



Role of LDCs in CDM in 2007
Options Paper for Consultation

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1 Introduction

The purpose of this options paper is to provide a basis for broad consultation to address three questions that the Ontario Power Authority (OPA) has committed to answer for the Ontario Energy Board (OEB) by the end of June 2006:

- What is the appropriate level of spending by local distribution companies (LDCs) on Conservation and Demand Management (CDM) in 2007?
- What is the appropriate future role of LDCs in CDM?
- Should there continue to be funding of LDC CDM programs through distribution rates in addition to the funding of LDC programs that is received through the Global Adjustment Mechanism, and ultimately an OPA procurement contract?

The Conservation Bureau of the Ontario Power Authority has asked IndEco Strategic Consulting and Navigant Consulting to jointly prepare this options paper as part of the Conservation Bureau's initiative to fulfill the OPA commitment to respond to these questions to the OEB.

The OEB has posed these questions with an LDC focus. However, in addressing these questions, it is necessary to examine the inter-linkages between the LDCs and the OPA. The level of spending, source of funding and role of the LDCs cannot be considered independently of the OPA's role in CDM. Just as LDCs currently have responsibility for realizing energy and demand savings on behalf of Ontario electricity ratepayers through their approved CDM plans, so does the OPA through various directives and other mechanisms. The role of the OPA in CDM is intimately connected to the role of LDCs in CDM.

1.1 OPA plan to address OEB questions

The OPA has decided to respond to the three questions posed by the Ontario Energy Board in two stages. The first stage, of which this options paper is a part, deals with the responses to all of these questions for 2007; the second stage deals with responses to these questions from a broad market perspective that will lead to the OPA long-term vision to be contained in the Integrated Power Supply Plan (IPSP), including the appropriate level of long-term spending for all CDM. Therefore, the second stage places more emphasis on identifying the roles of all of the major market players for the long-term.

A two stage approach is appropriate. Regardless of the long-term option for CDM that will be chosen in the future, a transition strategy is needed now to take us there. This transition may involve a significant ramp-up and/or ramp-down of certain activities and

as a result, will take time and resources to accomplish. Having a transition strategy will provide some certainty regarding CDM in 2007 and help to reduce LDC and OPA risk.

A “Do Nothing” approach for 2007 will lead to the wind down of LDC CDM in 2007. As of September 30th 2007, all CDM dollars for the LDCs will be spent, and at the time of writing this options paper, there is no mechanism in place for LDCs to obtain additional CDM funding beyond the end of September 2007. Such an outcome, if desired, should be based on informed decision-making, rather than occur by default. Informed decision-making should also be the basis of determining the long-term future of LDC CDM.

Whatever decisions are made with respect to 2007 must be made relatively quickly to allow sufficient time to ensure the chosen approach can be implemented in 2007, if it differs from the “Do-Nothing” default option. A transition strategy will be needed for January 2007, in order to allow time to put in place any changes required to correspond to the 2007 rate year, which begins May 1, 2007. For example, if LDCs are to have CDM programs in 2007 beyond current commitments, time will be required to formulate plans, gain approval, and to initiate the programs in time for the beginning of the 2007 rate year.

1.2 Approach to developing options

The policy context for the development of options in this paper is the continuation of the aggressive pursuit of conservation in 2007. This aggressive pursuit was started by the Province in 2004, with legislative change permitting LDCs to do conservation, followed by the approval by the OEB of 2005-2007 CDM plans and additional LDC CDM spending in 2006, the establishment of the Ontario Power Authority and the Conservation Bureau within it, the series of directives to the OPA from the Minister of Energy to achieve conservation and demand management targets, and the ongoing launch of OPA initiatives to meet those directives.

This direction was confirmed in a recent speech of the Minister of Energy to the Toronto Board of Trade:

“On conservation, we are creating a culture of conservation backed up with leadership, policy, dollars and cents - something Ontario has not seen since all of our programs were cancelled in the early 1990's. We are investing as much as \$1.5 billion in conservation by 2010. And the legislature just passed conservation leadership legislation – the first of its kind in this country – which will make the broader public sector a leader when it comes to energy conservation.”¹

¹ Speech of the Honourable Donna Cansfield, Minister of Energy, to the Toronto Board of Trade, April 3, 2006. <http://www.energy.gov.on.ca/index.cfm?fuseaction=media.speeches&speech=03042006>

For the purposes of this options paper the definition of CDM is the one provided in Minister of Energy's letter sent to LDCs on May 31st 2004, with two exceptions: smart meters and distribution system improvements. These have been excluded from the definition of CDM. Smart meters are now treated outside the CDM framework, consistent with the instructions provided to the LDCs in the OEB's 2006 Electricity Distribution Rate Handbook. Distribution system improvements have been excluded because, while they may achieve energy savings by reducing distribution system losses, there are often pursued to achieve other goals, for example, to improve system reliability or service quality. With these modifications to the definition, CDM focuses on activities behind the meter including efficiency improvements, distributed generation, demand management, and fuel switching.

This options paper is based on a model of CDM that contains the following main elements:

- CDM program design - determines program parameters (e.g. incentive level, target market, advertising and promotion, program partners for implementing the program, monitoring and evaluation plan)
- CDM program delivery – implements program design and evaluates program performance
- CDM oversight – determines requirements for program design and delivery and prudence of expenditures

In this model, the OPA and the LDCs can be accountable for CDM, or can be responsible for certain aspects of CDM. It is assumed that oversight of CDM would continue to be performed by either the OEB or another body, determined by the government to perform this role.

If an organization is accountable for CDM, this means that it oversees both program design and delivery. In fulfilling this function, it has the option of contracting out some or all aspects of program design, delivery or both to other market players (e.g. energy service companies, consultants, community groups, universities/colleges, business associations). For example, in 2006 if an LDC is accountable for a lighting retrofit program for its general service customers, it could contract out the design of the program to a consultant specializing in program design, could foster partnerships with lighting retrofit companies to deliver the program to LDC customers, could carry out the advertising and promotion of the program in-house, and could contract out monitoring and evaluation. Regardless of how it chooses to develop and deliver the program, the LDC would still be accountable for the results achieved.

If an organization does not have oversight for both program design and delivery it is not accountable for the program, but may have responsibility for some or all aspects of either design or delivery. An example of where an LDC would have responsibility, but not accountability, would be where the OPA would be accountable for a particular province-

wide residential program, but would delegate responsibility for delivery of the program to the LDCs, which would implement the OPA program according to OPA specifications in the LDC's service area.

1.3 Structure of this Options Paper

This options paper addresses the options for the transition to where we are now in CDM to where we want to be in the long-term. To stimulate discussion, a broad range of options have been included. It is important to note, however, that the OPA may not be able to implement particular options presented. Input from the consultation on this options paper will be used to assess options and make recommendations for the transition.

