

# WORKING GROUP REPORT

## TOWARD A FULLY COMPETITIVE NATURAL GAS COMMODITY MARKET IN ONTARIO

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## 1. INTRODUCTION

### 1.1 BACKGROUND AND MANDATE

The Working Group's mandate comes from the Ontario Energy Board's ("OEB" or "the Board") Report on the Ten Year Market Review of Natural Gas Deregulation, dated September 27, 1996 ("Market Review Report").

The Market Review Report provided the Board's general conclusions and commentary on the development of a more competitive commodity market for natural gas in Ontario. It also included a list of issues to provide direction to a working group. The following excerpts from the Market Review Report summarize the Board's comments and its mandate for a working group:

The Board believes that a fully competitive gas commodity market will be more efficient than a regulated market. Accordingly, where an efficient and equitable market is possible and sustainable, the Board believes that customers can best be served by allowing the market to operate freely, without the need for economic regulation.

The Board concludes that a more competitive market for natural gas could improve customer choice and market efficiency as well as reducing the need for regulation. Given the changes taking place in the North American energy market and the possibility of improved customer benefits, the Board believes that further deregulation of the natural gas market is required and inevitable in Ontario. Consequently, the Board concludes that there is merit in determining to what degree additional deregulation should be permitted to enhance commodity competition in the province while continuing to protect the public interest. (page 7)

...

The Board also concludes that it cannot consider the removal of the regulated utility supply option without being satisfied that all customer groups will be adequately protected and that most customers want this change. (page 8)

...

While agreeing that a more competitive market should be developed, the Board believes that the market changes will need to be more gradual and managed to ensure that customers are protected and that the public interest is maintained during and after the transition. (page 9)

...

In advising the Government on legislative change, the Board will need to identify the statutory constraints to full competition and consider whether new regulatory approaches could be used to facilitate a more competitive market. The Board will also need to examine the degree of unbundling of regulated utility services that is required; which of the unbundled services can be offered competitively without requiring regulation; and, the extent to which more innovative approaches can be used to assist the market transition within the current legislation. The Government will then need to decide what legislative changes it is prepared to make in order to allow the natural gas market to operate more competitively and what role the Board should play during the transition to the new market. (page 10)

...

The Board agrees with the workshop participants who concluded that the LDCs currently control the entire delivery function, including billing and informational services, and that some of these services may not need to continue to be regulated as monopoly functions. To ensure that the market review process is manageable and timely, however, the Board believes that the current review should focus on the merchant functions and any related issues. Deregulation or separation issues related to other functions or ancillary programs of the utilities will need to be considered in another forum in the near future. (page 12)

...

The Board plans to continue its review of the gas commodity market using a working group process followed by a public hearing. It is the Board's intention that the issues identified in Appendix "C" and other pertinent concerns will be examined, either as unresolved issues or as resolution proposals, in a joint hearing next year as part of the utilities' rates cases.<sup>1</sup>

The Board believes that a working group of industry, customer and public interest group representatives can assist the market review process. The working group would identify which issues require additional study, analysis or proposals by the utilities in preparation for the hearing. The working group would also attempt to propose resolutions or reduce the scope of the issues through discussions prior to the hearing. The results of the utility work, any proposed issue resolutions and a summary report on the outstanding issues would be filed with the Board by April 30, 1997 for consideration in the joint hearing. (pages 12-13)

This Working Group Report ("WGR") is a summary of the issues discussed and alternatives examined by the Working Group. It is not meant to be an exhaustive study of natural gas deregulation, and thus does not include extensive references or evidence. To aid the Board, the Working Group has included a Glossary of Terms (Appendix B).

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<sup>1</sup> The list of issues in Appendix "C" of the Market Review Report is reproduced in Appendix D of this Working Group Report, together with references to the Working Group's responses to the questions.

## 1.2 CONSTITUTING THE WORKING GROUP

On an informal basis, some participants in the Market Review process met during the month of October, 1996 to discuss the Market Review Report and organize a working group as the Board envisaged. The participants elected to adopt an inclusive process under which all interested parties would participate in the working group. Through various discussions, a formal Working Group of stakeholders was constituted by its members. By agreement:

- C all parties to the Working Group, except OEB technical staff, executed an agreement to constitute the Working Group (“the Agreement”);
- C the Working Group appointed Mr. Ken Rosenberg as the independent facilitator and Chair of the Working Group;
- C the Working Group appointed Mr. James Gruenbauer as the Secretary of the Working Group; and,
- C The Consumers Gas Company Ltd. (“Consumers Gas”) and Centra Gas Ontario Inc./Union Gas Limited (“Union/Centra”) provided funding, at the direction of the OEB, to certain parties and to Messrs. Rosenberg and Gruenbauer.

## 1.3 THE WORKING GROUP’S ACTIVITIES

All of the Working Group discussions were established as confidential and without prejudice, save for a Report, which the OEB requested to be completed by April 30, 1997. The Agreement created a forum in which parties could enter into an exchange of candid views and positions.

The Working Group drew up a plan for the completion of its work by April 30, 1997. The Group divided its task into three phases:

**Phase 1** – The education and information phase was completed by its deadline of January 31, 1997.

**Phase 2** – February 1 through to March 15, 1997 was to be the issue resolution phase. The Working Group completed a Phase 2 Work Plan Memorandum and a Market Transactions Model, and parties submitted written position papers. The discussions continued through to the end of the process.

**Phase 3** – For the writing phase, a sub-group was formed to provide working drafts of the WGR to the main group for comments. Several drafts were circulated and parties submitted written comments. The Working Group met several times during this phase to review and comment on the working drafts. The Working Group sought from the Board and received an extension to May 31 to complete the WGR.

The Working Group created a confidential file at the offices of the OEB, which was monitored by the Secretary of the Working Group. The file is for members of the Working Group and is not to be disclosed to the public. The record includes minutes and detailed notes of Working Group meetings and all documents reviewed by the Working Group. In this manner, the Working Group ensured that the proceedings were documented through a confidential record. Some of the Working Group’s reference materials are publicly available in the OEB library.

In addition to the full Working Group discussions, subgroups concentrated on various topics:

- C code of conduct (including a drafting committee);
- C consumer protection;
- C storage and upstream/downstream transportation; and,
- C legal issues.

#### **1.4 OUTREACH**

The Working Group undertook an outreach programme to ensure that certain stakeholders were advised of its discussions. These parties were invited to send comments and/or participate in the Working Group. They included the City of Kingston Public Utility Commission, which is not regulated by the OEB, and certain small local distribution companies (“LDCs”) that are under OEB jurisdiction but not actively regulated by the Board. None of these parties participated.

#### **1.5 THE QUANTITY AND QUALITY OF THE COMMITMENT TO THE WORKING GROUP**

Over the eight months of the Working Group’s activities, considerable time and resources were spent by the participants in Working Group activities, subgroups and preparation.

An examination of potential changes to the Ontario natural gas market is a highly complex undertaking, with most issues being interrelated. There were constraints and benefits to the



Working Group's process. The only discipline was the consensual discipline of the group. Overall, the process allowed for broad discussion of diverse and interrelated issues within the available time period. The process strengthened the parties' understanding and focused them on bottom-line positions. It resulted in better informed consensus and/or scoped differences of opinion.

## **1.6 CONTRIBUTORS TO THE WORKING GROUP REPORT**

Appendix A lists all of the contributing parties to the Working Group Report.<sup>2</sup> They believe the WGR is a fair summary of the Working Group's discussions. The Working Group process was not an evidentiary one. Parties accept that the WGR may not contain the full details of their positions, and they expect to have an opportunity to explain their positions fully in subsequent proceedings.

Despite much debate, the Working Group could not come to a consensus on the merits of attributing parties' positions on the various alternatives set out in the WGR. Some parties argued that it would assist the Board if all parties identified their positions. Other Working Group members saw the tying of names to an alternative as being prejudicial, or inconsistent with the purpose of the WGR.

Given these conflicting views, the Working Group Report does not attribute positions.

## **1.7 CONSENSUS AND CORE ISSUES**

The Working Group defined its mission as providing a report to the OEB that examines: "achieving as soon as possible, subject to the protection of the public interest, a fully competitive natural gas commodity market in Ontario." The natural gas market is a key component of Ontario's economy. The North American natural gas marketplace is evolving, and the Government of Ontario must be proactive in its energy policy, to ensure Ontario's continuing competitiveness in the North American economy.

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<sup>2</sup> Ministry of Environment and Energy ("MOEE") staff supported the Working Group's Phase 1 discussions to obtain a better understanding of issues related to further deregulation, and to assist the Group in the interpretation of government policy as appropriate. The Ministry did not participate in the discussion of the Group's positions on the issues for recommendation to the Board.

A principal challenge for the Working Group in organizing consensus was the sheer complexity and interrelatedness of the issues. Despite the variety of issues and perspectives (see, for example, Section 3.4), the result of the Working Group’s discussions can, at the risk of oversimplification, be distilled to two main areas of consensus and four core issues.

**Consensus recommendations:**

- C the legislative impediments to burner tip sales (“gas commodity title transfers in Ontario”) should be removed as soon as possible; and,
- C the OEB should not regulate whenever there is full and effective competition.

**Core issues:<sup>3</sup>**

- C timing and conditions of LDC exit from the merchant function;
- C marketplace governance in a deregulated environment;
- C transitional issues within the Working Group’s mandate (partial consensus was achieved); and,
- C certain issues outside the Working Group’s mandate.

All of these are expanded upon in this WGR, and various alternatives are discussed for the first three core issues.

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<sup>3</sup> A code of conduct governing the relationship between the LDCs and gas marketing affiliates was a fifth core issue for some Working Group members. This issue was the subject of a separate proceeding before the Board.

## 2. ONTARIO'S NATURAL GAS MARKET

### 2.1 THE HISTORY OF NATURAL GAS COMMODITY DEREGULATION

The development of direct purchase began with the signing of the Agreement on Natural Gas Markets and Prices (“the Hallowe’ en Agreement”) by the Governments of Canada, Alberta, British Columbia and Saskatchewan on October 31, 1985. An objective of the Hallowe’ en Agreement was to create market conditions that would stimulate gas-on-gas competition. The Hallowe’ en Agreement enabled consumers to purchase natural gas from producers at negotiated prices, either directly or under buy-sell arrangements with distributors.

At the time of the Hallowe’ en Agreement, TransCanada PipeLines Limited (“TCPL”) was the major long-term supplier and transporter of western Canadian natural gas to Ontario. The Ontario LDCs purchased bundled transportation and sales service from TCPL under long-term contracts, and sold gas to end-users at bundled sales rates regulated by the OEB. Existing customers who wanted to purchase gas directly from western Canada (“direct purchase”) could not obtain firm TCPL transportation for that gas without displacing the volumes contracted to the LDCs. Various regulatory decisions by the National Energy Board (“NEB”) and the OEB, and changes to contracting practices, alleviated some of the problems of displacing gas supplies contracted by the LDCs. Partly as a result of these measures, a competitive gas commodity market developed in western Canada.

A barrier to the development of a natural gas commodity market in Ontario was, and remains, the legislation that regulates the supply of natural gas to consumers in Ontario. Early in the development of the direct purchase market in Ontario, the Board determined<sup>4</sup> that agents, brokers and marketers (“ABMs”) were suppliers of gas within the meaning of the relevant legislation. Because the legislation prevented unregulated gas sellers from transacting with end-use customers in Ontario without approvals, it was only practical to transfer title to the gas outside of the province. This restriction introduced a number of cumbersome mechanisms into the direct purchase market.

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<sup>4</sup> in E.B.R.O. 410-II, 411-II, 412-II

## 2.2 CURRENT DIRECT PURCHASE MECHANISMS

Two forms of direct purchase currently dominate the Ontario gas market. A third alternative, ABC-T service, has recently been developed. The first involves customers purchasing and taking title to gas outside of the province and arranging for transportation of that gas via TCPL and the LDC to the burner tip ("T-service"). Title to the gas commodity is never held by the LDC. Large volume customers have made extensive use of T-service.

The second form of direct purchase is the "buy/sell." This mechanism allows end-use customers or their ABM to purchase gas and sell it to the LDCs, either in western Canada or at the Ontario city gate. The price the LDC is obligated to pay to the end-use customers or ABMs for the gas they supply is primarily derived from its weighted average cost of gas ("WACOG").

Buy/sell customers remain sales customers of the LDCs. The buy/sell customer pays the same regulated sales rate as other customers. Since the commodity portion of the sales rate is related to WACOG, the potential benefit or cost is approximately the difference between WACOG and the price at which the customer or the ABM purchased its supplies.

