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February 9, 2004

**Response to Report of Board's Staff to the Board
on
Demand Side Management and Demand Response**

Introduction.

Direct Energy is Canada's largest, unregulated, energy services retailer. We have over 5 million customers across several North American jurisdictions. Our parent company, Centrica PLC, has over 45 million energy and essential services customer relationships worldwide.

In Ontario, Direct Energy serves 1.9 million households, which take 2.8 million energy and services products from us. Our products and services include: fixed price electricity and natural gas supply contracts; water heater rentals and servicing; heating, ventilation and air conditioning equipment sales, service and protection plans; plumbing protection plans; and home renovation/energy efficiency products and services.

Through our Business Services group Direct Energy provides a comprehensive suite of energy supply and usage services to commercial customers, including load management services through either on-site or remote control of our customers' heating, cooling, lighting, refrigeration and other energy consuming operations. As an example of what these systems are capable of, during the August, 2003 North Eastern blackout, Direct Energy Business Services was able to respond, on our customers' behalf, to the government's call for conservation. From our central control facilities we were able to reduce power consumption across the Ontario locations of some of our largest customers, significantly contributing to the Ontario Government's call for demand reduction.

It is in the context of this commercial scope and experience that Direct Energy provides its comments on Board Staff's January 23, 2004 *Report to the Board on Demand Side Management and Demand Response in the Ontario Energy Sectors* (the "Report").

General Comments.

Direct Energy believes that the recommendations in the *Report* should be reviewed against the general principles that:

- ***Competitive entities, acting under ordinary commercial incentives, are better placed than central government/regulated institutions to deliver benefits of technological innovation while assuming and managing risk.***
- ***A primary commercial incentive is the opportunity to develop direct and continuing customer relationships.***

Commercial Delivery of Conservation – The U.K. Example.

The market based model adopted in the U.K. for delivery of conservation is instructive. While not directly transplantable to the Ontario context, the U.K. model provides a benchmark against which to evaluate the extent to which the recommendations in the *Report* address the general principles set out above. An objective of the Ontario model should be to leverage the innovation, efficiency, customer responsiveness and risk management benefits offered by a competitive model for delivery of energy services.

The essential elements of the U.K. “Energy Efficiency Commitment” model are as follows:

- The U.K. *Utilities Act, 2000* provides the statutory authority for government regulation of energy conservation. Under that authority, the U.K. Government has made the *Energy Efficiency Obligations Order* (“*EEO Order*”), which mandates the imposition of energy efficiency obligations through license requirements on energy suppliers. In the U.K. regulated default supply service does not exist. All suppliers operate competitively. The *EEO Order* sets energy savings targets for the U.K. energy supply sector as a whole, and delegates to the Office of Gas and Electricity Markets (“*Ofgem*”), the regulator, the tasks of detailing and administering the licensing mechanisms to achieve those targets.
- *Ofgem* allocates the total energy efficiency targets across suppliers, in proportion to their respective customer bases. Each supplier then has to design and deliver programs that achieve their allocated energy savings target.
- *Ofgem* publishes a list of approved efficiency measures, each with an associated assumed energy savings impact. Energy suppliers design their own programs around these published measures and submit their proposed programs to *Ofgem* for accreditation.
- Once accredited, programs are delivered by the energy supplier. The supplier must recover its costs of its own programs through its operations. As all suppliers have

proportional obligations, they are all subject to equivalent cost pressures in respect of delivery of conservation. Ultimately, of course, consumers pay for the policy decisions of Government in setting the efficiency targets. Participating suppliers benefit if they can achieve their conservation targets more efficiently than their competitors. In this way conservation costs are fully internalized, without compromise or distortion of competitive incentives or private sector efficiencies.

- *Ofgem* audits the compliance of each supplier, through detailed reporting and, in many instances, sampling and testing of initiatives delivered to the market.

Unlike in the U.K., Ontario has a regulated cost recovery default supply service. In this context leveraging the benefits of ordinary commercial incentives and private investment by imposing obligations across suppliers is not workable. The “playing field” as between competitive suppliers and the default supplier is not level. Nonetheless, the U.K. model provides useful lessons on how to leverage private sector initiative and innovation in the efficient, customer responsive delivery of conservation, and the management of associated commercial risks.

Comments on Specific Recommendations in the Report.

“A hybrid framework using both market-based and public-policy approaches should deliver DSM and DR activities in Ontario’s energy markets.”

- Government should set public policy in respect of conservation, including setting overall conservation targets.
- Design and delivery of conservation initiatives should be left to competitive commercial entities.

“A Central Agency should be responsible for the design and delivery of DSM and DR activities in Ontario’s energy sectors.”

- As has been illustrated by the U.K. framework, a central agency can play a useful role in providing: i) guidelines and assumptions against which programs will be measured; ii) review of proposals for program approval; iii) audit and monitoring; and iv) a repository for the accumulation and disbursement of any government/regulator mandated “conservation fund”.
- Any centralized conservation funding programs should be designed to incent, and reward product and service innovation and efficiency and to encourage access by a range of energy services providers and programs.

