

June 7, 2010

Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, Suite 2700
Toronto, Ontario M4P 1E4

Dear Ms. Walli,

**Re: Review of Demand Side Management (DSM) Framework for Natural Gas Distributors;
(EB-2008-0346)**

Direct Energy (DE) welcomes the opportunity to provide input to the Ontario Energy Board's (OEB) review of the DSM framework for natural gas utilities. While we are supportive of a review of best practices for the delivery of DSM initiatives in other jurisdictions, DE is of the belief that this review would have been greatly enhanced by the inclusion of an in-depth analysis of the various DSM program delivery methods. Unfortunately the report and subsequent stakeholder session completed by Concentric Energy Advisors (CEA) has failed to include a comparative review of DSM delivery models, and has instead focused on "best practices" within the existing utility administered model.

Enclosed is Direct Energy's submission with respect to the CEA and PEG reports and subsequent recommendations. We look forward to the continuing consultation in this matter, and should you have any questions or comments, please contact the undersigned.

Yours faithfully,

Original signed by

Ric Forster
Director
Government & Regulatory Affairs
Direct Energy Marketing Limited

Review of Demand Side Management (DSM) Framework for Natural Gas Utilities

Direct Energy is one of North America's largest integrated providers of electricity, natural gas and related services, serving more than 5 million customer relationships in ten Canadian provinces and twenty US states. In Ontario, Direct Energy handles over 1.8 million residential and commercial customer relationships. Our Home Services business supports the provincial supply chain through the procurement and installation of thousands of water heaters, air conditioners and furnaces a year. Our professional energy advisors perform on average 8,000 home energy assessments per year. In 2009 alone Direct Energy's home energy advisors performed almost 7,500 pre-retrofit and 1,700 post-retrofit assessments. With the current energy inspector headcount, Direct Energy has a capacity to deliver between 12,000- 13,000 energy assessments per year.

Our technicians are in the homes of our customers every day providing advice on how the home energy performance could be improved and offering solutions that balance customer needs and budgets with recommended individual home energy upgrades. Therefore, Direct Energy could become one of the key private sector players helping Ontario's government and the OEB to meet and exceed its DSM and Conservation Demand Management (CDM) goals.

CEA Report Comments

Alternative DSM Frameworks (Issue #14)

One of the primary impetuses for the review of the natural gas DSM framework was the result of ongoing stakeholder concerns that the "current DSM framework has failed and should be replaced by a fundamentally different framework, which will require re-thinking of how DSM is measured, what shareholder financial incentives are provided, and the role of gas distribution companies in program development, delivery and evaluation."¹ It is our belief however, that CEA has failed to complete a thorough examination of delivery models for DSM programs and specifically has not completed any analysis on the comparative benefits and costs of a third party administrator model versus the current utility delivered DSM model.

Instead, CEA has merely noted that there is an ongoing review by many jurisdictions as to whether DSM programs should be delivered by the gas utilities or by third party administrators; and has determined that the relative merits of third party administrators is inconclusive. Yet CEA notes on pages 148 and 149 of the report that some jurisdictions appear to have determined that a third party administrator is more cost effective; and specifically mentions the state of Maine introducing legislation in 2009 mandating an overhaul of the DSM framework transitioning utility administered programs to a central agency. Furthermore, CEA goes on to state that even when given the mandate to implement DSM programs, utilities in the state of Wisconsin unilaterally created a third party administrator to continue the delivery of DSM programs.

DE is of the opinion that CEA's determination that the relative merits of third party administration for DSM initiatives as being inconclusive are unsubstantiated and warrant further review. From a "first principles" perspective, DSM programs are not inherently a natural monopoly function, and should not be at the sole purview of the natural gas utilities as they are now. As noted on page 147 of the report, "stakeholders have argued that the current DSM Framework is outdated and ill-suited because there are several layers of government, various utilities, non-governmental organizations and private companies who deliver conservation programs". Furthermore, the private sector does not differentiate between fuel sources as do the utilities and regulators. This lack of differentiation coupled with the private sectors' ability to cross the very definitive geographic boundaries of both gas and electric utilities, would

¹ Page 146, Concentric Energy Advisors "Review of Demand Side Management (DSM) Framework for Natural Gas Distributors" Report – March 19, 2010

allow for improved design, coordination, integration, and implementation of gas and electric DSM initiatives. As noted in the report, CEA indicates that a third party administrator model is seen as more cost effective; especially where small gas utilities that may not have the economies of scale necessary to achieve savings targets in an efficient and cost effective manner. Considering over 80 electric utilities exist in the province, a third party administrator would seem to be best suited to coordinate the integration of electric CDM initiatives with the two major gas utilities. To a certain degree, the OPA's approach to CDM programs for the province's LDCs is akin to a third party administrator model, and should be looked to as a starting point for natural gas DSM.