The table below shows that at December 31, 1996, the three major LDCs in Ontario had 671,000 direct purchase customers, accounting for 69% of their total volumes delivered.

Customers Currently on Direct Purchase  
(as of December 31, 1996)

Customer Class	Consumers Gas		Centra Gas		Union Gas		Total**	
	Customers	Volume* (%)	Customers	Volume (%)	Customers	Volume (%)	Customer	Volume (%)
Residential	398,000	36	60,000	35	134,000	18	592,000	30
Commercial	41,600	72	15,700	55	16,000	51	73,300	66
Industrial	3,400	87	300	87	2,000	>90	5,700	>90
All Customer Classes	443,000	63	76,000	82	152,000	69	671,000	69

Note:

\* "Volumes %" — proportion of volumes within each customer class consumed by direct purchase customers.

\*\* "Total Volumes" — the weighted average of all three LDCs within each customer class.

### **2.3 LIMITATIONS OF THE BUY/SELL MECHANISM**

While the buy/sell mechanism enables unregulated marketers to sell gas to an aggregate of small volume customers, it has certain limitations. The buy/sell reference price, because it is primarily derived from the LDC's WACOG, sends market signals which are often out of date. Because the buy/sell reference price relies on the characteristics of the LDC's gas portfolio and transportation arrangements, it can give misleading price signals. This problem is exacerbated by the evolution of the North American commodity markets toward short-term contracts, resulting in more volatile prices. The buy/sell can also be cumbersome from a regulatory perspective. Since some LDCs set their buy/sell reference price on the basis of a forecast, the reference price has become a matter of contention at Board hearings, adding regulatory lag and cost to the list of its limitations.

### **2.4 ABC-T SERVICE**

One advantage of the buy/sell, particularly in the residential market, is that it does not need a separate billing system. In recognition of market demand, and the introduction of new billing technologies, a third direct purchase mechanism was developed, in part to overcome buy/sell limitations. In 1996, all three major Ontario LDCs proposed an Agency Billing and Collection ("ABC") service, to be used in conjunction with bundled T-service (together, "ABC-T"). ABC service enables ABMs to bill their customers directly through the LDC. ABMs contract with the LDC for bundled T-service, as agents for customers, and set the terms and conditions of gas supply with the ABMs' customers. They use the LDC's billing system to collect the gas costs. The pricing arrangements are not limited to the LDC's buy/sell reference price or necessarily related to WACOG. The LDC flows back to the ABMs the commodity price paid by the end-use customer, less administrative charges.

As ABC-T has only recently been implemented, it is too early to judge its success or failure. Some parties pointed out that ABC-T is not the only way of addressing billing and collection. Another way would be to allow the ABMs to bill for the services provided by the LDCs.

## **2.5 SHORTCOMINGS OF THE CURRENT SYSTEM**

Direct purchase has helped create at least a partially competitive gas commodity market for Ontario customers. A competitive commodity market now exists for industrial and large volume commercial and institutional buyers. The extent to which residential customers currently benefit from competitive commodity supply is controversial. Nonetheless, there is consensus that competition has brought some benefits thus far, and that the system can be improved.

Today competition in Ontario's gas market works within the constraints of the current legislation. Changing the legislation to allow gas commodity title transfer in Ontario is a more direct, transparent and effective solution than the various mechanisms that have worked around the legislation in response to the demand for a competitive market. The creative approaches available to the OEB within the current legislation are insufficient to keep pace with changes in the North American natural gas commodity market. While much of the WGR is devoted to a discussion of unresolved issues, this underlying area of consensus for legislative change should not be overlooked.

### 3. PLANNING FRAMEWORK AND METHODOLOGY

#### 3.0 INTRODUCTION

Every Working Group member started out with a set of assumptions about what was possible, what was likely and what was desirable for the future of Ontario's natural gas commodity market. To create a framework for organized discussion, the Working Group developed a model of a competitive end-state and used it as the central model for discussion. This chapter describes that model.

#### 3.1 THE DISCUSSION MODEL END-STATE (THE "DME")

The Discussion Model End-state ("DME") is in essence a common set of objectives around which the Working Group agreed to frame the debate. While all parties had additional, often very specific, objectives, they were able to accept the components of the DME at least as a starting point for the rest of their objectives and issues.

The Group developed the DME by first identifying the functional components of natural gas service. With reference to each component, the Group then pieced together the elements of the DME. The 16 functional components, or building blocks, of natural gas service as viewed by the Working Group are:

- (1) supply of the gas molecule;
- (2) upstream transportation outside of Ontario ("ex-Ontario");<sup>5</sup>
- (3) upstream transportation in Ontario;
- (4) downstream storage;
- (5) load balancing;
- (6) backstopping;
- (7) supplier of last resort;
- (8) distribution;
- (9) sales;

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<sup>5</sup> Strictly speaking, TCPL interconnection points are within Ontario; however, the term "ex-Ontario" is the common term used in the industry, and was adopted by the Working Group.

- (10) marketing;
- (11) billing and collections;
- (12) meter reading;
- (13) demand management and energy utilization services;
- (14) information;
- (15) safety and integrity of the system and equipment; and,
- (16) regulation.

The Working Group agreed to consider for the model only those components it believed were within the scope of the Board's Market Review Report. Each of those components was separately analysed and discussed within the context of the present, the DME and a transition to the DME. Not all building blocks are affected equally by moving to the DME.

The DME is broadly defined as full and effective competition at the burner tip, in which the regulated LDCs no longer provide gas commodity supply. The model is a theoretical construct which postulates a competitive end-state market in Ontario for natural gas commodity that would have the following characteristics:

- C the merchant function of the LDCs is eliminated;
- C the legislative impediments to title transfer of the natural gas commodity within Ontario are eliminated;
- C there is customer mobility between a diversity of gas marketers;
- C there is price transparency;
- C gas marketers are able to aggregate any customers subject only to system operational constraints;
- C bundled and unbundled delivery arrangements are available between the LDC and all customers including large and small volume end-use customers and gas marketers; and,
- C the assignment of storage and upstream transportation capacity is available to all end-use customers or gas marketers on a non-discriminatory basis.



As a modelling tool, the DME is descriptive, not prescriptive. It gave the Working Group a structured way to address the myriad of issues that would be confronted in deregulating the gas merchant functions. The DME is not the “answer” to the questions of how, why or whether to deregulate fully the merchant gas function. And by definition, the model limited the debate to a review of the issue of deregulating the LDC’s gas merchant function.

### **3.2 TIME LINES: TRANSITION, DME, POST-DME**

The Working Group considered issues of timing to be critical in the move to a deregulated commodity market. It considered four time periods in its discussion:

- C the present;
- C the transition to the DME;
- C the DME; and,
- C the post-DME.

While there was no consensus on timing, the transition to the DME (if all parties’ concerns were adequately addressed) might reasonably occur within the next two to five years.

The Working Group took the view that the competitive market in Ontario would be enhanced by multiple upstream pipelines serving central Canada, to create a real and effective competitive alternative to TCPL. If such conditions were to exist, transportation on upstream pipelines would be commoditized and therefore could be deregulated. This would be the “post-DME” period, and would exist when:

- C the ex-Ontario upstream transportation market is fully commoditized, leaving the associated risks, benefits and responsibility of planning, contracting and holding upstream transportation in the hands of end-use customers or gas marketers.

Once this condition (as well as those in the preceding section) has been met, a fully and effectively competitive market for the sale of natural gas will be said to exist. However, no time line was proposed for the post-DME period. Some parties were of the view that it is improbable that the post-DME period will ever be reached.

### 3.3 PUBLIC INTEREST PRINCIPLES

The Working Group identified four public interest principles that should guide any decision to further deregulate the market: safety; security of supply; economic efficiency and customer benefits; and consistency with policy and legislative environment. These principles were used to “filter” discussion of the DME; each building block was analysed and considered in the context of each principle. The Working Group agreed that in moving to the DME, each principle should be enhanced, or at the very least, not diminished.

#### 3.3.1 Safety

It is the consensus of the Working Group that the information and services needed to maintain the safety of the natural gas system in Ontario must continue to be provided.

In the DME, the requirements in the *Energy Act* and in the relevant Ontario Regulations<sup>6</sup> would remain in force to ensure natural gas safety. The *Energy Act* provides a role for a “distributor” in two instances. One is that, prior to the initial activation of any natural gas appliance, the distributor must be notified of the address of the premises at which the appliance is installed. The other role is that, prior to the activation of an appliance in premises that are attached to gas service for the first time, the distributor must “examine the installation of the appliance and accept the installation and use as being in compliance with this Act and the regulations”. The *Energy Act* also requires that, upon request, a pipeline owner must provide “reasonable information as to the location of the pipeline”.

The wording in the *Energy Act* parallels that of the *Ontario Energy Board Act* (“*OEB Act*”) by defining a “distributor” as “a person who supplies a hydrocarbon to an end user.” If the *OEB Act* is amended to distinguish between the supply of natural gas and the distribution of natural gas, the *Energy Act* should be similarly amended. If the *Energy Act* is not amended, the responsibilities of the “distributor” would apply to both the LDC and the gas marketer. The essential point is that, regardless of whether or not the *Energy Act* is amended, the requirements in the *Energy Act* and the regulations would continue to apply and therefore no change in customer safety is expected.

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<sup>6</sup> 330 - Gas Pipeline Systems, 348 — Certificates, 546 — Gas Utilization Code

### **3.3.2 Security of Supply**

The Working Group has defined security of supply as: gas commodity, transportation and related services made available for delivery of gas.

The DME provides for a progression toward greater security of supply based on contracts, as market liquidity improves. The Working Group expects that in the DME, with appropriate mechanisms in place, the market will provide security of supply by focusing on customers' needs, increasing supply alternatives and sending clearer price signals. Also, Ontario-based hubs may facilitate security of supply by increasing market liquidity, price transparency and delivery alternatives (see Section 3.5.1). Chapter 5 discusses various security of supply mechanisms.

### **3.3.3 Economic Efficiency and Customer Benefits**

The discussion of economic efficiency by the Working Group for the purposes of the WGR centred on: production of demonstrable, incremental benefits to the market and customers; reduction in regulatory burden; recognition of contract integrity; minimization of transitional instability; and, enhancement of customer protection through greater mobility and greater access to information.

While the Working Group agreed that the DME should improve economic efficiency, there was no consensus on whether or not the DME would improve economic efficiency, compared to economic efficiency in the existing regulated market. The divergence of views is described in Section 3.4.

### **3.3.4 Consistency With Policy and Legislative Environment**

The Working Group agreed that a process for the elimination of the current legislative impediments on gas commodity title transfer in Ontario should be pursued.

Current discussions on electricity market restructuring are expected to result in significant changes in Ontario electricity markets, creating both an opportunity to amend the *OEB Act* and other legislation and an impetus to ensure that natural gas markets are not handicapped. Therefore, this is an opportune time for considering further deregulation of the Ontario gas commodity market. The Working Group believes that there may only be a single opportunity for legislative change and that missing this opportunity will disadvantage Ontario consumers in an

increasingly integrated North American energy market.

### 3.4 PRINCIPAL VIEWS

Working Group members held differing views about the merits and the scope of further deregulation. The Working Group was able to resolve part of the debate by agreeing to limit the scope of the DME to only the gas merchant functions of the LDC. What could not be resolved were fundamental issues of the merits of proceeding toward the DME.

Some parties argued that consumers would benefit from the LDCs exiting the merchant function expeditiously, enabling a competitive market to develop more quickly. Other parties maintained that the LDC should exit the merchant function only if certain conditions are met to ensure that the resulting marketplace is not detrimental to any natural gas consumers. Still others maintained that an imperfectly competitive market would result from the LDCs exiting only the merchant function, resulting in higher costs to small volume natural gas consumers.

Another issue was the Working Group's focus on the LDCs and the merchant function. Some parties argued that the discussions ought not to have been focused on the issue of LDC exit from the merchant function, but rather should have been expanded to consider the mechanisms required to create a competitive environment. This discussion would include a review of distribution, billing and metering functions in addition to transportation and storage, and in the view of some parties, other functions as well (e.g., ancillary and other non-monopoly functions).

The WGR attempts to capture and discuss all of these positions, within the limitations of the DME. The four main views are summarized as:

**“View A”: An Unregulated Natural Gas Commodity Market is Necessarily Better.**

Working Group members subscribing to this position held that, by definition, a more competitive market for the supply of the natural gas commodity in Ontario as described by the DME will be more economically efficient than a regulated market. They expect reform to eliminate barriers to title transfers of gas by non-LDC entities, encourage energy convergence and result in better alignment of prices with value, thereby promoting a more efficient use of resources by end-user customers. In their view, the introduction of competition will create greater incentives to adopt price-reducing and quality-enhancing innovations in technology and service that will be to the benefit of

end-use customers.