The structure of this options paper is as follows:

- This first introductory chapter sets the context for the options that are developed, including a description of the three questions the options are designed to address, the approach to options development, limitations on them, and how the feedback from the consultation will be used.
- There is a separate chapter for each of the three questions, in which possible options are identified and the pros and cons for each option are discussed.
- Since it is the combination of options that will define the CDM framework for LDCs in 2007, three illustrative scenarios representing combinations of options across the three questions are presented to help provide better context and understanding of how the choices interact and are inter-dependent.
- Finally, the last chapter invites readers to provide comment by considering the options presented, identifying possible combinations of these options and evaluating these combinations against evaluation criteria.

Although the focus of this paper is on options for 2007, it is important to recognize that whatever decisions are made regarding them could limit future choices related to CDM funding and roles beyond 2007. For this reason, potential limitations on long-term choices and flexibility associated with particular options are also discussed.

1.4 Moving from the Options Paper to the Final Report

The options paper was developed based on informal consultation with some key stakeholders and input from the Ministry of Energy's Energy Conservation Working Group. The paper is intended to be, to the extent possible, a balanced account of the pros and cons of the options presented and to solicit stakeholder input on these options as well as scenarios based on combinations of these options. Based on the input received as well as additional research that may be required, the consultants will evaluate options and

make recommendations to the Conservation Bureau regarding each of the three questions. The OPA will submit a final report to the OEB by the end of June 2006 that provides recommendations on the answers to each of the three questions posed by the OEB for 2007.

The Conservation Bureau has begun to investigate the answers to the three questions for the long-term. There will be an opportunity for stakeholders to provide comment on options for the long-term which will be considered in the development of OPA recommendations. The final report on the long-term that will address the appropriate level of spending by LDCs, the appropriate future role of LDCs in CDM, and what the appropriate funding mechanism should be is planned to be completed by the end of August 2006.

2 Appropriate level of CDM spending by LDCs

Issue #1 – What is the appropriate level of spending by LDCs on CDM in 2007

We have chosen to address this issue first, because the other two issues could be rendered moot based on the response to this first issue.

2.1 Context for the issue

Before tackling this first issue, the broader issue of the appropriate overall level of spending on electric CDM in the province in 2007 must be considered. Only in the context of the overall level of spending can an appropriate level of spending by LDCs on CDM be properly assessed. Essentially, the appropriate level of spending by the LDCs is dependent on two factors: 1) the overall investment to be made in CDM; and 2) how much of that will be made by LDCs.

2.1.1 Current CDM commitments for 2007

Even if no incremental funding for CDM was provided, it is estimated that somewhere in the range of \$90 - \$110 million would be spent in Ontario on CDM in 2007. This spending reflects the current plans and commitments of LDCs and the OPA.

LDCs' spending commitments relate primarily to the approximately \$160 million collected under the 3rd tranche CDM funding mechanism². These funds were to be spent over no more than three years, ending in September of 2007. While some LDCs will have spent their 3rd tranche CDM funding by the end of 2006, leaving no 3rd tranche funding for 2007, it is expected that many LDCs will still have some 3rd tranche CDM funding to be spent in 2007. While it is difficult to quantify the remaining 3rd tranche funding that will be available in 2007, it is likely to represent somewhere in the range of \$40 to \$60 million. For simplicity, we estimate that \$50 million of 3rd tranche funding will be available for LDC CDM spending in 2007³.

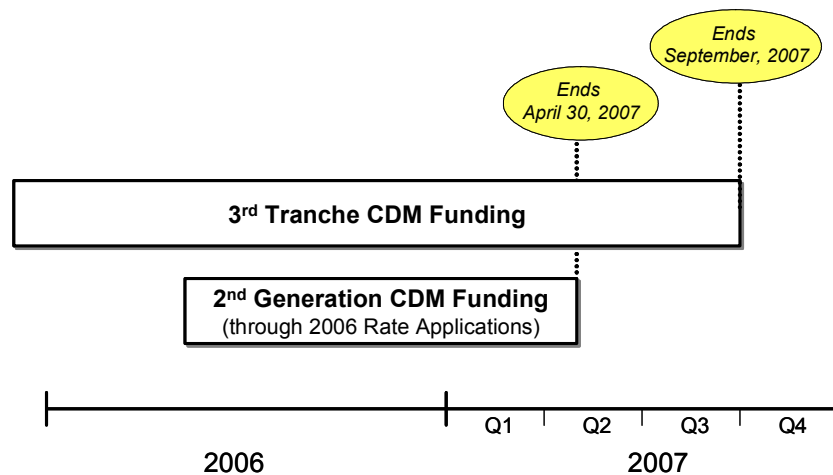
² This is referred to as 3rd tranche funding because it is related to the 3rd and last tranche of a stepped increase in distribution rates to allow LDCs to earn a commercial return on their assets.

³ Many LDCs' CDM plans included distribution system improvements to reduce system losses, with ancillary benefits in reliability and service quality. Based on the definition of CDM provided in the introductory chapter, distribution system improvements would not be considered as CDM. However, it is difficult to quantify exactly how much of the estimated \$50 million in available 3rd tranche funding would be spent on distribution system improvements. For this reason, the \$50 million estimate likely overstates the LDCs' CDM spending, since some of this money may be spent on distribution system improvements.

LDCs could also have included a request for incremental CDM funding as part of their 2006 rate applications to the OEB. Ten LDCs applied for and six have received approval from the OEB in April, 2006 for such incremental funding, totaling \$2.7 million (so-called second generation CDM funding), but this funding is for rate year 2006 only and cannot be counted on beyond April of 2007.

The period over which these two sources of LDC CDM funding would be spent is shown graphically in Figure 1. As shown, the current funding sources would end on September 30, 2007.

Figure 1: Timeline for 2007 LDC CDM Spending



For its part, the OPA has also entered into a number of spending commitments, many of which flow from directives issued by the Minister of Energy. These commitments include:

- Demand response programs, initially in York region and the broader 250 MW demand response program
- Conservation programs in social housing
- The “Cool Savings” program targeting residential air conditioning
- The “Every Kilowatt Counts” coupon program

Other CDM programs⁴ the OPA is expected to launch in the next few months include:

- First Nations and secondary fridge retirement programs
- Programs to address the directive to realize 300 MW of reductions in Toronto
- MUSH and commercial programs

⁴ The OPA’s 1000 MW High Efficiency Combined Heat and Power (CHP) procurement and Standard Offer Program is also expected to encourage a large investment in behind-the-meter generation. However, given typical lead times for generation construction, spending on behind-the-meter generation under the CHP and Standard Offer Programs is expected to be minimal in 2007.

Considering all of these initiatives and programs, the OPA is conservatively estimated to be spending in excess of \$60 million in 2007 on CDM.

