

October 2013

The Honourable Bob Chiarelli  
Minister of Energy  
Hearst Block  
4th Flr, 900 Bay St  
Toronto, ON M7A 2E1

Dear Minister Chiarelli:

On behalf of the Ontario Energy Association's (OEA) Board of Directors and members, I appreciate the opportunity to provide the following comments outlining our advice to the Government of Ontario relating to conservation and demand management (CDM).

The OEA's members have come together to provide this collective advice to the Government. We believe our recommendations are illustrative of the industry's thinking about CDM and provide a strong foundation upon which coherent policy can be built for our industry in Ontario.

As Ontario's energy voice, the OEA is representative of key players on both the supply and demand-services side of Ontario's energy equation. Such diversity allows us to offer a broad and comprehensive perspective on the review of Ontario's conservation and demand management policies. The OEA has devoted considerable effort and resources to gathering intelligence and developing a position on these issues, the results of which are outlined in the attached submission.

We look forward to continuing the dialogue with you and your team on how changes to the CDM framework can help address some of the challenges and opportunities before Ontario's energy sector. If you have any questions regarding this submission please feel free to contact me at your convenience at 647.920.3269 or [tina@energyontario.ca](mailto:tina@energyontario.ca).

Look forward to continuing to unravel the most complex energy challenges, together.

Many thanks,



Tina Arvanitis  
Vice President  
Government Relations and Communications  
Ontario Energy Association

ONTARIO ENERGY ASSOCIATION  
**ADVICE TO GOVERNMENT ON  
CONSERVATION AND DEMAND  
MANAGEMENT**

October 2013

To shape our energy future for a stronger Ontario.



Ontario Energy Association

# ABOUT

## THE OEA

The Ontario Energy Association (OEA) aspires to be the most credible and trusted voice of the energy sector. We earn our reputation by being an integral and influential part of energy policy development and decision making in Ontario. We represent Ontario's energy leaders including over 150 corporate members that span the full diversity of the energy industry.

The OEA takes a grassroots approach to policy development by combining thorough evidence based research with executive interviews and member polling. This unique approach ensures our policies are not only grounded in rigorous research, but represent the views of the majority of our members. This sound policy foundation allows us to advocate directly with government decision makers to tackle issues of strategic importance to our members.

Together, we are working to build a stronger energy future for Ontario.

# CONTENTS

PAGE TWO  
CONSIDERATION OF THE ISSUES

PAGE THREE  
5 RECOMMENDATIONS

PAGE FOUR  
CONTEXT

PAGE FIVE  
RECOMMENDATION #1: ROLE OF CONSERVATION AND DEMAND  
MANAGEMENT

PAGE NINE  
RECOMMENDATION #2: CLASSES OF CDM INITIATIVES

PAGE ELEVEN  
RECOMMENDATION #3: MANAGING CDM INITIATIVES

PAGE TWELVE  
RECOMMENDATION #4: MEETING THE CHALLENGES OF FINANCING CDM  
INITIATIVES

PAGE FOURTEEN  
RECOMMENDATION #5: SCOPE OF CDM INITIATIVES

PAGE SIXTEEN  
SUMMARY

## CONSIDERATION OF THE ISSUES

The Government of Ontario is preparing to refresh the Long-Term Energy Plan that was released in 2010, and part of that is addressing issues relating to conservation and demand management (CDM). This process is timely, as the circumstances facing Ontario's energy sector continue to evolve.

The Ontario Energy Association's members have come together to provide collective advice to the government. The OEA's recommendations are the result of an extensive effort to distill the understandings of its members to find common ground. Individual members may each offer the government their unique perspective on any number of issues (and many members have already provided their own advice on CDM issues directly to the government), but the OEA has focused only on core matters of principle, as this is where a substantial majority of its members agree. We believe that this concentration of the industry's thinking about CDM provides a strong foundation upon which a coherent policy can be built for our industry in Ontario.

To prepare this advice to government, the OEA:

- Disseminated the government's discussion papers among members, and encouraged members to attend regional stakeholder meetings held by the OPA across the province;
- Discussed LTEP and CDM issues at Board and Executive Committee meetings;
- Arranged information meetings with government representatives, attended by senior representatives of many OEA member companies;
- Conducted Executive Surveys among all affected OEA members seeking input on CDM issues;
- Discussed CDM issues through panels at the annual OEA Conference on September 11 and 12;
- Undertook significant research to assemble the information collected below.