These parties also expect customers to benefit from an expanded menu of services and options. These benefits will increase economic efficiency in three ways: through the unbundling of regulated services (allowing end-use customers to choose from the variety of different-priced options); through the elimination of less-valued services; and, through the rebundling of services by new and existing providers into innovative, cost-effective solutions that will better meet the needs of end-use customers.

Proponents of “View A” suggested the high proportion of the Ontario market that is currently on direct purchase demonstrates end-use customers’ acceptance of a competitive alternative. Therefore it is desirable to phase out regulated supply.

**“View B”: An Unregulated Natural Gas Commodity Market May Not be Better.**

According to this view, the DME will not necessarily provide net benefits to residential customers. Proponents of this view could accept elimination of system supply as long as certain conditions, intended to protect the interest of smaller volume customers and enhance competition, have been met. Until these conditions have been met, customers should be entitled to choose between unregulated and regulated supply. These parties argued that return to regulated system supply provides a safety valve to an evolving and yet undetermined market.

Proponents of “View B” argued that if the unregulated options are truly competitive and attractive to customers, then the customers will select those options and choose not to return to system supply. If they choose to return to system supply, it demonstrates that those options are not truly competitive.

**“View C”: Deregulating Only the Merchant Function Is Not Better.** At a more fundamental level, some parties queried whether the Board’s Market Review Report asked the right questions. These parties shared the concerns of View B that an unregulated commodity market may not be better. They argued that the solution to problems created by only deregulating only the merchant function would be full separation of all competitive functions from monopoly functions.

They characterized the separation of the merchant function, possibly with directly related functions such as transportation and storage, as “partial separation.” These parties

pointed out that the DME will enhance competition only in the functions where there is the least opportunity for efficiency gains, while building in additional costs (e.g., increased margins, risk compensation and marketing costs). They supported their conclusion that residential customers may face higher prices in an unregulated commodity market with the following arguments:

- C gas supply has been subject to competition for 11 years and is already priced competitively;
- C there are only small operating efficiencies to be gained by separating out the merchant function on its own from the regulated utility;
- C these minor operating efficiencies will probably be too small to offset the increased mark-up expected to result from deregulating the cost of gas; and,
- C partial separation could well increase regulatory requirements and complexity, as it would allow significant potential for cross-subsidy. It would leave the LDC with all the associated functions — meter-reading, billing, collecting, selling and marketing various end use products and services — but not selling the underlying product.

Proponents of this view believe that the right approach to further deregulation is to continue regulating natural monopoly functions, while separating all other functions and transferring them into an effectively competitive market. This separation, it was argued, would be a more logical and effective way of achieving the benefits of a competitive market, with less need for regulatory oversight, better protection for end users and ultimately greater efficiency.

These parties believe that until this separation between monopoly and non-monopoly businesses is effected, further development of competition in the marketplace for energy services in Ontario will be inappropriately and unnecessarily constrained. If separation is limited to the merchant function, the resulting market is unlikely to be fully competitive because it is too small a function on its own to support many competitors. The result may be a market that is neither competitive nor contestable, and regulated monopoly pricing would be replaced by unregulated oligopoly pricing.

Proponents of this view argued that under partial separation, gas supply for small volume customers will cost more and other gas-related services will not cost less. The continuation of regulated system supply in the transition was crucial to parties supporting this position. These parties argued that under partial separation, denying system supply to customers may very well be denying them the lowest-cost gas supply option.

Parties to this position also argued that partial separation will increase the incentive to the LDC to recover fixed and common costs in an inequitable manner (i.e., primarily from the most captive customers).

For all these reasons, parties to this view believe that the partial, merchant function only, separation envisaged in the WGR should be undertaken only in conjunction with a firm commitment by the Board to proceed with separation of all other competitive functions as soon as possible. They believe that the Board should define the principles for moving to full separation of monopoly and competitive functions in this proceeding and that it may be necessary to leave implementation details to a later proceeding.

**“View D”: Either Partial or Full Separation is Better Than the Status Quo.**

Proponents of this view adopt the proposition in View A that an unregulated gas commodity market is necessarily better, and they also agree that deregulating only the merchant function is not enough, as is put forward in View C. However, they do not agree with the proponents of View C that partial separation should not be pursued in the absence of complete separation. In other words, the proponents of View D believe that the LDCs’ associated functions of meter reading, billing, collecting, selling and marketing various end-use products and services should be separated from the LDC. However, the inability to attain separation of all these functions should not prevent the exit of the LDC from the merchant function.

### **3.5 MARKET CHARACTERISTICS**

#### **3.5.1 Liquid Trading Points in Ontario**

This section describes how the DME may operate. The Working Group recognized that a physical market would naturally evolve once legislative and regulatory controls are altered. Legal and contractual commitments, gas measurement and other real constraints will influence the form of the physical market. The physical market could develop several different transaction

points, including: wholesale price discovery points; city-gate title transfer points; transaction points at the customer meter; published price discovery points; and, storage transfers.

Large volume customers and gas marketers would probably be interested in wholesale price discovery points. Wholesale points will emerge over time where there is sufficient volume, liquidity and measurement capability. Delivery points on the transportation network in Ontario, such as Dawn, Parkway and Niagara, may develop into wholesale trading hubs where large volume users and aggregators could trade gas and capacity. One or two of these points may become liquid enough to support financial trading.

City-gate title transfer points may occur at specified points on some distribution laterals. While many parties expressed the desire to be able to transact anywhere in Ontario, this is not operationally practical. Price liquidity points can only occur at places with gas flow measurement capability. Gas flow measurement capability is not currently installed at many existing city-gate transfer points, so this capability would have to be added. Also, while the Union and Consumers Gas franchises probably have sufficient infrastructure and diversity of assets to support trading hubs, on Centra's system in northern Ontario, the ability to physically trade gas would be more limited. In any event, a commodity market is expected to evolve through transactions and price discovery.

End-use customers and gas marketers could opt for bundled service to the meter, instead of delivery at a wholesale trading point. They could evaluate the wholesale distribution rate and prices at wholesale trading points in deciding whether to buy bundled or unbundled service. Customers would have entitlements at their end-use location, subject to meeting their delivery obligations. Upstream transportation delivery obligations to various points would become tradeable.

The Working Group expects that published retail prices would be available for various new locations; for example, gas marketers might advertise their retail prices for Hamilton and for Ottawa. The market may, in fact, provide many windows on price.

It is hoped that new financial markets would support the physical transactions. The LDC, as operator of the distribution system, would remain responsible for the reliable and efficient operation of the system. The LDC would not take a position in the market other than to buy balancing or fuel gas.



Many Working Group members saw title transfer within storage as an important component of the DME. The Working Group suggested the LDCs should develop proposals that would facilitate title transfer within storage that are acceptable to existing customers and are economically viable. Some Working Group members pointed out that right now, gas trading is practical at several points, including the outlet valve of storage, but not actually in storage. The problem with title transfers in storage is that injection and withdrawal rights are currently step functions that change with storage space. If space were traded, those rights would be constrained. Also, transfers of gas in storage pose an administrative burden, and unconstrained trading of storage space could change the contract obligation on the facility with no corresponding physical change. When these physical and contractual problems are overcome, then title transfers within storage may be more efficient than moving gas through price discovery points outside of storage.

A schematic of the physical construct of the DME is provided in Appendix C.

### **3.5.2 Independent System Operator (“ISO”)**

This section describes an alternative to the DME to facilitate market activity, the gas ISO. This proposal was not discussed in any detail by the Working Group, although it was presented to the Group at the beginning of Phase 2. The gas ISO concept corresponds to the electricity ISO used or under development to promote retail electricity competition elsewhere in the world. Some parties opposed applying the ISO concept to the gas market in Ontario.

A gas ISO would not take positions in the market. The ISO could assist parties in meeting their short-run commodity trading requirements while managing short-run physical system constraints, such as storage bottlenecks and transmission congestion. The primary mechanism to achieve these objectives is an open access physical spot market coordinated by the gas ISO. Spot market pricing would guide the gas ISO’s short run operational decisions. Monopoly mechanisms, such as performance requirements and penalties, may also be imposed on users by the gas ISO.

Gas ISOs may conserve and expand existing diversity benefits of the LDCs by ensuring low transaction costs and readily available information among users interested in trading physical gas supplies. The gas ISO could perform optimization trading to help users meet load balancing or backstopping needs by inviting all users to post incremental injection and withdrawal prices and volumes, ranking the bids, clearing the market as frequently as required, notifying the affected

parties as to the physical actions required, and sorting out the financial settlements. Supporters of this proposal believe that, unless the gas system operators have access to an economic ranking of participants' willingness to supply, and a ranking of the value that users associate with demand, their operational actions will be arbitrary and likely inefficient.

According to this view, the functioning and costs of the gas ISOs should remain regulated, although the spot price should not be regulated. If the LDCs no longer owned gas for resale, the desirable efficiencies and customer service capabilities now provided by "system gas" would have to be replaced. System gas, now owned by the LDCs, could be replaced by delivered spot gas. The ISO could be responsible for providing accounting and other transactional services allowing gas traders and users of all sizes, including small volume customers such as homeowners, to utilize the spot market as they require. Under this proposal, the OEB could guide an evolutionary transition away from system gas by directing the development of a spot market, observing that market's activity, and removing system gas only when the spot market demonstrates sufficient liquidity to support the needs of customers using system gas.

Without some kind of system operator using market mechanisms to incorporate the preferences and values of users while operating the system, the development of retail access could become stalled at the wholesale stage. Supporters of the ISO believe it is possible that, without an ISO, all but the largest users of gas will have to rely on middlemen to manage their supplies, even though they would be content with spot market supplies.

The gas ISO would be responsible for operating the transportation and storage system within Ontario, and coordinating closely with operators of interconnected transmission, storage and distribution systems. Some parties are sceptical of the value of the ISO concept, because the costs associated with the proposal have not been scoped.

## **4. A MODEL FOR COMPETITIVE SALES OF NATURAL GAS**

### **4.0 INTRODUCTION**

The Discussion Model End-state was developed by the Working Group to focus the discussions on the changes that were explicitly contemplated in the Board's Market Review Report. As discussed in Chapter 3, the DME focused on the merchant function.

The Working Group identified 16 functional components of natural gas service. The Working Group then attempted to reach consensus on how each function should be undertaken in the DME and how that function would be handled in the transition to the DME. In this chapter, each of the 16 functions is discussed individually.

### **4.1 SUPPLY OF GAS MOLECULE**

#### **4.1.1 Present Functions**

The current merchant function is defined as: activities that are essential to the supply of gas molecules to the LDCs and the sale of those molecules by the LDC to the end-user. Current legislation in Ontario precludes parties from making title transfers of natural gas within the province without an authorization from the OEB. The buy/sell, bundled T-services, load balancing and backstopping, and other mechanisms, have enabled Ontario customers to transact for gas supply with ABMs or suppliers despite the current legislation.

The regulated LDC merchant function consists of the following:

- C the purchase and regulated resale of the gas molecules;
- C fuel management (upstream and downstream fuel and losses); and,
- C the obligation to supply.

The WGR considers the LDC merchant function to be limited to activities taking place within Ontario. Therefore, while ex-Ontario upstream transportation is obviously an important aspect of providing service, it is not a component of the merchant gas function within the DME.

### 4.1.2 Gas Supply DME

In the DME, a regulated supply option for customers provided by the LDCs or others is not required, as gas would be bought and sold by gas marketers and end users. The LDC would neither own nor buy gas, with the exception of that necessary for minimum operational requirements (e.g., base pressure gas in storage, line pack and gas for own use).

It was recognized that regulators will need to continue to approve LDC system expansion plans, to ensure that expansion of the regulated distribution system is economic. In the DME, LDCs will continue to design and offer capacity-constrained interruptible delivery services to maximize the overall utilization of their regulated distribution systems.

### 4.1.3 The Transition

Some parties believe that the delivery service mechanisms that allow delivery in Ontario of gas purchased outside the province would need to evolve as the LDCs withdraw from the molecule business. Others believe that these delivery mechanisms should not be changed unless the change is coincident with the LDCs' withdrawal from the molecule business.