At the stakeholder conference on April 29, 2010, Jim Coyne, VP CEA, indicated that Wisconsin, Maine, Vermont, and other jurisdictions in the U.S. deliver DSM programs through a third party administrator. He also stated that CEA has seen accelerated penetration of DSM programs in these states but that CEA has not done a thorough examination of a comparison between third party and utility delivered programs. Given stakeholders concerns with the current DSM framework coupled by the author's admission that a thorough comparison between utility delivered and third party administered DSM programs has not been completed, DE believes the omission of this analysis undermines the foundation for the development of the DSM framework moving forward. As such, DE respectfully suggests that the OEB review the costs, benefits, and market penetration statistics between utility delivered DSM jurisdictions, and those jurisdictions using a third party administrator.

Cost Effectiveness Test (Issue #1)

Another area that deserves a comprehensive review is how natural gas DSM programs fit into overall provincial conservation goals. The key consideration in assessing the cost effectiveness of DSM programs is how the cost of acquired natural gas savings compares with the cost of natural gas to consumers. This cost to consumers needs to be understood in order to establish the rationale for conservation. Is the conservation designed to reduce costly infrastructure investment, avoid emissions or simply to save people money? Whatever the rationale, the cost of the conservation effort needs to be balanced against the cost of the avoided activity. Achieving energy savings at any costs is not sustainable and should not be pursued from a societal standpoint.

Another consideration when assessing the adoption of a Societal Cost Test is the evolution of regulated carbon markets in Ontario. The Province is contemplating regulated caps on carbon emissions and the establishment of a carbon offset market. The Amendments to the Environmental Protection Act (December 2009) have created the framework for future regulations governing that market. DE believes that a market mechanism is best at setting real carbon pricing. In the absence of such a market, carbon pricing under the Societal Cost Test proposed by CEA would be purely arbitrary and may inflate DSM program costs and adversely impact provincial consumers of natural gas. DE is concerned that including carbon pricing in the Societal Cost Test at this time would create an environmental tax for natural gas consumers in the absence of a regulated carbon market.

Furthermore, one of the key reasons CEA suggests the need for a societal cost test is because it is considered best practice when implementing environmental policy. Since Ontario's environmental policy is still very nascent and likely highly dependent on similarly uncertain outcomes both federally and internationally, it would appear highly premature to move to this sort of framework.

DE also believes that as a pre-cursor to the implementation of a Societal Cost Test measure a number of issues would need to be addressed. An example is the ownership of the environmental attributes (EA) associated with DSM programs delivered using this test. A determination on who owns the attributes is necessary in order to avoid multiple benefit claims against a single EA (perhaps by both the DSM recipient and installer) should a meaningful carbon market develop in the Province, and also to avoid the resale of an EA by a party that does not have title to it. DE believes this issue can be addressed by determining that the ownership of the EA shall belong to the recipient of the DSM

measure, with the ability to assign the attribute to a third party. This would allow the DSM program home or business owner to assign EA to the installer of the DSM program as part of the eligibility requirement for the program.

DSM Program Design – Low Income DSM Programs (Issue #5)

DE believes that the overall problem of fuel poverty in Ontario should be addressed by the Ontario Government as part of a wider Provincial reduction strategy. The integration of all low income programs into a single provincial platform would allow leveraging of resources allocated by the provincial government, the OPA, regulated electricity and natural gas distributors and any voluntary contributions from the private sector. This would contribute to the elimination of duplicative efforts and program overlap, would enhance the referral system of the social assistance network and would control for DSM/CDM system-wide costs.

Therefore, DE would suggest that if the OEB is involved in addressing this issue that it do so in the least distortionary way possible through the collection of a system benefit fee that would accrue into a Low Income Energy Benefit Fund. Such a fund would ensure equitable access to a standard set of services and benefits for all eligible low income customers in the province and, most importantly, the delivery of low income programs can be tendered out to ensure optimal cost effectiveness. This structure would eliminate issues with distributors' performance targets, shareholder incentive mechanisms, program differences in distributor service territories, suggested lower Societal Cost Test thresholds and other distortions under existing low income DSM/CDM program arrangements.