The OEA's advice to government is distilled into five key recommendations. These are the official positions of the OEA, as adopted by its Board of Directors.

This paper contains substantially more than just the OEA's recommendations to government. Additional information is offered and intended only to provide assistance to the government in its deliberations. A wide variety of sources were consulted and gathered in the hopes that it would provide useful context for the recommendations of the OEA, but none of this additional material forms part of those recommendations. As the OEA has argued elsewhere<sup>1</sup>, our members firmly believe that energy policy should be founded on publicly available facts and data; we have therefore attempted to gather together information that we hope will prove useful.

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<sup>1</sup> OEA Energy Platform, released September 11, 2013.

## 5 RECOMMENDATIONS

### Recommendation #1

Demand-side resources should be pursued whenever they are efficient from the perspective of net system cost in Ontario.

### Recommendation #2

A sophisticated approach to CDM targets and programs is required, which distinguishes between conservation and efficiency, demand response, and other potential initiatives which focus on objectives such as system operability.

### Recommendation #3

Distribution companies should play the central role in developing and delivering conservation and efficiency programs across Ontario, while demand response and system operability initiatives should be market-based and managed by the IESO.

### Recommendation #4

Obstacles to alternative financing mechanisms should be eliminated, so that consumers have more options to pursue conservation and efficiency.

### Recommendation #5

CDM targets, programs and markets should encompass not only electricity, but also the potential for fuel-switching, and multi-fuel energy benefits.

## CONTEXT

Ontario's energy systems provide electricity to power our lights, electronics and air conditioning, natural gas to heat our homes and drive chemical processes, and transportation fuels to carry us and our goods from place to place. Without these systems and the energy they provide, we would not have a modern economy. We would not be able to lead our lives in comfort, safety and security.

A well-functioning system is one that is balanced and sustainable over time. In the case of electricity, this requirement is an operating principle: electricity demand must be balanced with electricity supply on a minute to minute basis, or the system will collapse. In natural gas and petroleum, where storage plays a much larger role, the balance between supply and demand must only be true on a seasonal or longer term basis, but is still a fundamental principle.

A common habit, formed through a history of discovery and development of new energy resources, is to focus on the supply side of the system balance equation. However, if balance is what is important, then the demand side is just as legitimate a focus for planning and management. Moreover, since the production of energy inevitably has environmental and social consequences – ranging from air and water emissions, to land use, to changes in traffic and employment patterns – it is sensible to consider whether it would be possible to avoid these consequences altogether by reducing or otherwise beneficially controlling expected demand.