There was no consensus as to when the LDCs should leave the regulated merchant function. Some parties believe that the elimination of regulated supply should be the final step once the rest of the transition to the DME has been completed. Other parties believe that regulated supply might be eliminated in the transition subject to certain conditions. Still others believe that the LDCs must leave the regulated supply early in the transition to the DME.

If customers perceive benefits as Ontario moves toward a deregulated natural gas market, the number of customers remaining on system gas would be expected to decline. The concern was expressed that, at some point, it may become impractical or uneconomic to continue to serve customers remaining on system supply. This argument was not accepted by all parties, although it was agreed that some of the current LDC activities may not be cost-effective if the level of system supply were to fall below some threshold.

One alternative outlined in the WGR contemplates the elimination of regulated system supply during the transition phase. Should this occur, it will be necessary to set a planning date for the elimination or transformation of activities supported by regulated system supply, such as buy/sell and molecule-based load balancing.

The Working Group agreed that in the transition to the DME, it would be necessary to have price discovery at liquid transaction points in Ontario as described in Section 3.5.1. Some parties believed that price transparency would evolve naturally, while others anticipated that explicit price discovery mechanisms would need to be developed.

#### **4.1.4 Issue: Elimination of System Supply**

While it was agreed that in the DME a regulated source of commodity would not be required, the Working Group did not agree on how the elimination of this option would occur. To some within the Working Group, the elimination of system supply is inextricably linked to the issues of consumer protection. Others consider the issues of customer protection and regulated system supply to be separate and unrelated. In Chapter 5, the WGR discusses the customer protection issues related to system supply.

The spectrum of views can be summarized as:

- C those who seek a fixed date, determined in advance, at which time all remaining system supply customers must be removed from regulated supply;
- C those who advocate a planning date and a publicly announced date on which system supply would be eliminated, which date may be reviewed as the market evolves to the DME; and,
- C those who believe that it would be premature and/or prejudicial to announce a date, implying customers would lose their regulated supply option, before it is apparent that the other conditions of the DME will be met.

Below is a description of the alternatives. Regardless of the alternative chosen, an appropriate mechanism is needed to deal with residual system supply customers; this is discussed in Section 5.3.

**Working Group Alternative: Public Planned Exit with Date Certain.** This option contemplates LDC exit from regulated supply by a specific date, such as November 1,

1998 or April 1, 1999.<sup>7</sup> One of the factors influencing the design of the mechanism is the anticipated size of the residual supply needed at the date certain.

Proponents of this option argued that restructuring can best be achieved if the necessary reform is completed as soon as possible rather than over an extended phase-in. Delay can impede rather than facilitate the transition to the new environment. First, delay increases the likelihood that LDCs will make further investments or contractual commitments which cannot be supported in the new competitive market, exacerbating any stranded costs. Second, delay may increase the period in which conflicts must be resolved between the LDC, its affiliates and other gas marketers. Third, delay increases the likelihood that consumers will, during the transition period, commit themselves to supply arrangements which differ from those that they would make in the new market and regulatory environment.

**Working Group Alternative: Planned Exit With Extendible Date.** In this alternative, an exit strategy would be designed to include a customer education strategy and the introduction of price discovery mechanisms. There would be periodic progress reviews to ensure that all components of the exit strategy have been put into place. This alternative recognizes the need to set a date certain, so that contractual commitments can be addressed and transition costs minimized, while giving customers and market participants assurance that an effective exit strategy is being implemented.

**Working Group Alternative: Exit Only Once Full and Effective Competition is Achieved.** This option calls for the continuation of a regulated supply offering by the LDC, subject to periodic progress reviews by the OEB. Proponents of this option argued that customers should not be forced to leave regulated system supply if that is their preferred supply option.

In this way, regulated system supply provides a check on a market that has yet to demonstrate it offers customers additional benefits over the current supply options. The following pre-conditions for a fully competitive market would have to be satisfied before supporters of this alternative would accept a planning date for the LDCs to exit the gas supply function:

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<sup>7</sup> These dates are significant for storage planning purposes. November 1 is the notional full storage date, and April 1 is the notional empty storage date.

- C there exist price discovery and transparency;
- C customers have mobility at the burner-tip;
- C customer education and information is sufficient;
- C the opportunity exists for gas marketers to sell in Ontario; and,
- C customers have diversity of choice.

Satisfying these conditions, rather than getting the LDC out of the supply business, is the key to effective competition in this view. These parties argued that until competitive discipline emerges, a regulated supply option is the only check on excessive prices. They did not accept that forcing any customers off system supply would assist in the development of a fully competitive market.

Supporters of this alternative accepted that if the Board determines that a fully competitive market exists, a planning date for the LDCs to exit the gas supply function could be set. The existence of the planning date would enable LDCs to wind up gas supply contracts in a managed fashion which minimizes stranded costs and other liabilities.

#### **4.1.5 Issue: Elimination of Buy/Sell**

The Working Group discussed the future of the buy/sell mechanism, particularly in the event that the commodity sales rate is discontinued.

Some parties argued that either a planned or a certain target date is necessary to allow an orderly transition of buy/sell volumes to new arrangements. It is anticipated that an orderly transition would include provisions for phasing out buy/sell renewals, such that renewals would not extend beyond the agreed-upon date. This approach might require a process whereby existing buy/sell terms and conditions are pro-rated relative to the traditional twelve-month term. These parties argued that if the transition is longer than two years, it will be necessary to modify direct purchase services.

Other parties argued for continuation of system supply until conditions for effective competition have been satisfied and believed that it is not necessary to set any buy/sell termination date. Some of these parties also argued for the continuation of buy/sell as long as system supply is offered by the LDC. The disposition of buy/sell agency agreements is also discussed in Section 5.5.1.

Finally, some parties considered that elimination of buy/sell is distinct from the issue of the LDCs exiting the merchant function. They believe that eliminating the buy/sell mechanism will enhance the competitiveness of the market whether or not system supply remains available.

## **4.2 UPSTREAM TRANSPORTATION (EX-ONTARIO)**

### **4.2.1 Present Functions**

About 95 percent of the gas arriving in the eastern Canadian market still comes from western Canadian sources, through the TCPL system, although import capacity into Ontario from U.S. suppliers has increased six-fold over the past ten years.<sup>8</sup>

The LDCs currently contract for upstream capacity for Ontario customers, with the exception of T-service and some Ontario buy/sell customers, who may choose to contract for their own upstream transportation capacity. The party that contracts for the capacity bears the risks associated with upstream arrangements. Such risks can be redirected, in whole or in part, by contracts between the party primarily responsible and others to whom it is assigned.

### **4.2.2 Ex-Ontario Transportation DME and Post-DME**

In the long run, it is desirable to develop a market in which the benefits and risks of moving gas from source to burner tip are assumed by the user – either the end-use customer or a gas marketer in the DME. Some Working Group members believe that the key to achieving further efficiencies and benefits for end-users is for the LDCs to relinquish upstream capacity. Others believe that fully commoditized TCPL capacity is not necessary to achieve benefits for customers in the DME.

The Working Group agreed to assume that the post-DME period would have multiple pipelines providing real and effective competition for TCPL, such that commoditization of TCPL upstream capacity would result. In that end-state, molecule owners and/or gas marketers would be responsible for all aspects of gas supply, including upstream transportation.

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<sup>8</sup> Capacity from the U.S. is now at approximately 600 MMcf/day, although it is not fully utilized. In comparison, export capacity from Alberta is about 6800 MMcf/day and is fully utilized. Daily average Ontario demand is about 3000 MMcf/day.



For the DME, the Working Group sought ways to enable the residential and small volume commercial market to hold TCPL capacity directly, as do the large volume industrial and commercial markets. The Working Group recognized that under current TCPL rules, as approved by the NEB, the LDC may release capacity unilaterally but not unconditionally to the open market. The Group discussed how, under these constraints, to plan and contract for new TCPL capacity in the DME, when the LDC no longer provides the molecule. Parties' positions depend to a large extent on whether or not upstream transportation capacity has been, or even can be, fully commoditized (i.e., post-DME).

The Working Group also noted that the unique characteristics of the transportation capacity serving northern Ontario make this market subject to more physical constraints than those of eastern and southern Ontario. Special consideration will be required to ensure that the northern Ontario markets benefit from further deregulation. Some parties suggested that end-user control of transportation and storage assets is one way of maintaining a liquid market in northern Ontario.

The issue of upstream transportation is critical to an effectively competitive market in Ontario. Some alternatives in the transition, the DME and post-DME are described below. Whatever alternatives or other options ultimately prevail, some Working Group members believe it is essential that stakeholders, including the NEB, the OEB and the Government of Ontario, take steps to change the terms and conditions of service for federally regulated pipelines, to facilitate progress toward a fully commoditized upstream transportation market.

### **4.2.3 The Transition**

The transition to the DME must address allocation or release of current upstream capacity. Some transitional issues require resolution in conjunction with the release of the upstream capacity. While a secondary market does exist for transportation on upstream pipelines, some parties believe that several factors prevent a fully commoditized market for upstream transportation capacity (ex-Ontario) from developing. These include:

- C the absence of multiple pipelines delivering western Canadian gas to central Canada;
- C the lack of opportunity capacity on TCPL and other upstream pipelines; and,
- C constraints on assigning/releasing capacity contracted on TCPL and other upstream pipelines.

The term “opportunity capacity” was defined by the Working Group as capacity, above the average day requirements, that is available to facilitate transactions.<sup>9</sup> Some parties argued that purposely building excess upstream capacity would have a cost, which would ultimately be borne by distribution customers. Other parties believe that building opportunity capacity would reduce costs. In the DME, opportunity capacity may occur naturally through the contracting practices of market participants, who can be expected to balance the costs of holding additional capacity against the benefits of capitalizing on market opportunities. During the transition, a limited amount of additional capacity would provide this market flexibility.

#### **4.2.4 Issue: Allocation of Existing Upstream Capacity**

The Working Group agreed that until there are effective competitive alternatives to TCPL (in the post-DME), regulation of the primary market for TCPL capacity is likely to continue. The LDCs can continue to provide open access to TCPL capacity by using the TCPL assignment mechanism.

Assignment and recall rights apply to all of the alternatives below. They would be dependent on who holds upstream transportation capacity and of the LDC’s new tariff provisions, including the balancing and storage mechanisms of the new services. In addition, they would be determined by system operating constraints and design. Where the LDC is the shipper and contracting party for upstream capacity, the LDC would facilitate in- and ex-franchise assignments subject to system constraints. Recall rights would continue only where necessary for the needs of system operations.

While the primary market for capacity would be regulated, the secondary market would remain unregulated. Where end-use customers or gas marketers are the shipper or contracting party, assignments would take place subject to each party meeting their tariff and contractual obligations. In the DME, gas marketers and/or end-use customers may require additional upstream or downstream capacity. In the event transportation capacity is physically committed to a different delivery point, there could be a need for additional facilities to assure continued firm delivery capability. Coordination and planning would be required to ensure system integrity.

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<sup>9</sup> One proposed calculation of opportunity capacity is: total normalized market demand, plus one percent for flexibility, minus total firm transportation to Ontario.

It is envisioned that over time the market may naturally take steps to increase either upstream capacity or downstream deliverability, increasing overall flexibility. If this occurs, then flexibility for assignments could increase and recall rights could be minimized.

**Working Group Alternative: Assignment.** In the absence of commoditized upstream capacity, a proxy for competition should be developed under the existing regulations and rules governing TCPL capacity. In the transition and the DME, the proxy may be found in the continued use of the TCPL assignment mechanism. Under this mechanism, the party who is assigned capacity obtains the risk and the benefit of holding that capacity over the assigned term. The LDC carries the risk that the assignee cannot live up to the terms of the assignment. In addition, the time period of the assignment may not be aligned with the time period of the LDCs' TCPL commitment. If upstream TCPL transportation is to remain part of the regulated delivery service provided by the LDC, then there must be an examination of how the LDC will be compensated for this role.

Advocates of this position noted that some combination of the LDC and the gas marketer or end-use customer holding upstream transportation capacity could exist not only through the transition period but also in the longer term. This could be preferred by parties who are unable to accept risk or prefer to shed risk to others, while ensuring acceptable control and access to upstream transportation capacity.

**Working Group Alternative: Capacity Release.** Under this alternative, upstream capacity is released for its remaining term to all market participants, except those who cannot meet the financial and contractual conditions of the upstream pipelines. Release would be irrevocable. The release would be conditional on the LDCs' contractual ability to do so, the parties' willingness to accept the terms and conditions (which can vary from contract to contract) and the development of a mechanism to address the asymmetrical risk associated with unreleased capacity. All parties should be encouraged to take up the released capacity. Any end-use customer or gas marketer that was unable to take up the released capacity could continue to contract for upstream transportation from the LDC on a bundled basis, to the extent that the LDCs have sufficient remaining capacity.