Combined, the total level of spending based on 1) LDCs' remaining 3rd tranche CDM funding, 2) LDCs' second generation CDM funding for the 2006 rate year, and 3) OPA's current CDM programs and initiatives is estimated to be approximately \$110 million. These funds are essentially committed and would be spent on CDM in Ontario in 2007 if the OEB does not approve any further LDC 2007 CDM spending and the OPA does not pursue any additional CDM programs or initiatives. To put this spending into perspective, it would represent approximately 0.7% of Ontario consumers' total estimated 2007 electricity bill of roughly \$15 billion⁵.

In addition to these initiatives funded by ratepayers, there are numerous other conservation and demand management initiatives underway in both the public and private sectors⁶. The amounts given here, therefore, do not reflect all of the CDM program spending in the province, but only spending on CDM programs and activities directly funded by electricity ratepayers either through distribution rates or through the Global Adjustment.

2.1.2 Overall level of CDM spending in 2007

The appropriate overall level of CDM spending must take into account the CDM opportunities available, the ability of entities accountable for CDM to act on these either directly or through others, and the resources required for these actions. The experience in other jurisdictions gives some guide to what might be appropriate for Ontario.

Although there were CDM initiatives in the 1990s, and the gas utilities have been very active in DSM for the last decade, pursuing electricity CDM in Ontario really only began seriously in Ontario last year. In 2005 the LDCs began to develop and launch programs

⁵ This is based on estimated consumption of 158 TWh, a forecast commodity cost of \$65/MWh (after accounting for the Global Adjustment and OPA Rebate) and assumes that across the entire customer base, the commodity cost represents approximately 2/3 of the electricity bill, and that transmission, distribution, debt retirement and other regulated charges represent 1/3 of the electricity bill.

⁶ In the public sector, the Ontario government has committed to reducing its electricity consumption by 5% by 2007. The Independent Electricity System Operator has implemented an aggressive customer education program to increase awareness of Ontario's electricity market and customers' options within this market, including demand response, load shifting and conservation. The federal government also has numerous programs for both the residential and commercial sectors, including the EnerGuide for Houses, EnerGuide for Existing Buildings, EnerGuide for Low Income Apartments and High Rises, EnerGuide for Low Income Residences and others. The City of Toronto has the Better Buildings Partnership and multiple other programs, and some other municipalities also offer conservation programs. The gas utilities offer programs to reduce gas use, some of which also reduce electricity consumption. The gas utilities are also interested in possibilities that may exist for decreasing electricity use through fuel switching.

funded by the third tranche, and the Conservation Bureau was established. The recentness of these actions means not only that there are abundant opportunities still available – the so-called low hanging fruit – but also that there is a limited experience in designing and implementing CDM programs.

Surveys of other jurisdictions⁷ indicate that CDM spending among the top tier utilities and jurisdictions is typically in the range of 1 to 3% of gross revenues, with the lower ends of the range associated with jurisdictions where there is either less experience or that are very large. California is one of the leaders, and is currently spending just over 1% of gross revenues on CDM, but plans to increase that to 3% over the next three years.

The Ontario government has made clear its desire for aggressive pursuit of CDM and has set an interim target of a 5% reduction in peak demand by 2007. With respect to government's long-term commitment to CDM, in a speech to the Toronto Board of Trade, the Minister of Energy recently stated that "*We are investing as much as \$1.5 billion in conservation by 2010.*" Assuming that total Ontario customer electricity bills are about \$15 billion per year through 2010, this level of spending on CDM would represent roughly 2% of customers' total bills on average over the five year period from 2006 through 2010.

As discussed, the appropriate level of CDM spending must take into account the CDM opportunities available, the ability of the entities accountable for CDM to act on these, and the resources required for these actions. Although there are abundant opportunities available in Ontario, the capacity of Ontario's public and private entities to realize CDM is developing and not yet mature. Hence, it is important to strike an appropriate balance between the pursuit of CDM opportunities and the ability to realize these opportunities. Assuming for example that spending ramped up from 2005 over a four year period to achieve the notional target derived from the Minister's recent statement, 2% of spending would be achieved in 2008. 2007 spending would then fall in the range of 1.5% as part of this ramp-up example.

The question of what is the overall level of spending on CDM in Ontario in 2007 can only be answered in the broad policy context. As discussed, LDCs' and OPA's CDM

⁷ See for example:

Demand-Side Management: Determining Appropriate Spending Levels and Cost-Effectiveness Testing, Summit Blue Consulting and the Regulatory Assistance Project, January 30, 2006.

Planning and Budgeting for Energy Efficiency / Demand-Side Management Programs, Navigant Consulting Inc., October 2005.

ACEEE's 3rd National Scorecard on Utility and Public Benefits Energy Efficiency Programs: A National Review and Update of State-Level Activity, Report Number U054, American Council for an Energy Efficient Economy, October 2005.

DSM Incentive Mechanisms in North American Energy Utilities, IndEco Strategic Consulting and Navigant Consulting, March 7, 2005.

spending in 2007 is estimated to represent approximately 0.7% of gross revenues (or total customer bills) absent any increase in CDM funding. Given the Ontario government's clear policy direction in this regard, it is reasonable to assume that some level of increase over the existing commitments would be required. To help make the specific issue to be addressed by the OPA – LDC spending on CDM in 2007 – more tangible, we have based our subsequent analysis on three possible increments for overall CDM funding:

1. An increase of \$50 million to increase the overall level of 2007 CDM spending from 0.7% to 1% of gross revenues.
2. An increase of approximately \$100 million to increase overall CDM spending to 1.4% of gross revenues, and
3. An increase of approximately \$200 million to increase overall CDM spending to 2% of gross revenues.

2.1.3 Incremental spending by LDCs

The second factor affecting LDC spending is how any additional spending – which would represent the shortfall between the overall level of spending targeted for 2007 and the existing commitments for 2007 – would be split between the OPA and the LDCs.

This shortfall could be made up entirely through LDC CDM spending, through other sources, such as OPA spending, or through some combination of LDC CDM spending and OPA CDM spending, as discussed in the options below.

2.2 Description of options and rationale

- ***Option 1: All incremental CDM spending in 2007 should be undertaken through LDCs.***
- ***Option 2: A portion of the incremental CDM spending in 2007 should be undertaken through LDCs, in combination with other CDM spending by other entities.*** Assuming the incremental spending was split 50 / 50 between LDCs and the OPA. (Of course other splits would also be possible.)
- ***Option 3: LDCs should not receive any incremental CDM funds in 2007 and any incremental CDM spending should be undertaken by the OPA.*** LDCs would still continue to operate their existing CDM programs funded through any remaining 3rd tranche money, but would not receive any incremental CDM funds. Hence, any incremental CDM spending would be initiated by the OPA.