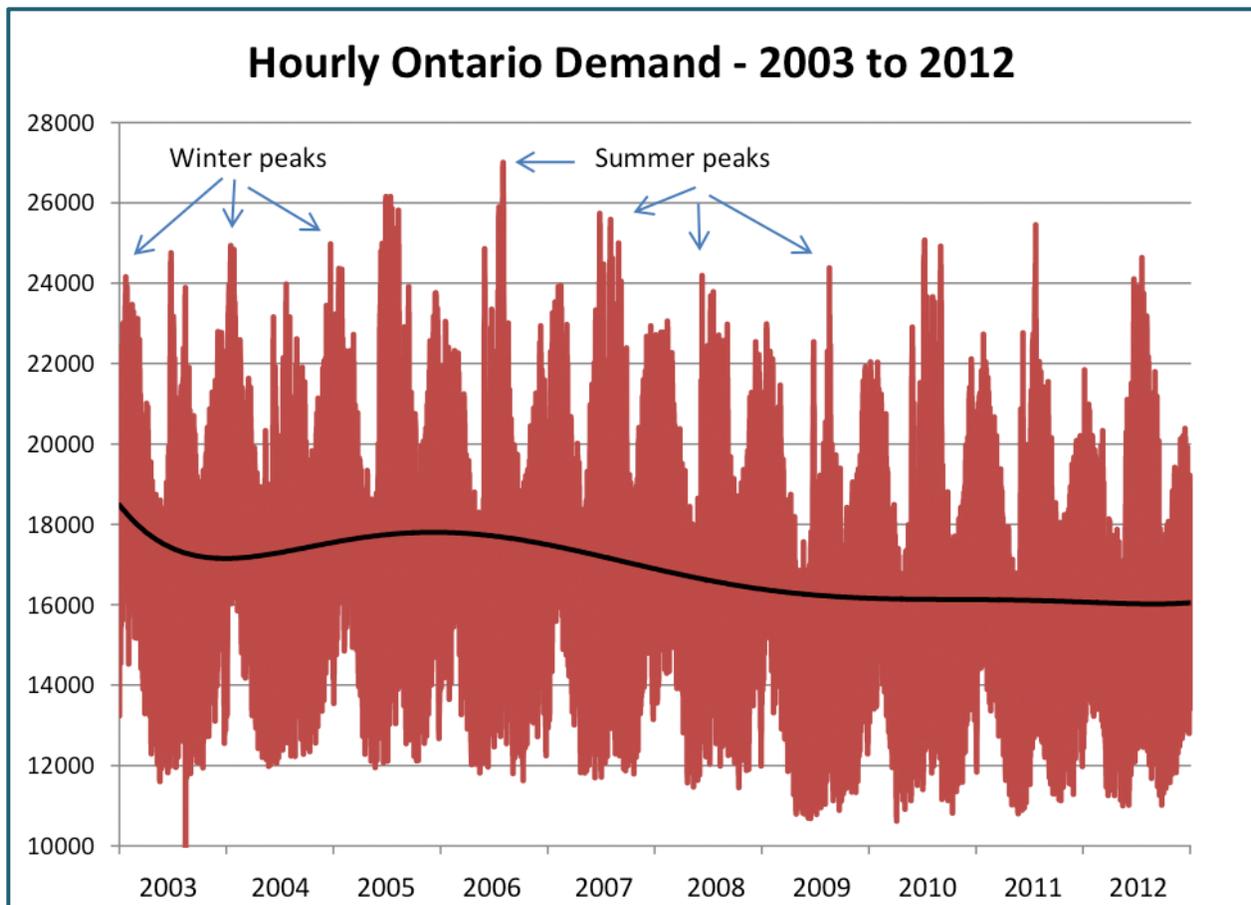
In the past 10 years, Ontario has reinvigorated the CDM sector. Where in the previous decade very little attention was focused on demand-related issues and opportunities, recent years have seen substantial spending on a wide variety of initiatives. In this context, it is valuable to review what has been done, take stock, and consider how best to move forward as pragmatically and efficiently as possible. The OEA applauds the government's efforts to do so, and hopes that its recommendations and advice can help lead to continued strengthening of CDM initiatives in Ontario.

## RECOMMENDATION #1: ROLE OF CONSERVATION AND DEMAND MANAGEMENT

Demand-side resources should be pursued whenever they are efficient from the perspective of net system cost in Ontario.

Electricity resources are typically extremely long-lived assets. Generating stations, transmission lines, transformers and switches have lives that can be measured in decades. Natural gas and petroleum resources are similar, whether the assets in question are pipelines, underground storage facilities or refineries. Decisions about such resources do not come up very often, and when they do, they require careful consideration and debate.

In contrast, demand changes on a daily basis. Weather drives seasonal shifts that are unpredictable, with one day's or month's performance often radically different from the previous or following periods. Yet trends are visible over time, and decisions can be made that will cause trend lines to shift up or down, or even change shape.



The chart on the preceding page shows the average hourly Ontario domestic demand for each hour between January 1, 2003 and December 31, 2012. The pattern of demand over the 10-year period is obvious: there are two demand peaks every year, in winter and summer, with the summer peaks greater than the winter peaks in every year except 2004, when an unusually cool summer kept the peak very low. The summers of 2005, 2006 and 2007 were also the most challenging in the history of Ontario from an electricity demand perspective.

A trend line<sup>2</sup> is superimposed on the graph (the black line), which shows that demand pressure peaked in 2005 and 2006, and has since both eased off and flattened out.

These changes have enormous significance. For example, review of the bottom-half of the chart shows that there has been a decline over the years in the minimum level of demand, from approximately 12,000 MW to 11,000 MW. This is relevant to any discussion about electricity planning, particularly with respect to baseload vs. other supply resources in the province. On the other hand, if the tops of the line can be driven downwards, then fewer peaking resources would be required in the province. Finally, a general decline in the trend line would mean that Ontario is consuming less energy overall, which could have impacts on total costs to consumers.

