, and can just roll up their sleeves and try to work things out. There is, most of the time, no "us and them". Bringing in a person representing the regulator could disrupt that balance.

15.2.12 Second, the time commitment for an EAC is substantial. The entire process of evaluation and audit for one utility in a given year takes 80-120 hours, including

meetings and preparation. To represent the Board on two EACs, a Staff member would need to devote at least 15-20 hours a month, and much more at some times of the year. This does not appear to us to be a good use of the Board's personnel resources.

16 STAKEHOLDER INPUT AND CONSULTATION PROCESS

16.1 *General*

16.1.1 Subject to our comments above on the Evaluation Process, SEC believes that the current approach to stakeholder engagement, embraced wholeheartedly by both the utilities and the stakeholders, appears to work well.

17 DSM/CDM PROGRAM INTEGRATION

No additional submissions.

18 MULTI-YEAR PLANS

No additional submissions.

19 GENERAL ISSUES

19.1 *Conclusion*

19.1.1 SEC appreciates being allowed to provide input to the Board on these important issues. SEC proposes to continue to be involved, either in any subsequent steps in this process, or in any further processes relating to rate-funded DSM by gas utilities.

19.2 *Costs*

19.2.1 SEC submits that it has participated responsibly in this process with a view to providing assistance to the Board, and requests that the Board order payment of its reasonably incurred costs for that participation.

All of which is respectfully submitted.

Jay Shepherd
Counsel for the School Energy Coalition