



January 10, 2010

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

*Attention: Ms. Kirsten Walli, Board Secretary*

**Re: Consultation on Regulated Price Plan Time-of-Use Pricing (EB-2010-0364)**

Dear Ms Walli,

Thank you for the opportunity to participate in the Ontario Energy Board consultation on Time-of-Use Pricing. Direct Energy is offering our comments for the Board's consideration, based on our knowledge of Ontario's electricity market, a thorough review of the white paper "Assessing Ontario's Regulated Price Plan" prepared by The Brattle Group, and our participation in the Board's stakeholder meeting on December 21, 2010.

Direct Energy is hopeful that the comments offered herein will be shared with the Ministry of Energy to ensure that the current design of the electricity market is appropriately adjusted to enable the desired effects of time-of-use pricing.

Should you have any questions on the enclosed comments please do not hesitate to reach me at 416 758 8072.

Yours truly,

< original signed by >

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## **About DE**

*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. Almost \$5 billion has been invested by Direct Energy in North America, much of it in Canada and specifically Ontario. Ontario's market is very important to Direct Energy and is a major component of our \$6 billion North American investment strategy for 2010 and beyond.*

## **DE position on real-time pricing**

Direct Energy is a devoted proponent of real time market pricing in all of the markets we currently serve. Only real-time pricing that reflects total costs of generating or purchasing electricity in the wholesale market can trigger adequate consumer response. Real time pricing is neutral and fair, unlike regulated rate setting that averages consumption over a six month period and ignores individual consumption patterns resulting in cross-subsidization between consumers.

Industrial and large commercial users have been exposed to real time (mostly hourly) market power pricing for more than a decade in deregulated markets. Those who were capable of shifting consumption to off-peak periods have clearly experienced lower electricity bills. The exposure to real time market pricing has also generated dramatic industrial demand reduction in the US states (New York, Connecticut, Massachusetts, Texas etc).

More and more jurisdictions are considering extending real time pricing to residential markets to temper demand. The implementation of real time pricing should reduce most of the pricing inequity and unfairness currently present in the residential electricity sector. Consumers preponderantly using electricity in off-peak hours would stop subsidizing those who consume electricity mostly during more expensively priced peaking hours.

There is also technology available that allows residential consumers to track the cost of power in real time and adjust their consumption accordingly. In fact, Direct Energy has piloted the technology that can inform consumers of the real-time cost of electricity and also allow the switching off of appliances or adjusting of thermostats. These in-home devices can be programmed, operated manually and even accessed remotely by phone or over the Internet.

Ontario enjoys a unique position by having invested considerable resources in its smart grid infrastructure. The presence of a smart meter in all Ontario households can truly maximize cost savings if real time market pricing was introduced. Only real time market pricing can justify the investment the Province has made in smart meters and smart grid technologies.

A real (hourly) market rate will allow consumers who want to, and can, shift their consumption to off-peak hours, to enjoy significant bill savings. Those who cannot tolerate the market price volatility or who cannot shift consumption may choose options available from competitive retailers. Specific consumer issues, such as individual capacity to adjust behavior or tolerate market price volatility can be addressed through customized retail products.

## **Ontario's proposed time-of-use pricing**

The proposed time of use pricing in Ontario is a proxy for real time pricing, where electricity rates are set administratively for specific periods of time on a six month forward basis. This type of time-of-use pricing is inferior to real time pricing in that it does not completely

eliminate consumer inequities and cross-subsidization due to the averaging of prices over time which is inherent in regulated rate setting.

As *The Brattle Group* has rightfully pointed out in its report to the OEB, to achieve meaningful consumption shifts, the differential between off-peak and peak rates must be meaningful. The current ratio between the OEB regulated peak and off-peak rates is only 1.9 (for the generation portion) and when all other electricity bill components are included, drops to 1.4. This is far below the mean ratio of 3.8 (for generation) in other jurisdictions benchmarked by *The Brattle Group*.

Also, in its report, *The Brattle Group* has found that the most meaningful peak demand shift occurs for an OEB simulated peak to off-peak ratio of 4.9, which includes the cost of renewable generation and increases the time of peak period to four hours. While the impact of this ratio would produce a desired reduction in peak demand, it severely infringes the principle that the cost has to reflect the time when the electricity was produced and consumed.

Notably, it is the current design of the electricity sector in Ontario that poses a major challenge for a fair determination of the peak to off-peak rate ratio. More than one third of installed generation capacity in Ontario today is on long term contract with the government (Ontario Power Authority, OPA and Ontario Electricity Finance Corporation, OEFC).

The contracted fleet mostly consists of natural gas, wind, mid-peak hydro generation and increasingly solar and bio-energy generation units. The contracted renewable generation facilities are non-dispatchable which means they run whenever the sun shines or the wind blows. Therefore, by the nature of these resources, the costs of most renewable generation sources can not be attributed to just peaking periods.

This is further aggravated by the existence of out of market price settlements such as the Global Adjustment (GA). As the full costs for contracted generation output are settled outside of the market, the reduction in peak demand would not generate the expected system wide cost savings. The ultimate effect of demand reduction that causes private investors to adjust plans in respect to new plants is also uncertain.

Ontario's investment in smart grid and smart meter technologies will prove meaningless if it fails to significantly shift and reduce peak demand and decrease system wide costs associated with investment in new-build peaking resources. Without a thorough review of the wholesale electricity market design in Ontario, time of use rate setting would result in a mere transfer of costs from one group of consumers to another.