Table 1 illustrates how the three options would impact the incremental spending by LDCs across various overall CDM spending levels. As shown, the impact of the options will vary depending on the overall level of CDM spending targeted for 2007.

Table 1: Illustration of how the impact of the three options would vary with different overall CDM spending levels

<i>Share of gross revenues</i>	<i>Total incremental CDM spending (\$ millions)</i>	<i>LDC incremental spending in...</i>		
		<i>Option 1 (\$ millions)</i>	<i>Option 2 (\$ millions)</i>	<i>Option 3 (\$ millions)</i>
1%	\$50	\$50	\$25	\$0
1.4%	\$100	\$100	\$50	\$0
2%	\$200	\$200	\$100	\$0

Although three discrete levels of overall spending are shown in Table 1 and the incremental LDC spending for Option 2 is based on half of the overall increase in CDM spending, it is important to recognize that there are an infinite number of combinations. As discussed, the level chosen will depend on the extent of the capacity of the market place in 2007 to ramp-up the design and delivery the programs (depending on the transition option chosen), and the regulatory approvals required.

2.3 Evaluation of options

<i>Pros</i>	<i>Cons</i>
Option 1 – All incremental CDM spending by LDCs	
<ul style="list-style-type: none"> • Supports LDC creativity • Existing CDM programs can be continued and expanded, maintaining momentum in the market • Allows local needs to be identified and addressed, and local opportunities to be realized • LDCs seen as credible, independent sources of energy information to customers • Ensures LDCs are part of the team building a ‘Conservation Culture’ • Reduces concern with boundary issues between LDCs and OPA 	<ul style="list-style-type: none"> • Would represent a significant ramp-up for many LDCs relative to their current level of spending • Would likely require new CDM programs to be developed by LDCs, which may create duplication of effort • Complex regulatory oversight under current framework, regulatory oversight would need to be addressed and streamlined • Some LDCs do not want to do additional CDM • LDC capacity constraints may limit how much additional CDM can be done
Option 2 – Some incremental CDM spending by LDCs	
<ul style="list-style-type: none"> • Attempts to combine advantages of option 1 and 3, including, for example: realize economies of scale and still be locally responsive • Can probably accomplish more with initiatives by both OPA and LDCs than by one alone 	<ul style="list-style-type: none"> • Requires work to clarify respective scope of LDC and OPA programs or risks overlap and duplication • Will require significant coordination activities to be effective • Most complicated regulatory oversight requirement

<i>Pros</i>	<i>Cons</i>
Option 3 – No incremental CDM spending by LDCs	
<ul style="list-style-type: none"> • Simplifies regulatory oversight • No duplication of effort for new CDM programs • Ensures economies of scale in CDM • Provides a consistent set of programs across the province • Avoids boundary issues between LDCs and OPA 	<ul style="list-style-type: none"> • Would lose current CDM momentum by LDCs • Loss of local market knowledge • May result in less innovation • Could create market confusion • Require significant ramp-up in OPA CDM activity, on top of current activities. OPA has capacity constraints • May not be possible to be fully responsive to specific local needs or opportunities

Informal consultations with LDCs of several sizes indicate they could comfortably double their existing efforts, so spending in the order of an additional \$50 million in 2007 is probably achievable. This corresponds to 1% in the LDC-only incremental spending option (option 1), or 1.4% of total revenue in the some incremental CDM spending option (option 2). With concerted effort, this could probably be increased somewhat, but spending at the upper ranges, particularly with the LDCs acting alone, is likely to risk missing targets, or a decrease in overall effectiveness and efficiency of CDM delivery.

3 The role of LDCs in CDM

Issue #2 – What is the appropriate role for LDCs in CDM in 2007

3.1 Context for the issue

Just as LDCs currently have accountability for realizing energy and demand savings on behalf of Ontario electricity ratepayers through the 3rd tranche CDM funding, so does the OPA through various directives and other mechanisms. The role of the OPA in CDM is intimately connected to the role of LDCs in CDM. For this reason, we discuss the relative advantages and disadvantages of allocating accountability for CDM between the LDCs and the OPA for the various options presented below.

The OPA's 2006 Strategic Plan, as approved by the OPA Board of Directors and the Minister of Energy, gives the Conservation Bureau the strategic objective for 2006 to develop, coordinate and stimulate electricity conservation and demand management. To fulfill that overall objective the Conservation Bureau has established three strategic objectives regarding CDM:

1. Create and foster the development and delivery of CDM initiatives informed by the best available market knowledge
2. Develop needed infrastructure and market mechanisms to deliver sustainable Conservation & Demand Management
3. Champion the building of a Culture of Conservation to achieve sustained commitment to conservation

Regardless of how accountability for specific CDM programs and activities is allocated, there are several additional activities and initiatives the Conservation Bureau can undertake that are consistent with its strategic objectives. These initiatives could include:

- Facilitate Ontario's CDM capacity building – e.g. training, certification
- Develop recommendations for product standards/information e.g. lighting to avoid consumer confusion
- Test products for conservation products
- Help to create a brand for conservation in Ontario, such as the recent PowerWise media campaign
- Develop recommendations for energy building code requirements and energy standards
- Develop recommendations for tax treatments to encourage CDM (such as recommendations related to PST rebates on energy efficient products)
- Provide a large fund of money for piloting CDM programs

- Develop methodology and tools for CDM program screening, monitoring and evaluation e.g. free rider studies, upfront assumption setting
- Conduct market potential studies
- Develop programs to raise awareness and stimulate conservation action
- Develop market transformation programs
- Develop programs for wholesale market participants in partnership with IESO (ie, those customers not served by LDCs)
- Undertake measurement and verification of LDC and other CDM programs for the purpose of its annual report, and
- Monitor activity and programs in other jurisdictions to find best practices and effective programs for adoption in Ontario.

Before the Conservation Bureau was established many of these activities were neglected and they are only now getting underway.

These activities would complement whatever decisions are made with respect to the three questions asked of the OPA by the OEB.

In the context of this issue related to the role of LDCs in CDM, we have assumed that the existing commitments of the LDCs and the OPA will be fulfilled. For the LDCs, this means that there will be an estimated total of about \$50 million for CDM activity through third tranche and second generation CDM funding. For the OPA, this means that the OPA would fulfill its existing directives, maintain its existing CDM contracts such as with Social Housing Services Corporation for a social housing program, HRAI for an air conditioner program and the EDA for an education and incentive program, and launch the programs that are planned for start up in the remainder of 2006.

Other factors that should be considered in determining the role of LDCs in CDM in 2007 include the government's desire for aggressive pursuit of CDM and the relatively limited capacity for CDM delivery in the Ontario market. Given the limited capacity and the rate at which the Conservation Bureau is likely to be able to ramp-up its CDM activity, LDCs represent a possible vehicle for CDM delivery and / or CDM accountability.