As market participants release or contract for upstream transportation capacity, it is anticipated the market in Ontario will become increasingly liquid. This would also be facilitated by opportunity capacity on TCPL and other upstream pipelines and by the implementation of proposals for the allocation of storage and storage-related

transportation. In the post-DME, the capacity release mechanism would no longer be necessary.

During the transition period when upstream transportation is committed to existing LDC supply contracts, supply capacity could continue to be displaced in accordance with the current provisions of each LDC's contractual entitlements until all customers have had an opportunity to make an election. Pipeline capacity could continue to be assigned and/or allocated to customers during a transition period. Capacity held by the LDC would be accommodated via contractual assignments subject to recall by the LDC, and priced at the regulated tariff.

Since the aggregated overall capacity demand is currently less than the sum of the individual customer demands, capacity releases would likely not be on a one-for-one basis. This loss of diversity occurs as the LDC is unable to continue to use individual customers' non-coincident requirements to minimize the transportation capacity it holds. The nature, term and type of service allocated to the customer would be based on the portfolio of the transportation that the LDC has available at the time that the customer makes an election. Assignment or allocation of the capacity could be at current tariffs during the transition. Coordinated market planning for capacity additions would be undertaken (see Section 4.2.5 below).

**Working Group Alternative: Date Certain Open Season.** This option allows for permanent assignment of upstream transportation capacity by the LDC to end-use customers and gas marketers. End-users or gas marketers would not be required to take capacity they do not want, but they would be required to exercise their option to take such capacity on or before a specified date (i.e., a date certain). The deadline for the exercise of such options should be before any date that may be fixed for LDC withdrawal from the merchant function. The release of optioned capacity would be on or before November 1, 1998.

Some of the parties supporting this alternative believe that, regardless of how upstream transportation markets evolve, NEB and Federal Energy Regulatory Commission ("FERC") regulation of upstream pipelines provide an adequate proxy for competition in the primary transportation market. These parties believe that management of upstream transportation by non-LDC parties on a competitive basis would be in the public interest.

Some parties argued that the release should be at cost and the LDC should make all reasonable efforts to pass along any discounted tolls. Others took the position that the upstream transportation should be released at market value.

Any upstream pipeline capacity for which no options were exercised would be auctioned by the LDCs in accordance with procedures established by the OEB (consistent with NEB rules). Any party would be entitled to participate in the auction, subject to compliance with any financial or contractual conditions imposed by the upstream pipelines. Regulatory oversight of the auction would be minimal and limited to ensuring that eligibility requirements are met and that no party can exercise market power as a result of its acquisition of pipeline capacity.

Proponents of an open season argued that the “Assignment” alternative (above) would prolong the dependence of some end-use customers and gas marketers on the LDC to manage their upstream capacity. This would reduce incentives for assuming full financial and contractual responsibility for the upstream capacity. Nor did advocates of this option see any reason for the LDCs to control upstream capacity in a market in which they were not gas suppliers.

The potential for an open season would depend, in part, on the ability of the LDC and new shipper to make satisfactory arrangements with TCPL.

Some parties supporting an open season did so only on the pre-condition that there exists a fully commoditized upstream market.

**Working Group Alternative: Annual Auction.** Some Working Group members believe that a surrogate for competition in the upstream transportation market could be created by an annual auction by the LDCs of the upstream capacity that they hold in their role as facilitators of the market. Under this alternative, end-use customers and gas marketers relying on assignments of capacity held by the LDC would have to pay the market price for annual assignments. Differences between TCPL tolls and the market price for upstream capacity would be passed through to Ontario end-use customers in their distribution rates, whether that variance was positive or negative. Market participants wishing to make longer term arrangements would have to contract directly with TCPL or make an arrangement with an intermediary other than the regulated LDC.

#### 4.2.5 Issue: Incremental Capacity

The LDCs currently manage, assign and release upstream capacity to customers in the franchises they serve. The NEB's economic feasibility test for incremental TCPL capacity requires shippers to commit to long-term firm service contracts and provide proof of a downstream market, upstream supply and creditworthiness. Without significant change in these access conditions or the development of significant competitive alternatives, it is not expected that upstream transportation will be fully commoditized.

**Working Group Alternative: Incremental Transportation Capacity Planned and Contracted For By LDC.** Until a fully competitive transportation market emerges, the LDC would continue to contract for upstream transportation capacity and assign capacity to customers. Assignment of capacity (see Section 4.2.4) will be for minimum terms of one year at the TCPL tariff rate. Additional upstream transportation would also be acquired by end-use customers or gas marketers, and the LDC would accept these unplanned deliveries on a best efforts basis subject to facilities constraints and queues for capacity. Capacity could be returned to the LDC on expiration of term for remarketing; alternatively, the end-use customer or gas marketer could remarket the capacity, subject to the ability to physically deliver at the contracted delivery points. The end-use customer or gas marketer would obtain capacity as required, either from the secondary market or by contracting long-term (subject to the terms and conditions of the pipeline company).

The LDC would have a planning role to determine and publicize aggregate demand for the market players to utilize in their contracting decisions. To ensure that an acceptable level of upstream capacity is contracted, major customers would participate with the LDCs in a regular planning process to co-ordinate transportation use and commit for future transportation requirements. Customers of the LDC would be required to provide advance notice of and commitment to expected future upstream transportation requirements and preferred routes. The LDC would monitor upstream transportation and storage capacity to assure itself that sufficient capacity is available either through the primary or secondary markets to meet all forecasted demands. Expected shortfalls would require the LDC or the marketplace to provide the necessary capacity.

As the LDC is still the contracting party for upstream capacity, the existing regulatory regime may need to change, to compensate the LDC for the risk of holding upstream

capacity and contracting for incremental capacity. An adjustment in rate of return or some form of performance-based regulation might allow compensation for the risk.

**Working Group Alternative: Gas Marketer Contracts For Incremental Transportation Capacity.** The gas marketer or end-use customer would obtain capacity as required either from the secondary market or by contracting long-term, subject to the terms and conditions of the upstream pipeline company.

As in the above alternative, the LDC would have a planning role to forecast and publicize aggregate demand for end-use customers and gas marketers to use in their decision-making regarding contracting. The LDC would continue to monitor upstream transportation and storage capacity to assure itself that sufficient capacity is available, either through the primary or secondary markets, to meet all forecast demands.

### **4.3 UPSTREAM TRANSPORTATION CAPACITY (IN ONTARIO)**

Currently Centra and Consumers Gas buy M12 and C1 services from Union, and STS from TCPL, to serve their markets. Some members of the Working Group believe that upstream transportation in Ontario is an integral part of the regulated delivery services provided by the LDC. In the view of the Working Group, it is desirable to continue to unbundle upstream transportation in Ontario in order to reach the DME.

In the DME, upstream transportation in Ontario will continue to be offered by the LDCs at regulated rates. The Working Group believes non-discriminatory access to Ontario capacity is needed in the DME and in the transition to complement storage and upstream storage transportation service on TCPL and other routes. Customers will require mechanisms to access and manage capacity, in order to unbundle their transportation, load balancing and delivery costs to a much greater degree than at present.

#### **4.3.1 Ontario Natural Gas Production**

Regulatory and legislative constraints currently restrict Ontario gas producers from dealing effectively with end-use customers for gas supply (commodity and load balancing) arrangements. With direct marketing to end-use customers, there is value in developing rates to allow for the efficient transport of Ontario production within the province.

#### **4.4 DOWNSTREAM STORAGE**

The Working Group identified numerous issues to consider, including: new storage development, renewal rights, existing contracts, pool-specific rights and assignment or sale of existing rented storage.

##### **4.4.1 Present Functions**

Currently the Ontario LDCs own and operate storage assets. In addition, the LDCs lease storage entitlements. Approximately 210 Bcf of working storage has been developed in Ontario. This storage is currently used to provide:

- C load balancing service for in-franchise customers;
- C storage under long-term contracts for ex-franchise, in-Ontario service;
- C storage under long-term contracts for ex-franchise, ex-Ontario service; and,
- C storage service under short-term contracts for all customers.

Short-term storage service for ex-franchise customers is currently sold under market-based, open season mechanisms. Long-term storage is currently contracted on a cost-of-service rate basis.

##### **4.4.2 Storage in the DME**

Downstream storage is a critical element in security of delivery and supply. Storage effectiveness and efficiency are improved by the planning and coordination of both short- and long-term upstream transportation capacity. End-use customers or gas marketers without access to storage would find it difficult to contract and manage upstream capacity. In the Working Group's view, all market participants ought to have non-discriminatory access to Ontario storage in the DME.

The Working Group believes the current regulatory oversight of the environmental and construction aspects of storage designation and development should be maintained for all parties developing storage. The Group recognized that parties other than the LDCs are evaluating the economic and regulatory aspects of storage development. There was no resolution as to whether non-LDC storage rates should be regulated in the DME; indeed, some parties argued that by definition, there could be no such thing as non-LDC storage.



The Working Group agreed that existing regulation of storage operation, and injection/withdrawal approvals, should be maintained, to ensure safe and adequate design and operation of storage facilities that will provide for long-term security of delivery and supply.

**Working Group Alternative: Regulated Rates.** Some parties take the view that LDC storage assets, as an alternative to transportation, comprise an integral part of the regulated delivery services business. Therefore, in the DME the primary market for storage should continue to be regulated on a cost-of-service basis, although the regulation might include some market-based range rates. The secondary market for storage would be unregulated.

**Working Group Alternative: Market-based Rates.** Some members of the Working Group are of the view that Ontario ought to adopt a regulatory framework that permits market-based rates for storage. These parties maintain that a change from the current cost-based regulated pricing regime is necessary to obtain a fully and effectively competitive market at the burner tip. These parties maintain that new storage can only be developed at market-based rates.

#### 4.4.3 The Transition

The Working Group agreed that Ontario should adopt a regulatory framework for storage that would facilitate a competitive market for natural gas. The Working Group recommends that storage continue to be regulated in the transition and that rates be cost-of-service based through the transition for existing storage; i.e., storage that is currently contracted to Ontario users or notionally allocated for in-franchise use.

Some parties support the use of market-based rates for new storage or short-term released storage in excess of the contracted and allocated storage. Other parties believe market-based rates should apply to short-term released storage only. There was no agreement on how the net revenues from market-based regulated storage rates should be disposed of.

There was agreement that storage will be allocated to customers on a year-by-year basis in proportion to the capacity that would have been notionally allocated to them had they remained buy/sell, bundled-T or sales customers. In the event that there is insufficient storage to satisfy total demands, for example due to loss of diversity, some form of allocation mechanism will be required through the transition to ensure that customers continue to have access to storage in

proportion to the demands which underpin the LDCs' existing gas supply plans, including volumes used to support buy/sell and bundled-T services. Some parties believe that, in addition to allocation, a trading mechanism would be required.

Co-ordinated planning will be required to determine market demands in order to establish at an early date the need for new storage facilities. The LDCs will facilitate assignment of downstream storage entitlements in accordance with the terms and conditions of the contracts. Planning, coordination and justification of new storage assets could either be managed as at present, or be fully determined by the market.

#### **4.4.4 Issue: Allocation of Existing Storage**

The Working Group identified the following alternatives to address the allocation of existing storage to requesting parties in the transition to the DME. None of the alternatives obliges end-use customers or gas marketers to accept their storage entitlements. To the extent that storage allocated to customers is not taken up, there may be additional stranded costs or benefits.

**Working Group Alternative: Proportional Allocation.** Storage capacity would be allocated to end-use customers annually in proportion to their daily or seasonal load balancing requirements. Storage service would be available on a bundled or unbundled basis. Allocation would be based on a deemed amount, determined by the customer forecast and supply plans in place at the time of the allocation. Cost of service/cost-related rates would apply to storage currently under contract or allocated to in-franchise use.

**Working Group Alternative: Open Season.** An open season could allocate storage capacity to parties on the basis of price, volume or term (in other words, the highest net present value). The open season allocation could take place just prior to the end of the transition period, and would be comparable to the "Open Season" alternative described in Section 4.2.4 for ex-Ontario upstream transportation.

**Working Group Alternative: Allocation and Open Season.** This alternative is a combination of the above options whereby all existing capacity would be allocated on a prorated basis and all new capacity would be allocated through an open season.

#### 4.4.5 Issue: Asset Structure

The Working Group agreed that, although the structure of LDC storage assets was not one of the issues identified in the Board's Market Review Report, it must be addressed in the WGR.

