OEA RESPONSE TO ONTARIO ENERGY BOARD STAFF RECOMMENDATIONS

Demand-Side Management (DSM) and Demand Response (DR) in the Ontario Energy Sector

Introduction

The OEA is pleased to respond to each of the Ontario Energy Board staff recommendations on DSM/DR reproduced in italics below. Our comments follow immediately after each of the OEB Staff recommendations. The OEA represents both electricity and natural gas interests.

OEB Staff Recommendations and OEA Response

1. *A hybrid framework using both market-based and public-policy approaches should deliver demand-side management (DSM) and demand response (DR) activities in Ontario's energy markets.*

Under the present legislation, the Ontario Energy Board is responsible "to promote energy conservation, energy efficiency, load management and the use of cleaner energy sources, including alternative and renewable energy sources, in a manner consistent with the policies of the Government of Ontario." [1]

The OEA believes that the DSM/DR policy framework should include clear roles and accountabilities:

- Government leadership in setting the DSM/DR policy framework and objectives.
- Government leading by example by setting conservation standards in its own facilities and operations. (We support, and expect the Government to draw on the advice of, the recently appointed Conservation Action Team of Parliamentary Assistants to coordinate government policy across all Ministries).
- DSM/DR delivered through market-based and commercially driven initiatives, with regulatory oversight only where warranted.

2. *A Central Agency should be responsible for delivery of DSM/DR activities in Ontario's energy sectors.*

Creating a conservation culture will require leadership from the Ontario government and the cooperation of the industry and customers. The OEA cannot unanimously support the government delegating its authority to make policy on DSM and DR to a newly created regulatory entity or to an existing regulator.

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[1] *Ontario Energy Board Act.*

While some OEA members feel strongly that a central agency should be created, other members are not persuaded that a new central agency could feasibly be responsible for design and delivery of DSM and DR. They suggest that the IMO and OEB have sufficient authority to coordinate implementation of government DSM/DR policy by engaging consumers and the energy industry in delivery. We note, however, that if authority were to be delegated to either the IMO or OEB it would be important to avoid potential conflicts of interest between the OEB and IMO roles in economic regulation of the market and added responsibilities to implement specific conservation policies of the government. It would be important to implement appropriate safeguards to ensure ongoing impartial administration and oversight of the electricity market.

3. *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.*

The OEA agrees with these statements, which reflect current realities.

4. *Transmitters and distributors should be allowed to act as delivery agents of 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.*

The OEA is concerned that the boundary between activities that are to be regulated and those that are to be competitive must be made explicit. Whatever delivery mechanisms are proposed, it will be important to protect the financial viability of LDCs in respect of the safe and reliable operation and maintenance of the distribution system. In the absence of appropriate compensatory mechanisms, the revenues of LDCs, approved by the OEB for the purpose of operating, maintaining and investing in distribution systems, will be eroded by DSM and DR activities.

At the same time as LDCs are to be asked to implement demand-reducing conservation measures, LDCs must invest in their systems to serve new customers, to accommodate load growth and to maintain and enhance the safety, reliability and efficiency of the system. LDCs are commercial entities and must earn a competitive rate of return on investment to be able to attract needed capital for expansion and enhancement of Ontario's distribution infrastructure. Uncertainty over system capacity and utilization increases risk and affects capital costs. The lack of lost revenue adjustment mechanisms would strand utility investments financed by shareholders risking capital in good faith, would reduce the resources of LDCs to operate, maintain and invest in critical distribution infrastructure and would be a barrier to delivery of DSM/DR. Shared saving mechanisms have contributed to the success of DSM programs in Ontario.

We would also note that it will be important to create the policy stability necessary to give transmitters and distributors the confidence to invest in DSM/DR enabling technology, and thus alleviate concerns about the potential for stranding assets through future changes in policy and regulation.

For DSM and DR activities delivered competitively, policy and regulation must ensure a level playing field among all market participants. LDCs, energy savings companies, competitive retailers and other companies will be prepared to invest and take on risk to achieve energy cost savings for customers, but only if they are assured that their competitors are facing similar risks and costs.