Although the options presented below relate to the appropriate role of LDCs in CDM in 2007, potential limitations on long-term choices and flexibility related to a longer term CDM framework for Ontario associated with any particular option are also discussed.

3.2 Description of options and rationale

- ***Option 1: The appropriate role of the LDCs in 2007 is to be accountable for as many CDM programs as possible.*** Being accountable for CDM programs

is defined as being responsible for the design and delivery of CDM programs. LDCs would be free to contract out design and delivery, but would ultimately be accountable for performance. Therefore, in this option, to the extent possible, all future CDM to be procured by the OPA in 2007 (beyond its existing obligations and plans as discussed above), would result in CDM for which the LDCs would be accountable. This would require a shift in how the OPA carries out procurement. Instead of designing programs and procuring their delivery, the OPA would need to develop a contractual mechanism to ensure that the program developed and delivered by the LDCs met OPA requirements.

For illustrative purposes only an example, among many possibilities, of how this mechanism might work is presented. This example involves the OPA establishing a set of performance measures for program design and delivery that the LDCs would be required to meet. An organization such as the EDA would support the LDCs in developing a province wide program satisfying the performance measures that each LDC would deliver in its own service area. LDCs would be accountable for the results achieved in their service area. The LDCs, through policy direction from the government, would be advised of their obligation to participate in this program design and to deliver the program once designed.

- ***Option 2: The appropriate role in 2007 of the LDCs is to be accountable for certain CDM programs in a laissez faire environment.*** This would allow overlap and competition with no attempt to rationalize overlap and competition between LDCs and the OPA. This option would also allow the OPA and the LDCs to design and deliver whatever programs they feel are appropriate to serve their customers (in the case of LDCs it is the customers in their service area; in the case of the OPA it is all electricity customers) subject to existing regulatory scrutiny.
- ***Option 3: The appropriate role in 2007 of the LDCs is to be accountable for certain CDM programs in a coordinated environment.*** This option rationalizes the CDM portfolio of the OPA and the LDCs to minimize unproductive duplication and overlap. There are many possibilities to achieve this rationalization. Some possible approaches are presented here for illustrative purposes only.

One approach would involve allocating accountability by sector. For example, the OPA would be exclusively accountable for CDM for the large industrial customers that are not LDC customers.

Another approach would be to allocate accountability by geography. For example, the OPA could be accountable for province wide programs. Certain

of these programs would be mandatory for LDCs to deliver within their service area under guidelines specified by the OPA, which would ensure uniform access across the province. The OPA could also establish templates for a set of optional programs. The LDCs would be able to choose from the optional set of programs and/or could develop programs specific to their service areas to capture unique opportunities or measures not covered by the province wide programs. LDCs would be accountable for these programs. To expedite development and regulatory approval of the mandatory and optional programs, the OPA would provide the LDCs with the TRC calculations and input assumptions to minimize the level of regulatory scrutiny required by the OEB. The LDCs would be required to meet OEB requirements on their own for their own programs. The OPA or the OEB could also set the percentage of the total CDM budget of the LDC that was required for the mandatory programs (e.g. 30 – 50% of total LDC CDM budget).

Another approach would be to allocate accountability based on the benefit / cost ratio of the program. For example, the LDCs could be accountable for measures with the highest benefit / cost ratios and the OPA would be accountable for programs with lower benefit / cost ratios that would benefit from economies of scale that LDCs would not be able to access acting independently.

- ***Option 4: The appropriate role of the LDCs in 2007 is to focus on program delivery, delivering certain CDM programs to their customers.*** The OPA would design and be accountable for the incremental CDM programs (beyond the existing program obligations of the LDCs as discussed above) that are delivered by the LDCs and other channel partners. The delivery role that the LDC would fulfill for a particular program would be spelled out in the contractual arrangements between the LDC and the OPA.
- ***Option 5: The role for the LDCs in CDM in 2007 is minimized.*** This would involve a wind down of the role of LDCs in 2007. No new opportunities for greater CDM would be provided to the LDCs in 2007. The OPA would be accountable for designing and delivering any new programs (beyond those already committed to by the OPA and the LDCs as discussed above). The OPA would not procure any incremental CDM with the LDCs. The OPA could choose from a broad range of market players for CDM delivery that may include, for example, LDC affiliates, other energy service providers, NGO's (e.g. community based NGO's experienced in delivering local programs), and business associations (e.g. BOMA).

3.3 Evaluation of options

Pros	Cons
Option 1 – LDCs accountable for as many CDM programs as possible	
<ul style="list-style-type: none"> • Achieves coordination between OPA and LDCs on CDM programming • LDCs are given clear and stronger mandate for program design and delivery of CDM • Link between LDC activity on CDM becomes more closely aligned with provincial policy objectives through link with directives • Takes full advantage of LDC creativity and ensure CDM programs address unique local situation and opportunities • Provides significant movement toward the elimination of overlap and competitive issues between the LDCs and the OPA 	<ul style="list-style-type: none"> • Presents a significant coordination challenge for the 80 plus LDCs to come to an agreement on a province-wide program that each is willing to implement • OEB regulatory oversight for the LDCs will be more complex • Presents significant challenges in achieving economies of scale • Policy direction and communication from the Minister will be essential to ensure that the LDCs understand their new responsibilities • Represents significant change in business model of the OPA to fulfill Ministerial directives that will be disruptive to current operations and detract from the OPA's ability to deliver on savings • The mechanisms required to implement this option are not known and will need to be developed quickly • Sets, to a significant extent, in a certain direction the role for LDC CDM beyond 2007
Option 2- LDCs are accountable for certain CDM programs in a laissez faire environment regarding overlap and competition	
<ul style="list-style-type: none"> • Capitalizes on strengths of central organization to deal with province wide programming and strengths of LDCs to ensure local needs are met • Supports LDC creativity for innovative programs that other LDCs can adopt or if appropriate the OPA can scale up provincially • Shared accountability for CDM among LDCs, OPA and other market players • Builds capacity at the provincial and local levels for CDM, developing both province wide delivery channels to assist the OPA and local delivery channels to assist the LDCs • Constructive competition and overlap may lead to greater savings 	<ul style="list-style-type: none"> • 80 plus LDCs makes regulatory oversight by OEB complex • Unproductive overlap and competition may reduce the level of savings achieved by both the OPA and LDCs • Unproductive overlap and competition will result in confusion in the market place among market players and potential program participants • Unproductive overlap and competition may lead to inflated incentives and greater numbers of free riders • Lack of coordination may lead to unequal market access to programs across the province