- Centralized program contracting and design would add an unnecessary layer of conservation program cost. This sort of activity would also inhibit product and service differentiation, which in turn drives the innovation, efficiency and customer responsiveness and risk management benefits that competitive entities, acting under ordinary commercial incentives, are best suited to deliver.
- Competitive energy services providers would be hesitant to engage in delivery of “outsourced” conservation programs. Such a model would preclude the development of direct and continuing customer relationships by the energy services provider, a primary commercial incentive for the development of products and services.

“The Ministry of Energy, the Independent Electricity Market Operator (IMO) and the Ontario Energy Board should work together to coordinate DSM and DR activities.

- ***The Ministry would be responsible for setting over-arching objectives for DSM and DR.***
- ***Where necessary, the IMO would make changes in the Market Rules to implement DR, and the Board would change regulatory instruments to facilitate DSM and DR activity. Both organizations would continue to carry out their legislated objectives.***
- Direct Energy endorses the respective roles for Government, the IMO and the OEB set out in this recommendation.

“Transmitters and distributors should be allowed to act as delivery agents of the DSM/DR activities for least-cost planning and/or optimizing their distribution systems. This might include investing in DSM/DR-enabling technologies such as meters, controllers, communications, and/or gateway services. In doing so, distributors should comply with Central Agency protocols and compete equally with private sector players, without provision for DSM variance account, lost revenue adjustment mechanism, or shared savings mechanism.”

- An active role for distributors in a competitive conservation framework is inimical to the current legislative structure that limits regulated distribution companies to the business of the delivery of power.
- The operation of a competitive business within a regulated distribution utility: a) increases shareholder risk and thus the cost of capital; b) can interfere with the competitive market through cross-subsidization of unregulated activities from monopoly services; and c) poses ratepayer service risk through distraction of human and financial resources from the regulated delivery business.

- If utility shareholders want to compete in delivery of conservation, they should do so through independent affiliates, subject to the Ontario Energy Board’s *Affiliate Relationship Code for Electricity Distributors and Transmitters*.
- Delivery service cost recovery precludes LDC “prejudice” from successful conservation. As the *Report* notes, distributors’ concern over revenue lost due to throughput erosion may be addressed through forecasted throughput adjustments.
- Competitive energy services providers would be hesitant to engage in delivery of “outsourced” conservation programs. This model would preclude the development of direct and continuing customer relationships by the energy service provider.

“The recommended framework should replace the current gas framework within three years.”

- Harmonization of gas and electricity conservation activities within a competitive framework would facilitate innovative product and services bundling, enhancing customer choice and providing added customer value. Focus would appropriately be on overall consumer energy efficiency.

“Electricity DSM and some retail DR initiatives should be funded by all electricity consumers through a transparent, non-bypassable consumption charge (kWh). Gas DSM initiatives should also be funded by a transparent consumption charge (m3).”

- Under the current Ontario supply framework, which includes default supply regulated on a cost recovery basis, a centralized funding mechanism to achieve pre-set conservation targets is appropriate.
- The requisite funds should be collected in, and then managed and disbursed by, a central agency, with defined and equitable rules for access to conservation program funding.

“In consultation with stakeholders, the IMO should design and develop economic DR to be put in place for 3-5 years as a transitional measure. Further, the IMO should revise the Market Rules to facilitate load aggregation (e.g. statistical measurement, metering and settlement requirements). No one player should be mandated to play the role of load aggregator.”

- Direct Energy endorses Board Staff’s recommendations that the IMO continue development of its economic demand response program, and revise the Market Rules to facilitate load aggregation by various types of market participants.

“The Board is currently working on interim and long-term Standard Supply Service (SSS) pricing strategies. These could include peak and off-peak time-differentiated SSS prices altered seasonally.”

- Retail pricing is key to conservation. In order to send proper signals as to the value of conservation, prices should be reflective of forward-looking power costs, with a mechanism for varying prices to reflect anticipated cost changes. SSS pricing should include time-differentiated and seasonal rates.
- In its expanded recommendations, Board Staff state (*Report*, p. 32):

“The Central Agency should consider pilots and demonstration projects for emerging and innovative technologies that enable retail load management; e.g. use of metering technologies, controllers, communications, and/or gateway services.”

Direct Energy supports this recommendation.

- Provision of metering technologies without the tools and skills to use them is of limited benefit. In order to provide value added energy management services to customers with “smart” meters, energy services providers need to have access to the meter/meter data.
- Current barriers to meter ownership and meter data access should be reviewed with a view to:
 - Assessing the value of, and appropriate delivery mechanism for, mandating “smart” meters for new housing.
 - Facilitating access to metering data by customers or their chosen energy services provider on their behalf.
 - Rule changes to facilitate meter ownership by the consumer (including distribution rate credits to users electing to supply their own meters).

Pilot and demonstration projects that include assessment of the value of the foregoing measures should be encouraged.

“The agencies involved in conservation in Ontario (the government, the Central Agency, the IMO and the Board) should coordinate consumer education plans to ensure consistent messages and avoid duplication. To help consumers understand their energy choices and the consequences of those choices in the Ontario market, the Board should design, develop and/or deliver information to consumers related to energy conservation, energy efficiency, load management and cleaner sources of energy.”

- Direct Energy supports co-coordinated consumer education efforts that are unbiased, factual and informative.