DSM Budget Development and Approval (Issue #6)

In its report, CEA has recommended that at minimum DSM budgets should be equal to 3% of utility operating revenue, and optimally increased to between 4–6%. DE is of the belief that this is an arbitrary means by which to establish DSM budgets, without any connection to established Government and OEB targets for greenhouse gas emission reductions, and/or aggregate, quantifiable reductions in natural gas usage. Furthermore, as outlined in relation to the cost effectiveness testing, conservation spending for its own sake is neither sustainable nor desirable.

During the stakeholder conference, the CEA panel agreed that no basis for tying DSM budgets to utility revenues exists, other than it being common in some jurisdictions. They agreed with DE that a much better approach would be a "top down" budgeting exercise to determine the level of spending over a specific period that is required to meet Government GHG and DSM targets; followed by an evaluation of the DSM programs required to meet such targets, the delivery model for those programs, and the allocation of funding.

DE submits that the top-down model for determining DSM budgets is more transparent and links DSM spending directly with Government targets and societal benefits. DE would also submit that this budget process would best be handled using the third party administrator model.

Lost Revenue Adjustment Mechanism (LRAM) (Issue #9)

Given that the use of revenue decoupling (RD) is a relatively new mechanism for addressing lost revenue by utilities, and given that a review of decoupling is currently underway, DE is of the view that the recommendation to allow utilities to apply for RD is premature at this time. Revenue decoupling has numerous implications for the Ontario gas market and should be assessed independently from this particular issue.

As noted on page 125 of the report, utilities may be reticent to adopt RD as it could remove the incentive to add new accounts and perhaps cause regulators to reduce the authorized rate of return.

From a consumer group perspective, RD could also be viewed as shifting traditional utility business risks from the shareholder to the consumer, and because RD protects the utility's revenues from volume fluctuations, this mechanism could actually create indifference on the utility's part towards DSM initiatives, and potentially to their core business of the distribution of natural gas. For these reasons DE believes any recommendations for RD should be delayed until such time as a thorough examination of the impacts to utilities and consumers is completed.

Impact Evaluation Methods (Issue #10)

Program evaluation is a key component of any DSM framework. The appointment of entities responsible for program evaluation would however curtail the already existing and growing market for evaluation services. As outlined earlier, DE recommends the development of a third party administrator model. Within that framework, the administrator could develop evaluation and measurement criteria and the framework within which programs would be evaluated. The evaluation would then be provided by service providers with particular expertise in these practises. DE therefore disagrees with CEA's recommendation on page 132 of the report suggesting that the OEB appoint entities to conduct DSM program evaluations and third party auditing of program results. Even if the OEB continues to be involved in the administration of these programs, a prescriptive approach to evaluation entities will not drive cost efficiencies or innovation in this key element.

Integration of Natural Gas and Electric DSM (Issue #13)

DE agrees with CEA's findings that natural gas and electric DSM programs should be integrated in order to reduce administration costs and improve the penetration of programs. As noted above, the private sectors' ability to cross the geographic boundaries of gas and electric utilities allows for improved design, coordination, and implementation of an integrated DSM portfolio. A third party administrator delivery model independent of the utilities should be put in place in order to best facilitate this process.

PEG Report Comments

The PEG analysis was interesting in that it highlighted a number of issues in the way conservation programs are managed and the type of data that is available for evaluation purposes. The modelling was in some instances limited by the lack of sufficiently robust data from Enbridge and Union. Further, even when reasonably accurate data was utilised in certain models, there was not a significant relationship between utility DSM spending and declines in natural gas consumption in the Ontario market.

The authors of the report did however bring to light a "bottom up" econometric approach being used in California, which separates demand models for participating and non-participating customers, and gathers consumption data at an individual account level. While this customer specific evaluation technique is more data intensive, DE submits that due to the transparency and reliability of the data gathered, the "California model" would appear to be the most appropriate means of determining the efficacy of DSM programs. The PEG results highlight that a lack of standardization is greatly limiting in-depth evaluations and increasing evaluation costs.

Given the robust nature of natural gas utility CRM and billing systems, the utilities should be able to distinguish between participating and non-participating customers; as well as calculate and aggregate individual customer consumption reductions. Should customer consumption not decline, this method would also allow for utilities and third parties to investigate the reasons for such, and identify any upward trends in consumption; potentially due to additional equipment. While this evaluation model may take time to develop, DE believes that it is a worthwhile approach which will help alleviate stakeholder concerns with the current evaluation framework and increase confidence in the validity of DSM programs in general.