CDM initiatives can make a difference to these trends. Obviously, there are factors beyond anyone's control, such as the weather and the general state of the world economy.<sup>3</sup> However, it is imperative for the province that demand-side efforts be taken seriously, and given the attention that they deserve.

## **DEMAND RESOURCES AND SUPPLY CAPACITY VS. ENERGY**

At first blush, it seems intuitive that reducing demand should be beneficial to Ontario: if less energy is consumed, then costs should go down, and consumers should benefit. However, in the short term there is no necessary relationship between conservation and cost savings.

In order to provide reliable power to Ontarians, we have a mixed fleet of supply resources. This consists of renewable resources such as water, wind and solar power, as well as natural gas and uranium based power (and, decreasingly, coal power). These facilities employ multiple technologies, and rely on diverse commercial arrangements for their economic viability. However, in general, costs can be divided between those that are fixed, and those that are flexible and based on the level of production required of them. Unfortunately, while Ontario has an abundance of resources, a majority of them have fixed or otherwise inflexible costs:

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<sup>2</sup> A sixth order polynomial trend line, calculated by Microsoft Excel.

<sup>3</sup> Note that in the bottom left corner of the chart there is a line that plunges to the bottom of the chart. This is the Northeast Blackout of August 2003, another instance of an occurrence beyond Ontario's control.

- Waterpower plants: most of the cost results from the construction of the plant, with a relatively small portion associated with annual operations and maintenance; because water is essentially free,<sup>4</sup> and maintenance largely has to be performed regardless of output, operating the plant less does not result in any substantial savings;
- Wind and solar power are very similar to waterpower, in that annual costs after construction are more or less fixed, and cutting production does not actually reduce costs;
- The costs for nuclear power plants include a much larger proportion of annual labour costs when compared to water and wind, and in addition operation entails the cost of uranium fuel. However, the nature of the technology is such that nuclear plants have to run almost constantly, and cannot follow loads up and down the demand curve. As a result, if the system requires less power, nuclear plants will not be able to reduce their output in any cost-efficient way;<sup>5</sup>
- Natural gas plants (and carbon-based renewables, such as biomass and biogas) can follow loads, both physically and economically, much more easily than the other forms of power supply; since a substantial part of the cost of a gas plant consists of its fuel, if demand falls and fuel is not burned, consumers actually are not exposed to the variable cost.

In the longer term, this description is less accurate: when a plant reaches the end of its life, planners have the opportunity to reconsider whether supply choices are still good ones. For example, if a waterpower or nuclear plant reaches the end of its life, analysis should demonstrate that the same specific supply characteristics are needed before the province embarks on the development of another facility with a high proportion of fixed costs, among other characteristics.

In this context, if a CDM initiative reduces energy demand in the province, it is easy to see that costs for consumers may not be reduced in the near term. If the program cuts consumption when no gas is expected to be burned, then the affected supply resources (water, wind, solar and uranium) will continue to cost the same, even if less is required. Only two differences would apply: excess energy could be exported for some level of revenue to offset the costs of production (however, exports in some cases have been valued at \$0 or even negative prices); and the cost of the supply resources would be spread over a smaller amount of consumption (therefore driving the price per unit of energy upwards). On the other hand, if the program actually reduces the amount of fuel burned, then there will be a real cost savings, and consumers unequivocally benefit.

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<sup>4</sup> Ontario does charge waterpower operators various taxes and “water rental” fees based on the production of the facility, but this is a very small part of the total cost.

<sup>5</sup> Note that some nuclear plants can be “manoeuvred”, however this amounts to the equivalent of spilling energy, and does not result in any cost savings at the nuclear plant itself. While this ability may be critical to the safe operation of the electricity system, it is not relevant to the economics focus of long term planning.

In many instances, CDM initiatives will have a mix of impacts on supply resources: sometimes fuel can be saved, and sometimes not. At the same time, the CDM measure is not itself costless: the cost of the CDM measure is passed on to consumers, so unless costs are saved elsewhere in the system (by burning less fuel, or gaining export revenue), then the CDM initiative could go from being perceived as a net saving to being a net cost to consumers.

A further complication relates to time: CDM measures often take substantial time to plan and implement; often these measures rely for their impact on long-term changes to consumer habits and standard operating procedures. While at one point in the life of the initiative there may be limited true impact on consumer costs (because no fuel is saved and no costs are reduced through exports), later on in the life of the initiative there could be substantial savings (because, e.g., construction of a new or larger supply resource is avoided entirely, to considerable permanent benefit).