Pros	Cons
<ul style="list-style-type: none"> Allows significant flexibility in determining the future role for the OPA and the LDCs 	
Option 3 – LDCs accountable for certain CDM programs in a coordinated environment	
<ul style="list-style-type: none"> Capitalizes on strengths of central organization to deal with province wide programming and strengths of LDCs to ensure local needs are met Supports LDC creativity for innovative programs that other LDCs can adopt or if appropriate the OPA can scale up provincially Shared accountability for CDM among LDCs, OPA and other market players Builds capacity at the provincial and local levels for CDM, developing both province wide delivery channels to assist the OPA and local delivery channels to assist the LDCs Steps to eliminate unproductive overlap and competition will enable LDCs and OPA to focus more effort toward achievement of savings Allows significant flexibility in determining the future role for the OPA and the LDCs 	<ul style="list-style-type: none"> 80 plus LDCs makes regulatory oversight by OEB complex Will require resources of both the OPA and LDCs to ensure ongoing and effective communication and coordination between OPA and LDCs Need to address “seams” issues between LDCs and OPA OPA may need to assist LDCs in meeting regulatory requirements for OPA programs that they deliver to streamline delivery OPA is just beginning to launch programs and as a result may find it very challenging to offer standard programs to LDCs for implementation in the spring of 2007
Option 4 – LDC role focuses on program delivery	
<ul style="list-style-type: none"> Ensures uniform programs available across the province Takes advantage of existing LDC delivery mechanisms, while allowing development of additional channels and capacity Can capture economies of scale in program design and delivery Accountability for CDM performance would fall primarily on the OPA Avoids boundary issues between OPA and LDCs 	<ul style="list-style-type: none"> If LDCs play a delivery role in many programs, could create an administrative burden for OPA, compared with using a single delivery agent Will severely constrain LDC ability to address unique local circumstances Will constrain LDC ability to offer a portfolio of programs that best matches the sectoral mix within its service area OPA has capacity constraints on resources to design and procure programs. Would be a serious strain on the OPA to assume this role, without a significantly larger operating budget for 2006 and 2007 and an ability to obtain and mobilize these resources quickly Sets, to a significant extent, a certain direction for the role of LDC CDM beyond 2007

<i>Pros</i>	<i>Cons</i>
Option 5 – LDCs have no role in CDM	
<ul style="list-style-type: none"> • Avoids boundary issues between OPA, LDCs and other market players in CDM • Accountability for CDM performance would fall primarily on the OPA • Can readily capture economies of scale in program design and delivery • Ensures uniform programs available across the province • Provides regulatory simplicity of CDM in that OEB will regulate one entity instead of 80 plus entities regarding CDM 	<ul style="list-style-type: none"> • Fails to capture strengths of LDCs in the market – customer knowledge, credibility with customers, experience in program design and delivery • Will likely lead to enhanced regulatory scrutiny of OPA CDM by OEB • Would lose current LDC CDM momentum • Would require significant ramp-up capabilities of OPA and other channel members to achieve significant results. Would be a very serious strain on the OPA to assume this role, without a dramatic increase in its operating budget for 2006 and 2007 and an ability to obtain and mobilize these resources quickly. • OPA has limited local presence • Sets, to a significant extent, a certain direction for the role of LDC CDM beyond 2007

4 Funding of CDM by LDCs

Issue # 3 - Whether there should be funding of LDC CDM programs in 2007 through distribution rates in addition to the funding of LDC programs that is received through the Global Adjustment Mechanism, and ultimately an OPA procurement contract

4.1 Context for the issue

The need to address this issue is dependent on the answer to the first issue. If there is no incremental CDM funding for LDCs in 2007, then there is no need to consider where the funding will come from. If however, there is to be incremental CDM spending by LDCs in 2007, there is a need to address this issue.

In considering potential funding of LDC CDM activities through the Global Adjustment Mechanism, it is important to recognize that until the IPSP is approved, the OPA can only undertake procurement of CDM based on Ministerial directives. The funds for any such CDM would be recovered by the OPA through the Global Adjustment Mechanism. The implication of this is that in order for funds to be provided to LDC CDM they would need to be associated with a Ministerial directive. This is possible, but for any material level of LDC CDM spending, this would require either a significant number of Ministerial directives or fewer, but broader directives.

The OPA can also pursue certain non-procurement CDM activities that would be funded through the OPA's operating budget, as opposed to through the Global Adjustment Mechanism. This would allow continuation of programs such as the Conservation Fund (which LDCs could draw from) and Conservation Bureau media, education and outreach programs. However, the total pool of CDM funds available from the OPA's operating budget is likely to be relatively small compared to the overall level of CDM funding. Also, this mechanism provides limited flexibility in funding CDM initiatives and increases the regulatory burden for CDM. Given this, it is not considered to be a viable option for any material level of CDM funding by LDCs.

Based on this, there appear to be three possible options for incremental funding of LDC CDM activities in 2007, as discussed below:

4.2 Description of options and rationale

- **Option 1: LDCs should be required to collect a mandated level of funds (expressed as a percentage of total customer bills) in 2007 through distribution rates for eligible CDM activities in addition to any funding of LDC CDM programs that is received through the Global Adjustment Mechanism.** The LDCs would be required to apply to the OEB for a mandated level of CDM

funding to be incorporated into their 2007 rates, possibly through an adjustment to the second generation incentive regulation. The level of CDM funding, obtained through rates, is mandated by the OPA. In addition to this funding through rates the OPA would also continue to procure CDM based on dollars from the Global Adjustment Mechanism.⁸ To streamline program selection, a menu of programs could be established by the OPA, with set parameters from which LDCs could choose within their budget envelope. LDCs could also establish a corresponding target to ensure selection of the most cost-effective programs from the “menu.” The Minister of Energy could provide policy support to the OEB for this approach.

- Option 2: LDCs would be allowed to apply to the OEB in 2006 for funding of 2007 CDM activities to be collected through distribution rates for CDM activities in addition to any funding of LDC CDM programs that is received through the Global Adjustment Mechanism.** This option allows the LDCs to select their own CDM budgets and to apply to the OEB for funding through distribution rates. This option is a continuation of the current voluntary framework covering LDC 2006 rate applications, for which 10 LDCs submitted requests for CDM funding. This option would allow for the same regulatory oversight as currently exists. In addition to this funding through rates the OPA would also continue to procure CDM based on dollars from the Global Adjustment Mechanism. As under the mandatory approach described above, the OPA could establish a menu of programs, with set parameters from which LDCs could choose within their budget envelope. Targets could also be established to assist in setting the budget and to ensure selection of the most cost-effective programs from the “menu.”
- Option 3: Funding for LDC CDM programs in 2007 would only be provided through an OPA procurement contract.** The OPA would fund LDC CDM programs solely through the Global Adjustment Mechanism. As discussed, until the IPSP is approved, the OPA is required to undertake procurement of CDM based on ministerial directives. Given the likely timing for IPSP approval, such funding for 2007 would only be possible through one or more Ministerial directives. A directive that the OPA collect a set amount per kWh withdrawn from the IESO-administered market through the Global Adjustment, of which a

⁸ The recent practice of incorporating DSM plans into rate applications may be difficult in 2007 because the OEB is planning to move to Second Generation Incentive Regulation and there will be no rate applications per se in 2007, but there may be cost allocation re-assessments. The OEB is expected to provide instruction to utilities on how to calculate rates for 2007 based on this new scheme. Under this process there will be no rate application process to address the approval of post-third tranche CDM dollars through rates. This in itself is not an insurmountable barrier. Some other jurisdictions have procedures for dealing with DSM plan approvals independently of rate applications with adjustments made to rates for approved DSM expenditures the next time rates are reset.

certain percentage would be provided to LDCs for CDM, would create a funding mechanism similar to a Systems Benefit Charge.