Some members of the Working Group take the view that the LDC storage assets are an integral part of the regulated delivery service and that such capacity ought to be available to provide end-use customers and gas marketers with a bundled delivery service. Others view the storage assets of the LDCs as a "molecule warehouse" and contend that a fully competitive commodity market in Ontario will be achieved only when the LDCs' storage assets are separated from their other assets. The following alternatives were proposed:

**Working Group Alternative: LDC-Owned Storage (status quo).** Some Working Group participants believe it may be more efficient for the LDC to own storage capacity instead of several end-use customers or gas marketers each building and owning their own storage facilities. This arrangement does not preclude end-use customers and gas marketers from contracting storage for their own load balancing needs.

**Working Group Alternative: Structural Separation (Affiliate or Separate Division).** Some parties argued that there is a danger in moving to market-based rates as long as the storage function is part of the regulated LDC. In light of those concerns, it was proposed that the storage function be separated from the utility, to avoid cross-subsidies between competitive and monopoly activities.

Some parties would accept separation of the storage assets to a division that is physically separate from the rest of the LDC, acknowledging that the creation of an affiliate company might have tax and legal implications. Other parties would only be satisfied if the storage assets were removed to a separate (although affiliated) company.

Under structural separation, a code of conduct would be needed to govern the relationship between the LDC and its storage division or affiliate. This code would be similar to that governing the relationship between the LDC and gas marketers.

**Working Group Alternative: Divestiture.** The proponents of this view argued that the prospect of the LDC offering market-based storage rates alongside its regulated cost-based delivery rates presents the possibilities of cross-subsidization and favourable

treatment of its affiliates. The only way to be sure of avoiding cross-subsidization is for the LDCs to sell their storage operations to unrelated companies.

Any benefit arising to an LDC from transferring its storage assets could be addressed by the Board.

Proponents of any degree of separation agreed that only after some form of separation has been completed, should market-based rates for existing storage be offered. It was also agreed by these proponents that the degree and nature of the separation could be the subject of further consideration in the context of the hearings regarding the LDCs' unbundled rates (see Section 4.4.6).

#### **4.4.6 Unbundling of Storage Rates**

There was no consensus about whether the LDCs should continue to offer bundled storage rates in the DME. Some Working Group members believed that the LDCs should be able to offer such bundled rates. Other Working Group members do not believe the LDC should offer bundled services; however, some of the Working Group members do foresee that, under a regime of structural separation or divestiture, a separate storage affiliate or division could compete in the provision of bundled storage service.

The Working Group agreed that, in order for all customers to take full advantage of their storage and load balancing options, the LDCs should provide unbundled storage services to end-use customers and gas marketers. Price discovery is imperative and gas marketers, end-use customers and the LDCs should work within the same unbundled storage tariffs.

### **4.5 LOAD BALANCING**

#### **4.5.1 Present Function**

Load balancing involves the proactive management of planned supply and forecasted and unforecasted consumption, through the use of transportation, peaking supplies, short notice supplies, storage and curtailment. Load balancing is provided by LDCs, gas marketers and end-use customers partly through the diversity of assets, including system supply, using the following methods:

- C underground storage;
- C peaking service/delivered seasonal supply;
- C fuel-switching/curtailment;
- C customer load diversity;
- C customer geographical diversity; and,
- C management of pipeline capacity.

Currently bundled T-service and buy/sell contracts provide for balancing of consumption and deliveries tied to a 4.0% to 5.5% (depending on the LDC) annual range of tolerance. Some bundled T-service and buy/sell customers may load balance periodically to avoid annual imbalances, or correct imbalances at the start of the next contract year. Unbundled T-service customers provide their own balancing by operating within the parameters of their transportation and storage contracts.

#### **4.5.2 Load Balancing in the DME**

Load balancing is seen by the Working Group as a necessary and critical component of a fully competitive market structure.

All load balancing requirements in the DME will be achieved through a combination of contractual obligations under transparent and efficient market mechanisms. End-users will either acquire and manage their own unbundled services or purchase rebundled services from bundled service providers. Subject to customer demand for service and the upstream transportation and storage models selected, the LDCs, gas marketers or end-use customers may provide load balancing upstream of the city gate.

Distribution capacity-related load balancing services will be provided by the LDC using its distribution capacity assets. Molecule-related load balancing will be undertaken by owners of the molecules, which in the DME do not include the LDCs. There was some concern expressed in the Working Group that removal of molecule-related load balancing by the LDC could lead to a loss or disruption of curtailable markets. If this were to happen, some parties believed that this could lead to proposals for the building of otherwise uneconomic distribution facilities to compensate for the loss of curtailable capacity. Others in the Working Group countered that, in the DME, commercial alternatives to curtailment would naturally arise, or could be designed, to compensate for this loss.

### **4.5.3 The Transition**

In the transition, the LDCs may continue to provide bundled delivery services, but would also offer fully unbundled services so that end users and gas marketers could provide load balancing services. Unbundled services would be offered on an equal basis to all market participants. As long as the system supply portfolio continues and is large enough, the LDC could provide molecule load balancing. If the LDC no longer performs a gas supply merchant role or manages upstream transportation and storage (except for operational needs), then it would be unable to utilize customer geographical and load diversity to balance loads.

In any event, the LDC would have sufficient diversity of assets to offer some distribution capacity load balancing at OEB-approved terms, conditions and rates. For example, if the LDC no longer performs the merchant role but still manages upstream transportation and storage, then it could still provide load balancing, but would not be able to purchase gas under curtailment or purchase peaking services/delivered seasonal supply. The LDC could provide balancing within pre-determined tolerance bands on a daily and monthly basis, by maintaining a limited amount of operational storage and related transportation. The cost of this service would be recovered through the regulated distribution service rate.

Parties performing load balancing may also hold upstream and downstream transportation and, in aggregate, may provide load balancing for end-use markets in multiple franchise areas. The load balancers may either own or hold contract entitlements for storage and other balancing tools such as peaking services and interruptible markets.

Given the potential loss of the flexibility currently provided by system supply, which accommodates swings in seasonal and daily demand, annual balancing provisions would likely be replaced with more frequent balancing requirements. Some parties believe that new gas commodity trading mechanisms are required to compensate for this potential loss of flexibility.

### **4.5.4 Operational Issues**

Current load balancing service may need to be redefined and segmented, depending on how upstream transportation and storage is managed.<sup>10</sup> Current distribution capacity-related and molecule-related load balancing services include:

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<sup>10</sup> Some parties believe that all of these operational issues can be resolved by the ISO model.

### 1. Daily standby service

On peak demand days, the use of underground storage may not be sufficient to balance supply and demand. Shortfalls could be met by using either curtailment or peak day supply, under one of two possible methods. The first is for the gas marketers or end-use customers to contract with the LDC for peaking service. The LDC would then subcontract the service to an energy services company. Under the second method, the gas marketer would negotiate directly with curtailable customers.

In either case, interruptible distribution rates would not be available to users of daily standby service. Interruptible supply would be contracted for in a manner similar to peaking service. The LDC would likely charge a reservation fee or a market-based demand charge for the right to curtail or purchase peaking gas.

### 2. Operational load balancing

Under a scenario where the LDC is no longer providing load balancing to gas marketers or end-use customers by using storage, the LDC would still need to contract for some upstream transportation and storage, or purchase gas on a delivered basis, for operational reasons. Such reasons would include meeting shortfalls between daily scheduled consumption and daily deliveries. If the LDC elects to use upstream transportation and storage for operational load balancing, then it would need to retain some M12 transportation capacity as well as STS.

### 3. Impact on measurement

To ensure that reliability is not jeopardized and that the cost consequences of load balancing activity are borne by the party using the service, new storage and delivery company measurement, billing and tracking systems will be required. Measurement in major markets may be necessary on a daily or even hourly basis. Until economic electronic measurement integrators have been developed and installed for residential and small volume commercial markets, new daily consumption estimating (approximation) techniques would be used.

## **4.6 BACKSTOPPING**

### **4.6.1 Present Function**

Backstopping is defined as the process of providing supply where the party with the contractual obligation to provide this supply has failed to do so. Backstopping also relates to the current

legal requirement to serve. The *Public Utilities Act* imposes certain obligations to supply gas if capable of delivery and if the gas is available. Once the regulated merchant role is eliminated, the obligation on the LDC to deliver would remain, but the obligation to supply would be eliminated.

#### **4.6.2 Backstopping in the DME**

The Working Group agreed that backstopping arrangements are critical and it is prudent for any gas consumer to make appropriate backstopping arrangements.

To some in the Working Group, backstopping is simply one, albeit important, of many services to be provided by the market. To others, the focus of backstopping is on customer protection. The consumer protection issues related to backstopping and/or supplier of last resort are expanded on in Section 5.4. The functional and operational details of backstopping and supplier of last resort alternatives are discussed in this section.

**Working Group Alternative: LDC as Backstopper.** In this alternative, the LDC would assume backstopping and supplier of last resort functions, in largely the same manner as it does today. The price of such service could be based on the current market price for replacement supply or it could be pre-contracted and pre-sold by the LDC. The price of the pre-sold backstopping service would be market-derived, using risk management tools. Net LDC revenues from backstopping would be used to offset distribution costs.

By definition, the DME does not include a merchant function for the LDC. However, the “LDC as Backstopper” alternative would exist in the transition until it can be demonstrated that backstopping could be adequately provided by the market.

A variation on the current LDC supplier of last resort regime could be a system supply safety net. This safety net could be held as permanent inventory or be cycled. If it were held as permanent inventory, the inventory would be replaced after it was drawn down and the costs of the replacement inventory would be charged to those customers who utilized the safety net. The costs of the permanent inventory (return on rate base, inventory carrying cost, and storage costs) would be included in cost of service. If the inventory were cycled, the gas could be purchased and injected in November and December to minimize the cost of storage. In the spring, the unused supply would be sold into the market to empty storage prior to the peak storage injection period.



**Working Group Alternative: The Market as Backstopper.** Three possible market mechanisms were identified. From an operational standpoint, these three mechanisms are similar. Each relies on the market to provide backstopping provisions, either on a pre-purchased basis (supply pool) or at the time it is required (contracts and industry fund).

1. Commercial contract arrangements

End users and/or gas marketers could provide their own backstopping service through the development of a gas supply portfolio with appropriate contract flexibility. At the end-state, backstopping could be contracted to third parties, who would assume the responsibility for obtaining the required supplies at market-based prices when the LDC identifies a need for the supply.

2. Supply pool

Backstopping could be carried out through a supply pool operated by a group of end users and/or gas marketers active in the Ontario market. If backstopping for the supply pool were tendered periodically, the LDC could retain a small level of upstream transportation capacity and assign it as required, to facilitate the operation of the pool. The pool's backstopper could use this capacity as needed, and at all other times, sell it in the secondary market.

3. Industry insurance fund

This is a hybrid of the above two options. In the event of a failure, the LDC would initiate a process at whatever cost necessary to obtain backstopping supply. The gas marketer whose supply failed must cover the cost of backstopping service provided by third parties under contract. If the marketer fails to pay, an industry fund, supported through contributions from gas marketers, would guarantee payment of the costs.

### **4.6.3 The Transition**

During the transition period, while operational backstopping and emergency supply services were being implemented, the LDC would continue to have an obligation to provide delivery service under terms and conditions specified in the regulated tariff. The tariff would contain provisions tying the delivery obligation of the LDC to the supply and storage obligations of the end-use customer or gas marketer under its contracts with the LDC. There would also be provisions for non-performance, such as in the event of insolvency. Non-performance penalties would motivate parties to meet their contracted obligations.

## **4.7 SUPPLIER OF LAST RESORT**

### **4.7.1 Present Functions**

A supplier of last resort is responsible for serving markets that others choose not to serve or fail to serve (e.g., for reason of bankruptcy). It can be viewed as a default supplier. Currently the LDCs are obligated to supply and hence are obligated to perform the role of default supplier.

### **4.7.2 Supplier of Last Resort in the DME**

The term “supplier of last resort” is often used in two different ways. One is in relation to backstopping or security of supply, and refers to the party who will supply the end-use customer when there is contracting failure. The other meaning refers to the party who will supply an end-use customer that nobody chooses to supply. The second meaning is discussed in Section 5.7.

In a fully commoditized market, customers are ultimately responsible for ensuring their own security of supply. Therefore, it was the view of the Working Group that, while it may be desirable, it is not necessary to include a designated supplier of last resort in the DME.