5. *The Board should put in place regulatory mechanisms to induce gas distributors, electricity transmitters and electricity distributors to reduce distribution system losses.*

The OEA supports this recommendation but cautions: (1) that positive inducements such as incentives and benefit sharing are preferable to negative inducements such as fines or penalties; and, (2) that LDCs require assurance of cost recovery for investments made to reduce losses.

6. *The recommended framework should replace the current gas framework within three years.*

The OEA does not support replacing the gas framework for DSM within three years. The OEA believes that it is premature to recommend replacing the current gas framework, which has served gas consumers well.

The OEB staff paper goes well beyond the recommendations made by the Advisory Group by recommending that the existing gas model of DSM delivery be phased out and replaced with the new central agency model within three years. The Advisory Group did not recommend the phase-out of the gas model. In fact, the group recognized the benefits that have been realized from the programs implemented by Enbridge Gas Distribution Inc. and Union Gas Limited over the past decade. The gas model is strongly supported by some stakeholders, including public interest groups and the gas LDCs themselves. As we gain experience on the electricity side, it may be that experience suggests positive changes that might be applied to the gas side of the business, but we believe it is premature to make such a recommendation at this point in time.

It is important to note that two large distributors that are widely held by private shareholders serve the majority of gas load and customers in Ontario. By contrast, there are a large number of municipally owned electricity distributors of varying sizes. Apart from a few large electricity utilities, most electricity distributors are much smaller in size than Union Gas Limited or Enbridge Gas Distribution Inc. The license conditions, rules, codes and standards for the gas and electricity LDCs are different, as is rate-setting. Moreover, all electricity distributors remain in transition to the role set out for them in the legislation and regulations. Not surprisingly, risk tolerance is lower on the electricity side, and the potential for electricity LDCs to deliver DSM and DR is different from that of the gas LDCs, at least in the near term.

The OEA supports streamlined regulation, as well as symmetrical regulation for gas and electricity where this is developed in consultation with the industry and is appropriate under then prevailing circumstances. Forced symmetry, even when restricted to DSM/DR, would be counterproductive and symmetry should proceed naturally as warranted by the evolution of the industry and the market and in consultation with stakeholders.

7. *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).*
    - *This charge would be levied on all consumers, including self-generation in electricity.*
    - *The Central Agency should be responsible for setting the rate applied to electricity and gas consumption annually, subject to review by a regulatory body.*

The OEB Staff report does not identify what the money raised by the proposed consumption charge would be used for and by whom. Among our membership, there are differing views as to the need for a levy and the appropriate level at which such a charge might be set. In the absence of a clear policy framework and priorities for DSM/DR such a proposal at this time is not sufficiently well founded for the OEA to give an unequivocal response. We suggest that the need for a levy and the appropriate level of such a charge warrants further study.

The combination of higher bills and commercially driven private sector DSM/DR to save energy costs for consumers will provide incentives for efficient conservation. From this perspective, it is vitally important to continue to evolve the market so that it produces correct prices (and correct incentives for conservation). Additional levies or charges on consumers must show clear and certain advantages over market driven solutions.

The OEA disagrees that a levy should be applied to self-generation. This recommendation would appear to be self-defeating by penalizing the exact behaviour that the government's conservation and supply policy would seek to encourage. The recommendation would also be inconsistent with the application of other charges and the evolution of policy to support distributed generation in Ontario. If there is to be a charge, we suggest that it should be levied on a net load billing basis, to provide appropriate incentives for demand reduction and load displacement.

We also observe the inconsistency between the OEB staff recommendation and the government's announcement that electric LDCs will be required to forego a return on investment in favour of investments in conservation to be funded from distribution charges. The same concern applies to both; until the policy framework is developed and roles and accountabilities are clear for all market participants, it may be premature to earmark specific levels of extra funding for DSM and DR or to target specific levels of spending without further study.