4.3 Evaluation of options

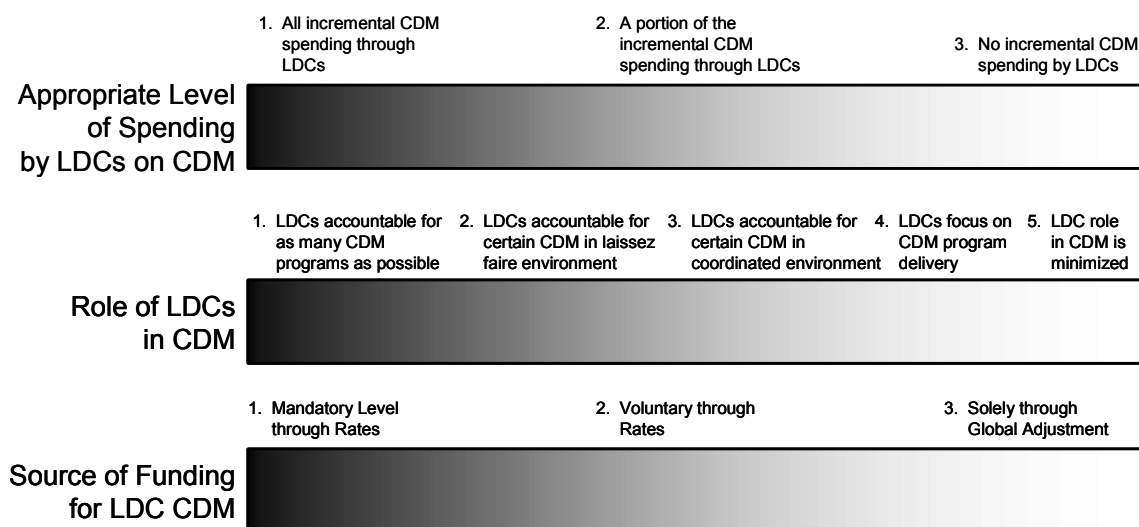
<i>Pros</i>	<i>Cons</i>
Option 1 – LDCs required to collect a mandated level of funds for CDM from ratepayers	
<ul style="list-style-type: none"> • The mandatory spending level could be set to match aggregate capacity to deliver savings and level of savings economically achievable in the Ontario market • Main elements of process are familiar to LDCs and OPA • Simplifies CDM budget setting and budget approvals for LDCs • Will reduce regulatory uncertainty for the LDC and encourage them to establish CDM as a core part of the utility business • Maintains momentum in CDM generated by LDCs and provides opportunity to ramp-up and focus on savings achievement through effective programs • Provides regulatory oversight by OEB to ensure LDC CDM programs are cost-effective and have appropriate rate class coverage 	<ul style="list-style-type: none"> • The provincial policy uncertainty for the OEB needs to be addressed. A Minister's letter to the OEB on 2007 CDM policy would assist in providing the OEB with guidance on setting the level of expenditures for 2007 • The level set may lead to spending levels below or above the capacity of the LDC to deliver and result in suboptimal levels of savings • Will require OEB to create regulatory oversight process for CDM as no rate filings planned for 2007. Setting targets may require additional regulatory effort • Even if mandatory, regulatory uncertainty regarding LRAM is a disincentive for some LDCs to aggressively pursue CDM – clarity needed on LRAM • SSM mechanism currently in place does not appear to provide adequate incentive to LDCs to aggressively pursue CDM (based on small number of '06 applications compared with apparent capacity) • If CDM is made mandatory, those utilities that do not want do to CDM will be forced to do so • The OPA will need to ramp-up to establish the mechanisms required to implement this option, and this will be challenging
Option 2 – LDCs allowed to request additional CDM funding through distribution rates	
<ul style="list-style-type: none"> • LDCs would continue to have a choice in offering CDM within their service territory. Each budget would be set to address the unique situation of the LDC, its CDM delivery capability, shareholder objectives, customer base and markets • Within the budget envelope the LDC could allocate CDM resources to best meet the 	<ul style="list-style-type: none"> • Uncertainty in approval of CDM budgets for each LDC • Regulatory oversight on setting budget levels for each individual LDC on a "one-off" basis will be required • Regulatory uncertainty regarding LRAM is a disincentive for some LDCs to aggressively pursue CDM – clarity needed

Pros	Cons
<p>needs of its customers</p> <ul style="list-style-type: none"> • Main elements of process are familiar to LDCs and OPA • Will reduce regulatory uncertainty for the LDC and encourage them to establish CDM as a core part of the utility business 	<p>on LRAM</p> <ul style="list-style-type: none"> • SSM mechanism currently in place does not appear to provide adequate incentive to LDCs to do aggressive CDM • Past experience with voluntary CDM suggests there may be very limited “take-up” by LDCs, which would exacerbate spotty coverage through hybrid (LDC and OPA) CDM activity • If CDM is optional, CDM is unlikely to become part of core utility business • No assurance of full market coverage
Option 3 – Any incremental CDM spending by LDCs funded through Global Adjustment	
<ul style="list-style-type: none"> • Simplifies sources of funding and can reduce complexity in obtaining funds • CDM resource allocation done provincially can focus on areas of greatest need and opportunity for savings within the province • Simplifies provincial branding of programming • Using the global adjustment to fund LDC? CDM provides maximum flexibility to OPA in delivery of CDM, provided there is an underlying directive for the CDM initiative • Can be structured to take advantage of ramp-up and momentum in LDC CDM programs and credibility that LDCs have with their customers 	<ul style="list-style-type: none"> • This is a short term solution and a longer term framework is required (e.g. through rates). Over the long-term, OPA CDM will be specified and approved through the IPSP, and the IPSP approvals process is expected to be complex • OEB would still need to be responsible for dealing with LRAM for the LDCs to keep LDCs whole • OPA or OEB would need to be responsible for providing incentives to the LDCs to overcome the disincentive to pursue load building rather than CDM • The OPA would need to develop the mechanism to flow dollars from the OPA to the LDCs and the rules of engagement for the LDCs to receive the dollars. This would be very challenging • While the rules of the game for CDM approval are well known if the OEB is the mechanism, providing some comfort to the LDCs, there is no LDC experience in obtaining CDM program funding from the OPA, creating a more uncertain environment for the LDCs in securing funds for CDM • There is no regulatory oversight of LDC spending