The Working Group generally agreed to work to eliminate the supplier of last resort responsibility by taking the following actions:

- C promote legislative change allowing gas commodity title transfers in Ontario, removing the obligation to supply from the LDC, and introducing an obligation to deliver; and,
- C promote the development and establishment of operating standards (including penalties), contracts and tariffs to build appropriate customer protection measures into the marketplace.

### **4.7.3 The Transition**

A supplier of last resort may be necessary through the transition period. Once all customers have elected their gas marketer and there exist operating standards and other mechanisms to ensure customer protection in the new marketplace, a designated supplier of last resort would no longer be required.

During the transition, it is expected that sufficient operating balancing supplies, peaking supplies, and storage and transportation assets and contracts will be required by the LDCs to maintain an adequate level of supplier of last resort capability.

## **4.8 DISTRIBUTION**

### **4.8.1 Distribution in the DME**

Two components of this building block were identified: construction and maintenance; and, operation – gas control. The Working Group agreed this was a necessary part of the market end-state. Some issues regarding distribution are related to the safety building block (see Section 4.15). There will continue to be safety code requirements on the LDCs and appropriate routing of emergency calls in the DME.

The LDC would continue to be responsible for the overall design of the system. This would ensure consistency in design specifications and practices, consistency in adhering to safety regulation, and economies of scale for the construction of new facilities. The LDC would also continue to be responsible for the operation and control of the distribution system. Having a single entity controlling system pressures and flows would help ensure highly co-ordinated response to emergencies, maintenance of safety, and system reliability and integrity.

For incremental distribution delivery service, the LDCs would continue to build economically justified facilities, as approved by the OEB. In circumstances where the projected throughput was insufficient to justify expansion, end-use customers or their gas marketers could provide a contribution to help pay for the new facility.

### **4.8.2 The Transition**

The following functions would have to be assessed to determine an appropriate response, and to decide which entity should be responsible for each function:

- C planning for LDC facilities (including storage, transportation and distribution);
- C planning and contracting for upstream facilities including routing diversification to maximize Ontario's flexibility and attractiveness to key North American supply basins and transportation routes;

- C monitoring, evaluating and adjusting supply for weather and market impacts;
- C monitoring upstream pipeline operations and seasonal impacts due to construction coordination or outages; and,
- C emergency planning and coordination with other delivery companies and upstream service providers.

#### **4.9 SALES**

Five components of this building block were identified: gas molecule; delivery services; appliances; servicing of appliances; and, financing.

Some members of the Working Group argued that all gas marketers should have the same rights and opportunities to offer these services as the regulated LDC or its marketing affiliate. The Working Group accepted, for the purposes of moving forward with the discussions, that the issues related to the sales functions of the LDC, other than the sale of the gas molecule, were outside of the scope of the WGR.

#### **4.10 MARKETING**

Five components of this building block were identified: gas delivery services; appliances; servicing of appliances; financing; and, maintaining and building gas markets. In the view of the Working Group, it is desirable but not necessary to include marketing in the DME. The Working Group achieved consensus that the LDCs should be free to engage in generic marketing of natural gas to promote gas utilization and the attachment of customers. The larger issue of joint promotions with gas marketers was deferred to the Code of Conduct (see Chapter 6). Other than agreement on generic marketing, consensus was limited to an acceptance, for the purposes of moving forward with the discussions, that the broader issue of the role of marketing within the LDC was outside the scope of the WGR.

#### **4.11 BILLING/COLLECTION**

In the DME, customers should be able to choose from whom they receive their bill. Gas marketers should have access to an unbundled, wholesale distribution rate. If gas marketers

want to contract for billing and collection, the LDC would be required to offer a separate rate for these. Accordingly, the billing and collection systems of the LDCs will have to be changed. Beyond this it was accepted, for the purposes of moving forward with the discussions, that the role of billing and collection was a functional building block outside of the scope of the WGR.

#### **4.12 METER READING**

In the view of some members of the Working Group, it is not necessary to change the metering or meter reading service of the LDCs in the DME. In the view of other members it is necessary to offer customer choices with respect to meter reading and metering services in order to achieve additional savings and benefits for customers. In any event, the Working Group accepted, for the purposes of moving forward with the discussions, that issues related to changes to meter reading were outside of the scope of the WGR.

#### **4.13 DEMAND-SIDE MANAGEMENT (“DSM”) & ENERGY UTILIZATION SERVICES**

Some Working Group members believe that the LDCs should continue to support this function while other members believe that energy utilization programs should be offered by firms in the competitive market rather than the LDCs. Therefore, consensus was not reached as to whether specific DSM programs should continue to be provided by the LDCs in the DME or post-DME. This will remain an issue because the need for, and nature of, DSM will change as the market evolves. Through the transition, as long as the OEB continues to endorse DSM, it is anticipated that the LDCs will continue to pursue such programs.

#### **4.14 INFORMATION**

This building block is related to the LDCs’ roles in promoting generic benefits of gas as well as safety (e.g., “Call Before You Dig” programs).

In the view of the Working Group, in the DME, the LDCs will remain responsible for providing safety information to customers. It is expected that both the LDCs and gas marketers will provide information on both safety and economic issues which serve to enhance and move toward the DME.

## **4.15 SAFETY & INTEGRITY OF SYSTEM AND EQUIPMENT**

### **4.15.1 Present Functions**

The Working Group agreed that maintaining system and equipment integrity is a necessary part of the DME. The LDCs would continue to be responsible for the safety of equipment they own. Currently, the LDC has the right to curtail service to specific customers and has set pre-determined priorities for curtailment in the event of emergency supply failure.

### **4.15.2 Safety in the DME**

The Working Group agreed that no changes should be undertaken that undermine the safety and integrity of the natural gas system in Ontario. Despite the provisions made for backstopping supply in the event of supply failures, there may be emergency failures. Emergency failures are events of an actual or threatened shortage of gas due to circumstances beyond those contemplated or the control of the third party supplier of backstopping service.

### **4.15.3 The Transition**

The LDCs currently participate in the Eastern Canadian Mutual Assistance Plan (ECMAP). If the LDCs continue to participate in ECMAP and are still in the role of managing upstream transportation, it may be necessary for these utilities to include a provision in their assignment agreements which states that, in the event of a *force majeure*, the LDC has the right to recall firm transportation capacity.

Emergency operations will be affected if the LDCs no longer have title and control of supply. ECMAP could be modified to provide the LDCs with the right to manage emergencies in much the same manner as they do today. LDC shippers would be required to waive their rights to title, to allow for the allocation of supplies to essential firm markets. The LDCs could coordinate their activities to ensure that the effects of emergency curtailments were minimized on essential firm service. In addition, surplus deliverability could be built into the upstream assets to provide capacity in excess of normal requirements, to meet firm market demands in the event of an emergency. Brokering the capacity during non-emergency conditions could mitigate its cost. In addition, opportunity capacity would tend to moderate off-peak pricing. The LDC could recover the residual costs of the opportunity capacity (net of brokering) in cost of service.

During the transition period, new priorities for curtailment during emergency supply failures may need to be established by the OEB, which the LDCs would then implement.

#### **4.16 REGULATION**

The Working Group agrees that the OEB would continue to regulate the rates for distribution, storage and transmission services. To the extent the LDCs continue to offer system supply during the transition, that service would be subject to OEB oversight and the OEB would have the jurisdiction to regulate the associated LDC rates. In the view of the Working Group, it may be necessary in the post-DME for regulation to address changes in the risk the LDCs face. For a fuller discussion see Chapter 7.

## **5. CUSTOMER PROTECTION**

### **5.0 INTRODUCTION**

The Board's Market Review Report placed a great deal of emphasis on customer protection issues. Customer protection was considered to be integral to any changes intended to facilitate increased competition (Market Review Report, pages 8-9). The Working Group formed a subgroup to address these issues.

There was no consensus reached by the Working Group as to the appropriate level of customer protection regulation. In general, some parties preferred a set of procedures to implement broadly defined principles, while others argued that competitive market discipline and contracts would be sufficient to provide adequate customer protection. In the latter view, the Board should adopt the least intrusive approach and let the market work. There was a consensus that some of the customer protection mechanisms needed in the transition may no longer be required in the DME, as they would have achieved their desired results.

The Working Group's examination of customer protection issues focused on residential and small volume commercial customers. The Working Group believes that large volume commercial and industrial customers may require less oversight than smaller volume residential/commercial customers. Residential and small volume commercial customers are, however, to some degree protected by general consumer protection legislation.

Broadly defined, the key issues were:

- C the need to educate the public as to the changes that are occurring in the market;
- C the availability of a regulated supply option, and the terms and conditions to be made available to customers in the transition and end-state;
- C how security of supply of the commodity is to be realized;
- C barriers to competition in a deregulated market; and,
- C the level of regulation and handling of complaints.

### **5.1 CUSTOMER PROTECTION PRINCIPLES**

After reviewing the work in some other regulatory jurisdictions, the sub-group identified a list of



basic customer protection principles.<sup>11</sup> The Working Group recognized that there was a considerable difference of opinion as to how these principles should be implemented and what degree of regulation, if any, they warrant. Also, the implications of these principles for existing contracts were unresolved. With these considerations in mind, the Working Group agreed that the following principles should guide the Board and other policy makers in the design of customer protection measures.

- C All customers should have access to objective, accurate and helpful information that will enable them to evaluate competing supply options on the basis of price, quality, risk and terms of service, and to enter into contracts accordingly.
- C Customers should have supply choices involving meaningful trade-offs of quality (e.g., term, price risk) versus cost.
- C Customers should have mobility; i.e., not be unduly restricted from switching between gas marketers.
- C All choices offered to customers should meet industry-wide minimum safety and service criteria, and should fulfill advertised terms and conditions.
- C Some form of backstopping should be available for residential customers, to ensure that gas supply under the new market structure is as secure and readily available as it is under the current structure.
- C There must be a neutral, prompt, no-cost or low-cost and effective process for resolving customer complaints.
- C Personal information and account records should be kept confidential.
- C Contracts should be honoured by all parties, provided that the parties have been given reasonable opportunity to review and accept all the terms and conditions.

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<sup>11</sup> These were adapted from the list of principles adopted by California's Direct Access Working Group for its report to the PUC on "Consumer Protection and Education in a Restructured Electric Industry."

In addition to the above principles, some parties believe that the following principle should apply:

- C All customers with similar characteristics (“like customer groups”) should have access to the same supply choices and pricing options without discrimination.

## **5.2 CUSTOMER AWARENESS**

Because the natural gas industry is complex and most people currently have a limited understanding of it, it will be necessary in the evolving market to convey information on any changes to customers. Customers must be able to make informed choices, so that the most competitive suppliers are rewarded and the less competitive ones either improve their service offerings or suffer the market consequences.

Some Working Group members believe that the market on its own will not adequately protect customers. These parties agreed on several strategies for disseminating information to the general public, described in Sections 5.2.1 through 5.2.4.

Others took the position that the market can be relied on to convey sufficient information. Some parties in this group endorse many but not all of the components of the mechanisms described in Sections 5.2.1 through 5.2.4.

### **5.2.1 Multi-media Campaign**

Some parties agreed that bill inserts would not be sufficient to convey to customers the significant changes occurring in the marketplace. A multi-media customer education campaign, under the authority of an impartial body, should expose customers to objective information from multiple sources, including television, radio and newspaper (both paid advertising and news coverage). Alternatives for financing the campaign were considered, including the recovery of costs through a distribution charge. These parties agreed that the education process should begin as far in advance of the changes as possible.

They considered two alternatives to implement this measure. The industry as a whole could sponsor and direct the multi-media campaign. A drawback is that it might be very difficult to attain any degree of consensus on the contents of the campaign and the quality of the

information. Since a timely campaign start-up is of the essence, such a lack of consensus could jeopardize its effectiveness.

Alternatively the OEB or a Government of Ontario ministry (e.g., MOEE) could devise and implement the campaign; for example, by directly hiring and directing an advertising consultant. Some Working Group members were concerned that this might be seen within the industry as overly intrusive and heavy-handed and that the OEB or the Government may be reluctant to take on so active a role.

In any case the Board, or other third-party authority, would likely be asked to adjudicate differing options as to the overall cost and general nature of the campaign. Use of an advertising agency or consultant to produce materials, under the oversight of the Government or the OEB, ought to be considered.

### **5.2.2 Call Centre and Information Booklet**

Some parties agreed that an education campaign must include the means for customers to get more detailed information. For example, there should be explicit customer information, education and programs to help customers to develop load balancing options and unbundled services as alternatives to traditional LDC bundled services. A call centre might also assist customers in understanding what supply options they have and what risks and benefits are associated with each option. These services should be available in conjunction with the education campaign outlined above, for customers who indicate that they wish to receive more detailed information or answers to specific questions.