It is apparent that careful, full-life economic and system analysis of every CDM initiative is required. When system needs are identified, whether with respect to energy or system capacity, consideration should be given to CDM mechanisms to solve the problems. However, the analysis should be thorough, and based on real data about the expected system impacts of the initiative over its life. It should not be assumed that every CDM initiative will actually save consumers money simply because energy consumption is reduced.

## RECOMMENDATION #2: CLASSES OF CDM INITIATIVES

A sophisticated approach to CDM targets and programs is required, which distinguishes between conservation and efficiency, demand response, and other potential initiatives which focus on objectives such as system operability.

Many different programs and initiatives can fall into the category of “Conservation and Demand Management”, for example:

- Energy efficiency standards and recycling programs for home appliances;
- Behavioural campaigns designed to encourage consumers to reduce waste by turning off lights, leaving unused space unheated or cooled, or making do with less by dropping heating temperatures in the winter;
- Better insulation of building envelopes to reduce stress on HVAC systems;
- Industrial and commercial demand response programs to reduce the height of hourly consumption peaks; and
- Real time voltage and ramping management through load control.

In general, this array of initiatives (and many more besides) can be divided into groups based on three objectives:

- a) Those focused on reducing energy consumption, measured in MWh;
- b) Those to reduce the need for system capacity, measured in MW; and
- c) Those designed to deliver system operability benefits, such as ramping or voltage management.

OEA members believe that making these distinctions is important as a first step to the planning and implementation of CDM initiatives, particularly with reference to the Long Term Energy Plan. Depending on the targets set out in the LTEP, different types of initiatives should be considered, and each should be measured in terms of the expected net system costs and benefits related to achieving it.

None of these objectives in isolation is any more important than the others, or receive more attention with respect to CDM planning. The choice between classes of initiatives should depend entirely on the system needs identified, and the analysis which demonstrates that one or more CDM initiatives can meet those needs more effectively than supply resources.

Admittedly, some programs can have impacts on more than one objective. For example, if an industrial consumer is encouraged through a program to replace an often-used pump with a higher efficiency version, then that pump will both lower total energy consumption, and reduce

the peak demand of the industrial consumer. However, the impact of the change will likely be greater with respect to total energy consumption rather than peak demand: since the pump itself is a “baseload” consumer that runs most of the time, the increased efficiency as a percent of peak demand will be less than its percentage of total energy.<sup>6</sup>

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<sup>6</sup> For example: assume an industrial facility consumes 100 MW of power on a sustained basis, and 876,000 MWh per year, and that an efficiency improvement of 5 MW is possible, which translates into 43,800 MWh per year. A savings of this magnitude would be 0.02% of peak load in the province of 25,000 MW, but 0.03% of total energy in the province of 142 TWh.

## RECOMMENDATION #3: MANAGING CDM INITIATIVES

Distribution companies should play the central role in developing and delivering conservation and efficiency programs across Ontario, while demand response and system operability initiatives should be market based and managed by the IESO.

A strong majority of OEA members believe that institutional responsibilities for CDM should be altered. Programs that are focused on incentivizing and encouraging efficiency, waste reduction and behavioural change among consumers should be concentrated in the hands of local distribution companies. LDCs deal directly with customers and have the daily interaction necessary to be able to target, design and manage programs that demand ongoing attention and two-way information flows. Ontario's gas LDCs have demonstrated success in pursuing conservation and efficiency programs over many years, under the regulatory supervision of the OEB, and this proven model should be adopted for electricity.

The OEA recognizes that there may be practical challenges that must be surmounted in transitioning to utility-led conservation. For example, currently there are a large number of electricity LDCs in the province, not all of which may be capable of designing a full range of conservation and efficiency programs. Another issue is the inefficiency for multi-locational customers (such as province-wide retail chains) of participating in conservation programs with multiple utilities. However, cooperation between LDCs, enlightened regulatory requirements from the OEB, and other mechanisms could be used to meet these needs.

Members believe that demand response programs and newer initiatives designed to address system operability should be integrated with Ontario's electricity markets. The IESO manages the electricity grid on a 5-minute basis, ensures that price competition is fair and efficient, and has the analytical depth and capacity to continue to develop new markets and options that will expand the province's demand-based energy resources. As the OEA has advised elsewhere,<sup>7</sup> members believe that wherever possible objectives should be achieved through market-based mechanisms, and both demand response and system operability initiatives fall into this category.