### **Integration of all costs into the wholesale market price: the GA issue**

Real time pricing could be a breakthrough policy in a truly competitive market. However, the Ontario market has clearly become increasingly regulated, with more than 16,000 MW of capacity contracted by the OPA as of the end of 2010 and another 13,500 MW of renewable capacity lined up for review under the provincial Feed-in-Tariff program.

It is simply not sustainable to have the costs of such a large portion of generation output to settle outside of the wholesale market through the GA. The GA will become even larger, once the Province starts implementing its Long Term Energy Plan and the OPA begins contracting additional nuclear, natural gas and hydro capacity at the Minister's direction.

To successfully implement time of use pricing and achieve targeted demand reduction goals, Ontario must first, integrate all generation costs into the wholesale price, and then, match the time of use cost with individual consumer loads. This requires some form of contract

divestiture, renegotiation or transitional allocation of contracted capacity to all load serving entities in the province before reverting back to an open market.

Without such a reform, time of use rate setting will not be able to fairly allocate the costs of peaking generation to peaking consumption; exacerbating existing consumer inequities and making the Board's mission to guarantee just and reasonable rates impossible to accomplish.

### **Conclusion:**

Direct Energy strongly supports the allocation of electricity generation costs to its time of use. However, we believe that the GA charge is a major distortion to the electricity price signal in the province. Unless the government integrates all generation costs into the wholesale market, the OEB will not be able to generate an accurate and fair allocation of peaking costs to peaking consumption.

Without clearing the wholesale pricing signal, the Province will perpetually rely on centralized government procurement secured with guaranteed future ratepayer funds, while the expected system wide cost savings will not be realized.

With reference to the remarks above we present our answers to the Board's list of issues below.

## **Answers to the list of issues identified by Board staff**

### **1. Structural issues**

Q: Are the current three price periods still appropriate given changes in Ontario's electricity demand profile and supply mix? What are the advantages/disadvantages of fewer price periods? Are there significant system cost issues associated with changing the number of price periods?

A: Real time of use pricing is the most preferred and most accurate allocation of generation costs to user consumption. However, acknowledging that consumers do not have the technology yet to monitor prices in real time, a three time price period is the best alternative. It is relatively easy to remember and therefore easy to follow and monitor.

Q: Is the current seasonal structure appropriate on a go forward basis? Does the change in Ontario's peak demand and the supply mix affect the seasonal nature of TOU? Are there significant system cost issues associated with changing the approach to seasonality?

A: The seasonal time of use pricing approach on a six month basis creates large equity transfers amongst ratepayers. A monthly set rate would considerably clear inequities however, only real time (hourly/or 5 minute interval) market pricing would completely eliminate any unfairness.

Q: Given that the Ontario electricity system is summer peaking, would it make sense to adopt a structure which specifically addresses the summer peak. i.e., a summer only super peak or critical peak pricing that operated during predetermined peak hours? What type of costs would be associated with implementing such a system?

A: Critical peak pricing works effectively only if triggered during actual super peak hours. Predetermined super peak events are hard to estimate six months in advance and would

become “diluted” in the peaking price. This is just one more reason to pursue real time pricing and facilitate the use of in-home devices enabling consumers to automatically adjust consumption when prices are above certain thresholds.

## **2. Price Setting Methodology**

Q: The Board has established in the RPP Manual target ratios of 1:2:3, are these targets still appropriate? Should the Board increase its focus on the price ratios when setting prices or continue emphasizing RPP supply cost recovery as the primary objective? To achieve the target ratios, should the Board focus on one price, i.e., increase peak prices or decrease off-peak prices?

A: As pointed in *The Brattle Group's* report the higher the ratio between peak and off-peak pricing the higher the demand reduction response is. However, the demand reduction in a market that has surplus base-load generation and fixed priced contracted generation would not be able to generate significant cost savings. This is another reason to pursue integration of all generation costs into the wholesale price.

Generation cost recovery is the key principle of time of use pricing. By artificially changing target ratios, the Board would just aggravate existing inequities and would arbitrarily pick “losers” and “winners” amongst small volume consumers.

Q: What are the advantages or disadvantages of differentiating the recovery of the variance account such that the variance account balances could be used to either enhance price ratios or buffer consumer bill impacts through accelerated or decelerated recovery?

A: The primary advantage of differentiated recovery of the variance account is that it may buffer consumer bill impacts through decelerated cost recovery. The downside of such strategy is the impact on consumer equity. The bigger the spread, the bigger consumer inequities would be. In considering alternative options the Board would have to acknowledge that electricity rate setting is not part of the provincial social policy.

Q: Currently the Board allocates forecast Global Adjustment (“GA”) costs to be recovered in the price period, which relates to the portion of the load curve that the GA-eligible contract serves. Should the Board continue this practice?

If not, what other method should the Board use to recover forecast GA costs? Should the Board use the GA cost assignment to enhance the time of use price ratios regardless of “cost causality”?

A: The cost causality principle is the foundation of time of use pricing. Any other cost recovery measure would distort the fair allocation of generation costs to actual consumer loads. The Board has to communicate with the government and identify the distortions created by the GA with the goal to integrate all generation costs into the wholesale market.