5 Possible scenarios

For each of the three questions, the options could be considered as points along a continuum, as shown below:

Figure 2: Options illustrated as points along a continuum



There are many possible combinations of the options described above, but certain combinations would not be possible or practical. For example, LDCs could not be held accountable for as many CDM programs as possible if they are not provided with funds to undertake CDM. To aid stakeholders in evaluating these options and understanding the inter-dependency of certain options, illustrative combinations representing possible scenarios for 2007 have been developed. Note that the scenarios listed below are not the only possible combinations, but they do represent internally consistent choices across the three issues from among the options identified.

Three possible scenarios (and the associated option for each of the three issues) are presented in Table 2. Note that in all cases, it is assumed for illustrative purposes that incremental CDM spending of approximately \$100 million would be undertaken above and beyond existing CDM commitments of LDCs and the OPA.

To demonstrate how the table is constructed, under the first scenario, which represents a choice of option 1 for issue 1, option 1 for issue 2 and option 1 for issue 3, LDCs would be responsible for all incremental CDM spending, would design and deliver as many CDM programs as possible and the funding for the LDCs' CDM activity would be mandatory through distribution rates. On the other hand, under the third scenario, which represents a choice of option 3 for issue 1 and option 5 for issue 2, LDCs would not receive any incremental funding for CDM in 2007 and their role in CDM would be minimized. Note that, as shown in the table, there is no need to address issue 3 – source of funding for LDC CDM – in this scenario since LDCs would not receive any incremental funding.

Table 2: Illustrative scenarios based on choices across the three issues

Scenario	Issue 1: Level of CDM Funding for LDCs	Issue 2: Role of LDCs in CDM	Issue 3: Primary Source of LDC CDM Funding
1. LDCs have primary responsibility for incremental CDM programs	~ \$100 million (Option 1)	Design and deliver as many CDM programs as possible (Option 1)	Mandatory through Distribution Rates (Option 1)
2. LDCs have responsibility for certain incremental CDM programs, OPA has responsibility for others without overlap or duplication	~ \$50 million (Option 2)	Design and deliver certain CDM programs through co-ordinated approach (Option 3)	Voluntary through Distribution Rates (Option 2)
3. LDCs have no incremental responsibility for CDM, OPA has primary responsibility for all CDM	\$0 (Option 3)	LDC role in CDM is minimized (Option 5)	No need to address

6 Instructions on written submissions

The Conservation Bureau is seeking your input on this options paper. The paper is intended to be, to the extent possible, a balanced account of the pros and cons of the options presented and to solicit stakeholder input on these options as well as scenarios based on combinations of these options. Based on your input as well as additional research that may be required, the consultants will evaluate options and make recommendations to the Conservation Bureau regarding each of the three questions. The OPA will submit a final report to the OEB by the end of June 2006 that provides recommendations on the answers to each of the three questions posed by the OEB for 2007.

To assist you in conducting an evaluation and the development of recommendations for the transition, we provide guidance on the type of comment requested. In preparing comments, the Conservation Bureau invites you to:

- **Develop combinations of the options to form reasonable scenarios.** These scenarios should be comprised of an option related to each of the three questions posed by the OEB. How to build scenarios is illustrated in Table 3 below. It is important to note that the OPA may not be able to implement in part or in full particular options presented in the options paper.
- **Use the evaluation criteria⁹ listed in Table 4 to evaluate the scenarios.** Feel free to add to or adjust the evaluation criteria in the table and kindly provide the rationale for any changes made. Please take into consideration and document in the evaluation any potential limitations that a particular scenario may have on long-term choices and flexibility related to CDM funding and roles beyond 2007.
- **Based on your assessment of the scenarios and their corresponding options, provide recommended responses for the transition to each of the questions, as shown below:**
 - 1) What is the appropriate level of spending by LDCs on CDM in 2007?
 - 2) What is the appropriate role of LDCs in CDM in 2007?
 - 3) Should there be funding in 2007 beyond September 30, 2007 for CDM programs through distribution rates, in addition to any funding of LDC programs received through the Global Adjustment Mechanism?

⁹ Note that if the analysis period was longer term (i.e. beyond 2007), additional evaluation criteria should be considered. These long-term criteria could include:
- Affordability (i.e. efficiency of the model in delivering CDM results)
- Risk mitigation (diversity)

Table 3: Constructing scenarios

Scenario:	Choose one option for each of the three issues....		
	Appropriate level of CDM spending by LDCs in 2007	Role of LDCs in CDM	Source of LDC CDM funding
Scenario a:	Option <input type="checkbox"/> (select one)	Option <input type="checkbox"/>	Option <input type="checkbox"/>
Scenario b:	Option <input type="checkbox"/>	Option <input type="checkbox"/>	Option <input type="checkbox"/>
Scenario c:	Option <input type="checkbox"/>	Option <input type="checkbox"/>	Option <input type="checkbox"/>

Table 4: Evaluation criteria

Evaluation criteria	Scenario a	Scenario b	Scenario c
1. Effectiveness - Does the scenario utilize the various market players, including those in the private sector, for what they are best at, without unnecessary overlap and duplication of effort?			
2. Equity – Does it enable similar access to CDM opportunities across the province (eg, for someone in downtown Toronto and Kenora)? And, are the sources of funding by customer class reasonably matched to the likely CDM recipients by customer class?			
3. Doability – given Ontario's current CDM infrastructure and the capabilities of the current market players, can it be fully operational by 2007?			
4. Capacity building – Does it help to build increased CDM capacity among Ontario's various market players, including those in the private sector?			
5. Innovation – Does it encourage innovation and does it allow CDM to reflect local needs?			
6. Simplicity for customers – Is it easy for customers to understand and does it help to reduce confusion in the market place			
7. Flexible foundation for growth – Does it help to establish a foundation for growth in CDM activity beyond 2007? And, is the foundation sufficiently flexible to accommodate a variety of possible CDM models to be pursued beyond 2007?			

The Conservation Bureau has begun to investigate the answers to the three questions for the long-term. There will be an opportunity for stakeholders to provide comment on options for the long-term which will be considered in the development of OPA recommendations. The final report on the long-term that will address the appropriate level of spending by LDCs, the appropriate future role of LDCs in CDM, and what the appropriate funding mechanism should be, is planned to be completed by the end of August 2006.