A strong majority of OEA members believe that there are new opportunities for the shaping of markets for operability products which can allow demand resources, storage technologies and traditional supply resources to compete to provide the most efficient possible use of assets. Such markets would allow new technologies and solutions to be developed and refined, and would avoid the dangers associated with "picking winners".

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<sup>7</sup> OEA Advice to Government on the LTEP, October 2013.

## **RECOMMENDATION #4: MEETING THE CHALLENGE OF FINANCING CDM INITIATIVES**

**Obstacles to alternative financing mechanisms should be eliminated, so that consumers have more options to pursue conservation and efficiency.**

Many CDM programs are designed to incent consumers to make better energy choices when they are faced with decisions to spend money. For example, efficiency programs often encourage consumers to replace older less efficient products with new ones which will use much less energy over their useful lives, therefore saving money for consumers over the long-term. However, consumers in these cases must still spend more money up front than they would on a less efficient product, and affordability may be an issue.

It would be very useful in the implementation of CDM strategies and programs if consumers had access to a greater variety of financing mechanisms to help manage affordability issues. Regulatory restrictions, current financial rules and simple market inertia may stand in the way of offering consumers expanded options.

LDCs could offer “on-bill financing” to consumers as an option for designated energy efficiency expenditures. This mechanism could make the implementation of consumer and small business efficiency programs simpler, and remove obstacles to consumer participation. However, there are hurdles to overcome to make these programs widely available. For example, utilities have customer relationships with homeowners that do not survive the sale of a home. Therefore, if a home is sold while an on-bill financing relationship is in place but not completed, the utility would face credit and administrative risks. Another issue relates to the treatment of financing services in utility ratebases: while utilities could provide the service to customers, their incentive to do so would be limited if they were not able to earn a return on that service under OEB rules (“other income” is usually deducted from allowable utility revenue, resulting in no benefit for utility owners).

LDCs are not the only potential source of alternative financing for CDM initiatives. Other financing mechanisms such as government-sponsored revolving funds, property-tax based financing and energy efficiency funds could be explored. The Ontario government recently made a change to regulations concerning property tax based financing schemes through “local improvement charges”. Municipal governments can now make arrangements to finance energy-related initiatives while ensuring the certainty of repayment through the use of property tax priority over all other real estate related obligations. However, this mechanism may be limited because it results in liabilities that appear directly on municipal balance sheets, and

municipalities may be reluctant to expand programs to the point that the liabilities become significant.<sup>8</sup>

### **MATCHING AMORTIZATION TO DEPRECIATION**

A critical issue in the financing of CDM measures is systemic in Ontario. Currently, all spending on CDM measures is passed on to rate payers in the year in which it is incurred, regardless of the program type or the duration of the impact of the program. For example, if a program encourages consumers to buy efficient air conditioning units that will use less energy over a ten year lifespan, the money spent on the program is charged to consumers immediately through the Global Adjustment, despite the fact that the benefit is spread out over ten years. Consumers today are paying for benefits that will be realized in the future. Benefits and expenditures are similarly not aligned for many CDM measures. Note, however, that in some cases it is entirely appropriate to charge all costs immediately: in the case of demand response programs, for example, the benefits of peak shaving are felt immediately in the market, and should be charged immediately. In some cases, such as behavioural programs which seek to alter consumption patterns through education of consumers, the benefits are so uncertain in their impact that spreading costs over time may not make sense. The change required in the treatment of CDM is not to spread all costs out over time, but to arrange the financing for each CDM initiative in a way that is appropriate to its design and impacts.

Assuming at least some CDM programs should be financed over time, appropriate arrangements are required that encourage program providers to manage them efficiently and responsibly. In cases where CDM programs are in the hands of LDCs in the future, then CDM financing should be a relatively straightforward matter, since LDCs currently have a variety of tools available to manage long-term financing (including both ratebase and regulatory asset arrangements). LDCs and the OEB could together address the arrangements required. In the case of programs related to large transmission-connected industrial customers who do not deal with LDCs, the customers themselves may be in a position to arrange necessary financing, if doing so were part of the CDM program rules.