Market transformation is not simply a question of spending more money. Clear and consistent policy leadership from government and clear rules for implementation from the OEB and IMO are essential in creating a conservation culture in Ontario. The OEA is encouraged that the government has appointed a committee of Parliamentary Assistants to align multiple government objectives and to ensure buy-in from multiple ministries and constituencies. If a conservation policy is to succeed, it will require the government as a whole to understand the issues and to put in place the appropriate policies at all levels to create the transformation that is required.

8. *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.*

The OEA recognizes that effective demand response programs can benefit the electricity market by enabling direct customer response to high prices or to curtailment requests to meet local reliability concerns. These kinds of arrangements (such as LDC water heater control programs) existed prior to industry restructuring and it is appropriate that these arrangements be facilitated in the future.

The "economic" DR proposed by IMO staff and supported by the OEB staff paper would require a series of side payments to selected loads qualified by the IMO, to trigger reductions in demand that would not otherwise have occurred. The primary purpose of the proposal is to lower prices for customers. This proposal will have the effect of reducing income for Ontario energy suppliers and transferring wealth to those customers selected by the IMO to receive the payments.

The proposal creates an inherent conflict of interest at the IMO. Under the proposed program, the IMO would target customers based on ability to deliver curtailment at a specific level of side payment. The IMO would set the level of side payment to achieve a target level of curtailment, and by direct inference, to achieve a specific price target in the real-time electricity market. This conflicts with the IMO's responsibility for impartial administration of the electricity market. The creation of a central agency, as some of our members suggest, might be one way to alleviate concerns about potential conflicts of interest at the IMO.

The IMO proposed DR pilot would be similar in concept and effect to the Import Offer Guarantee which the IMO and market participants are actively seeking to eliminate through implementation of a day-ahead market, i.e., to suppress domestic prices and to increase non-bypassable uplift charges for all customers. Uplift charges cannot be effectively hedged, so increased costs applied to uplifts (in particular during peak times when the proposed DR program would kick in), will increase the amount of the bill that can't be hedged, and therefore increase bill volatility and risk for all customers.

The benefits of "economic" DR outlined in the OEB staff paper could equally be realized through a series of side payments to high marginal cost generators, to reduce the price at which those units offer energy into the market, with the effect of reducing the steepness of the supply curve. This would also lead to lower prices for customers. In any case, intervention in the market to invent a demand curve where one doesn't exist or to manipulate the supply curve to produce lower prices reduces the benefits of competition and compromises the value of investments in Ontario's energy sector.

Given the uneconomic results and inefficiencies created by the proposal, there would seem to be no prima facie case that the program would provide overall economic benefits to Ontario. It is important that lower prices not be confused with gains in economic welfare. If the investment climate in Ontario is undermined by artificially suppressed prices, then additional risks and costs will be created on the supply side that will need to be compensated either by ratepayers or taxpayers through further government intervention in the market.

9. *Further, the IMO should revise the Market Rules to facilitate load aggregation (e.g., statistical measurement, metering, and settlement requirements).*

The OEA supports the facilitation of load aggregation in Ontario.

10. *No one player should be mandated to play the role of load aggregator*.

The OEA supports an approach to load aggregation that allows suppliers and customers the opportunity and the freedom to choose the service terms and conditions that are best suited to their needs.

11. *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.*

The OEA recognizes the effort required to implement the government's direction to the Ontario Energy Board to develop new mechanisms for setting prices in the future, to be in place no later than May 1, 2005.

It will be important to coordinate development and implementation of new pricing mechanisms for customers with the regulation and deployment of enabling infrastructure, e.g., metering and controls. In this respect, the OEA's Technology Joint Sector

Committee is developing recommendations for effective implementation of smart metering technology in Ontario. We will be pleased to share those recommendations with the Board when the Committee's report is complete.

12. *Until May 1, 2006, time-differentiated and seasonally adjusted commodity prices could apply to designated consumers.*

Agreed.

13. *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.*

Agreed.

14. *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.*

Agreed.

In closing, the Ontario Energy Association appreciates the opportunity to provide comments on the OEB staff paper. Individual OEA members may respond separately to the OEB's invitation to submit comments.