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<sup>8</sup> Several years ago, the City of Toronto proposed a “Tower Renewal Program” focused on approximately 1000 high-rise apartment buildings that are high priority targets for efficiency upgrades. At an average cost of \$5 million per building, full implementation of such a program would result in billions of dollars of liability for the city if financed through local improvement charges, which could undermine the city’s finances. Please see [www.toronto.ca/tower\\_renewal/](http://www.toronto.ca/tower_renewal/) for additional information.

## **RECOMMENDATION #5: SCOPE OF CDM INITIATIVES**

**CDM targets, programs and markets should encompass not only electricity, but also the potential for fuel-switching, and multi-fuel energy benefits.**

Energy takes many forms, and consumers often require multiple forms of energy simultaneously for any one purpose. For example, something as simple as a home furnace may use both natural gas as a heat source, and electricity to operate blowers and control devices.

CDM targets and programs should recognize the relationships between all energy forms, sources and uses, and not create artificial and inefficient silos between them. Saving energy, and improving GDP output per unit of energy, is a benefit to Ontario regardless of which form of energy is saved.

A prime example is building envelopes: high quality wall insulation and thermally sealed windows help to control heating needs in the winter (which may largely rely on natural gas as a fuel), and cooling needs in the summer (when electricity drives air-conditioning units). Programs designed to encourage the upgrading of insulation, windows and doors should address both natural gas and electricity savings, with benefits calculated for both, and costs of the program allocated to each fuel. Current barriers to this type of program include the fact that the providers of gas and electricity are different companies, and the institutional responsibility for each type of CDM program is also divided between the OEB and the OPA. However, these barriers can be overcome. While such multi-fuel programs will require careful design and management, they are essential to maximizing the benefits for Ontarians of CDM.

### **FUEL-SWITCHING**

Technology is increasingly providing consumers with multiple energy options for any given purpose. Home heating, for example, can be accomplished through the use of natural gas, heating oil, propane, electricity, geothermal or solar thermal heat, or any combination of these energy sources (in fact, as noted earlier, more than one energy source is usually required to actually accomplish home heating in any case). In any given situation, however, these many different fuels are not likely to be equal in terms of costs or performance characteristics, and it may make sense to encourage consumers to make specific choices at different times and places. Continuing the example, if natural gas is available, as in most urban environments, then a high efficiency natural gas furnace may be the most economic and energy efficient choice for consumers. However, in a part of the province where natural gas is not available, then some other combination of fuel sources (and corresponding equipment) might be appropriate, including a combination of geothermal, electric and propane fuels.

CDM programs should recognize the full range of energy options for different purposes, and address the possibility of fuel-switching if that makes sense. An initiative to encourage consumers to choose the most efficient furnace for their home should not be limited to the most efficient “X-fuel” furnace only, but rather the most efficient choice out of all the options that are available for their particular circumstances. Programs should not be narrowly restricted to a single energy form, as that would represent lost opportunities for energy management and savings. Again, however, there are current barriers to this kind of flexible program, largely because of the fact that no institution or program provider has a scope of authority across all different types of fuel in Ontario. No program or institution is broadly focused on “energy conservation and demand management”; instead, the target is “electricity CDM”, or “natural gas DSM”, etc. The narrow-casting of roles and responsibilities has stood in the way of flexible and creative responses to opportunities for end-user savings and efficiency across all forms of energy in Ontario.

## SUMMARY

### Recommendation #1

Demand-side resources should be pursued whenever they are efficient from the perspective of net system cost in Ontario.

### Recommendation #2

A sophisticated approach to CDM targets and programs is required, which distinguishes between conservation and efficiency, demand response, and other potential initiatives which focus on objectives such as system operability.

### Recommendation #3

Distribution companies should play the central role in developing and delivering conservation and efficiency programs across Ontario, while demand response and system operability initiatives should be market-based and managed by the IESO.

### Recommendation #4

Obstacles to alternative financing mechanisms should be eliminated, so that consumers have more options to pursue conservation and efficiency.

### Recommendation #5

CDM targets, programs and markets should encompass not only electricity, but also the potential for fuel-switching, and multi-fuel energy benefits.

energyontario.ca

**CONTACT**

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121 Richmond Street West  
Suite 202  
Toronto, Ontario M5H 2K1  
416.961.2339  
oea@energyontario.ca



Ontario Energy Association

Let's unravel complex energy challenges, together.