### **5.2.3 Customer Protection Code**

Some parties agreed that all gas marketers should be required to adhere to a customer protection code. A customer protection code was seen as necessary because natural gas is different from other products in that it is perceived as an essential service for residential customers.<sup>12</sup>

The customer protection code should cover service quality standards and rules on solicitation and switching, security deposit policy, cut-off policy and billing practices. This code should be

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<sup>12</sup> While a customer can substitute other fuels for natural gas in the long term, it is both impractical and costly for a residential customer to switch to other energy sources on short notice.

enforceable as a condition of licensing, or as a tenet of a voluntary industry association. The customer protection code will establish acceptable practices and standards. It would be better for the health and credibility of the industry to set common standards at the outset instead of reacting on an ad hoc basis to unacceptable practices in the future. This code should be developed by a stakeholder working group and approved by the appropriate forum. This code could build on the work of the DPIC code, including the ABC-T Addendum.

#### **5.2.4 Published Prices**

Some parties identified price transparency as an important aspect of effective competition. In order to provide customers with a perspective on natural gas prices, these parties proposed that weekly listings of price offerings from gas marketers be published in major newspapers. While gas marketers may offer differing services, the published prices would represent a benchmark service (such as a one-year fixed contract price). The information would also provide customers with a list of gas marketers, contract options and range of other prices as is deemed practical. These parties recognized that gas marketers would do individual advertising, but in the transition phase a more transparent and comparable mechanism of providing information is desirable.

### **5.3 THE TRANSITION TO MARKET OF SYSTEM SUPPLY CUSTOMERS**

Considerable time was spent by the Working Group on the issue of moving customers from regulated system supply to competitive market supply of gas. Under the current buy/sell and ABC-T services, there are options available to customers who do not want to be on system supply. While a significant number of residential and small volume commercial customers have chosen non-system options, a larger number remain on system supply. Some Working Group members noted that there is evidence that many small volume customers who have chosen direct purchase options are not aware that they are no longer supplied by the LDC.

Marketing by the gas marketers and the customer awareness program outlined above would be part of the program to help customers make informed choices in the new market. It was agreed by some Working Group members that, in the transition, customers must not be forced off the regulated system supply option. There was no agreement, however, on whether customers should be afforded the option of moving back from non-regulated to regulated supply.

It is clear that, whatever strategies may be employed to encourage customers to move to the

competitive market, some customers, from simple inertia or for some other reason, would be unwilling to change to non-regulated service. As the market evolves to the DME three questions arise from this conclusion:

- C when should a review of system customers be undertaken;
- C how would one determine if the customers' remaining on regulated system supply represented simple inertia or, more critically, a failure of the evolving market to be an attractive alternative to regulated supply; and,
- C if inertia, rather than market failure, were the reason for customers remaining on regulated system supply, what should happen to those remaining system customers?

The issue of regulated supply by a party other than the LDC was also discussed. Under this scenario, customers would have the option of choosing a supply of gas whose price was approved by the Board. However, it was determined that regulated cost-of-service supply necessitates a determination of appropriate costs that go into making up a particular rate. Nor was it immediately apparent what benefit regulated supply from a gas marketer would provide relative to LDC provision of this service.

### 5.3.1 Return to System Supply

The divergence of opinion described in Section 3.4 as to the timing and conditions of LDC exit from the merchant function is at the heart of two key issues: the need for LDC regulated supply, and the ability of all end-use customers to access that option. While there was general consensus that customer acceptance was the key in determining market success or failure, there was no agreement on how to measure customer acceptance.

Some members of the Working Group agreed that, during the transition, customers should be free to select non-system supply but not be forced off system supply. Currently, under buy/sell or ABC-T services, return to system is subject to some constraints. The Working Group could not come to any agreement on whether a similar provision should be maintained. The Working Group arrived at the options listed below.

**Working Group Alternative: No Return to System.** Some Working Group members argued that allowing return to system would be detrimental to the development of a fully competitive commodity market. This view postulates that, as long as system supply remains an option, customers will retreat to this supply source whenever they deem their

market supplier unattractive. Furthermore, it was argued that allowing unfettered access between regulated supply and gas marketer supply would make it overly difficult to arrange supply for customers. Allowing return to system may also increase the period in which conflicts must be resolved between the LDC, its affiliates and other gas marketers.

**Working Group Alternative: Return to System.** Other Working Group members argued that return to system provides a safety valve to an evolving and undetermined market. They noted that customers may choose regulated supply over the available competitive options and that denying system supply to customers may be denying them the lowest-cost gas supply option. If customers truly value unregulated gas options once they have some experience of the new market, then they will choose not to return to system supply. These parties argued that if they wish to return to system supply, then clearly they do not accept their unregulated alternatives, suggesting that those options are not sufficiently competitive.

Proponents of the “return to system” alternative countered the “no return to system” arguments by noting that contracts would be honoured, whatever arrangements are made by the customer, and that allowing customers to return to system would be no different than a customer under a one-year contract choosing to renew with a different gas marketer. Furthermore, it was argued that if the system supply option is available to those customers who never left the system, then it would be unfair and inappropriate to deny this option to other customers, who may have new accounts (for example, who have moved) or who may at some point in time have exited the system. Supporters of return to system noted that this policy is consistent with the principles of customer mobility and customer choice.

**Working Group Alternative: Time-limited Return to System.** Some members of the Working Group supported return to system, subject to honouring contracts and within the confines of a date certain. After the date certain, customers will no longer be able to return to system.

### 5.3.2 Allocation of Remaining Customers

It was accepted by the Working Group that at the end of the transition, even though unregulated gas supplies are an attractive alternative, all customers may not have elected a gas marketer. It was noted that currently the commodity makes up less than one third of a customer’s bill and

therefore even a price advantage may not provide sufficient incentive for all customers to leave system supply. For this reason some Working Group members argued that once the number of system supply customers falls to a certain pre-determined level, allocation of these remaining customers should be implemented. Others maintained that the “date certain” alternative proposed in Section 4.1.4 should be the trigger for allocation of system supply customers to gas marketers, irrespective of the reasons for which those customers may have remained on system supply.

Some parties opposed any form of allocation of customers.

A single method of allocating the remaining customers was not agreed upon. Some parties believe that it is most appropriate to wait until the point where an allocation becomes necessary, before choosing from among the following alternatives.

The discussion below applies only in the eventuality that the OEB at some point in time determines that system supply customers remain due to inertia, rather than having made a positive election to stay on system supply.

Any allocation process would have to address the terms and conditions of supply that would normally be included in contracts with the allocated customers. The allocation process would also have to address the timing of initial contracts with the allocated customers.

**Working Group Alternative: System Supply Customers Allocated to LDC Affiliate.**

Customers would be given information explaining the pending elimination of system supply and their assignment to the LDC affiliate if they do not select another gas marketer. Customers would be entitled to switch to another gas marketer on the first anniversary of the allocation at no cost, by notifying the affiliate at least 30 days prior to such anniversary.

Supporters of this alternative noted that assigning remaining customers to the LDC affiliate may increase the comfort level of those customers who wish to remain within the LDC family of companies.

**Working Group Alternative: System Supply Customers Below Threshold Allocated**

**to LDC Affiliate.** Some Working Group members proposed that, when the percentage of system supply customers fell below 20% of the total number of residential customers served by the LDC, the remaining customers would be assigned to the LDC's affiliate. This alternative is conditional on agreement by the LDC that it would actively encourage system supply customers to choose a non-LDC affiliate marketer and that the affiliate refrain from marketing in the interim.

**Working Group Alternative: System Supply Customers Allocated under a Supervised Auction.** The OEB would set the terms of service and conditions of supply, then invite gas marketers to bid for the right to supply these customers. The bids would be ranked by price; in order to be selected as a default supplier, the bidder would be obliged to serve customers at its bid price. The auction should take into consideration the financial and technical capability of any gas marketer to whom customers are allocated. The winning bid would get all of the customers, provided the Board was assured that the gas marketer could meet the terms and conditions of the bid. This approach should provide customers with secure gas at a competitive price. If the winning bid was insufficient to supply the total available market, a selection process may be required.

Proponents of this allocation method argued that allocating default customers directly to the LDC's marketing affiliate, unless it were to win the auction, was not acceptable as this would give the affiliate a windfall and would not protect the interests of the default customers.

**Working Group Alternative: System Supply Customers Allocated to an Industry Pool.** At the date certain, customers who had not elected an alternative supply would be allocated to an industry pool. Customers in the pool would be required to agree to release their names, addresses and phone numbers to market participants to facilitate attachment. This alternative necessitates a positive decision on an industry supply pool as outlined in Section 5.4 below. Other procedural and operational issues relating to the industry pool would need to be considered and resolved by the OEB and/or the Government.

#### **5.4 SECURITY OF COMMODITY SUPPLY – BACKSTOPPING**

The operational aspects of backstopping were addressed in Section 4.6 of the WGR. This section focuses on the customer protection aspects of alternative backstopping mechanisms.



Security of supply is highly valued by customers, particularly residential customers, and is critical during the winter season. All market participants have an interest in preserving the natural gas system's reliability. A key issue is whether or not mandatory backstopping mechanisms are necessary in the DME.

Some Working Group members believed that mandatory backstopping was necessary. These parties believe that, both during the transition and in the end-state, small volume customers will need a safety net supply, to ensure that gas service is maintained in the event of a failure to supply by their gas marketer (e.g., bankruptcy). Other members of the Working Group took the position that mandatory backstopping measures are unnecessary, as the market will provide adequate protection for whatever level of backstopping an end user or gas marketer prefers.

**Working Group Alternative: LDC as Supplier of Last Resort.** The operational aspects are covered in Section 4.6. Proponents of this alternative argued that having the LDC as supplier of last resort would ensure that supplies are available to deal with supplier failures and provide a bridging supply for customers. Acceptance of a "date certain" alternative (see Section 4.1.4) means some non-utility provision would have to be made for backstopping. However, proponents of this alternative argued that even if there were a date certain for the discontinuance of system supply, it would be desirable for the LDC to provide backstopping, until such time as it is shown that backstopping could be adequately provided by the market.

**Working Group Alternative: The Market as Backstopper.** The operational aspects are covered in Section 4.6. Proponents of this view argued that individual end users and/or gas marketers should provide for their own backstopping by contract. Some parties may prefer to self-insure against supply failure, some parties may wish to make backstopping arrangements and some may prefer to do nothing.

Some proponents of this view noted that if the Board were to decide in favour of mandatory backstopping, then either a mandatory supply pool or industry fund (as discussed in Section 4.6.2) would be an acceptable customer protection measure.

**Working Group Alternative: Mandatory Industry Fund.** The operational aspects are covered in Section 4.6. Parties supporting this alternative considered that a mandatory fund would capture the market advantages of contract-based backstopping, while ensuring customer protection. A key aspect of this view is that small volume customers

should be protected against significant cost consequences of supplier failure. Whatever the backstopping costs are, every effort should be made to collect the money from the gas marketer whose supply failed. If collection is unsuccessful (e.g., due to bankruptcy), then the costs should be covered by the industry fund. This mechanism would be similar to the customer protection insurance fund used in the travel industry.

## **5.5 EXISTING AGENCY AGREEMENTS**

Some Working Group participants identified existing ABM agency agreements as impediments to an effective competitive market. Mobility is essential to effective competition. If customers are mobile, then gas marketers will work harder to keep their customers satisfied. Individual customers may switch around unpredictably, but there is no reason to expect a tidal wave of customers to leave a gas marketer unless it is doing a terrible job. Also, gas marketers still have the option of offering fixed-price/fixed-term contracts; if they demand stability (long-term agreement) from their customers, then they must offer it in return (long-term fixed price). If the price is variable, then there are no grounds for customer commitment beyond one year at most. Customers must be allowed to make informed choices in the new supply market. For these reasons, some Working Group participants argued that buy/sell customers must be allowed out of existing agency agreements, unless they clearly understand the duration of the agreement.

Other Working Group participants argued that current contracts must be upheld and that current agency agreements should be changed only with the agreement of the gas marketer. It was argued that under the ABC-T option, most customers would naturally migrate from agency buy/sells to supplies based on fixed-price/fixed-term contracts.

The Working Group recognized that long-term agency agreements might significantly reduce customer mobility. As prices will be unregulated, there will be a need to ensure that prices are restrained through the market discipline created by customer mobility. Customers should be educated to understand the nature of the contracting options available and given a chance to select a new contract form once the existing agreements expire. It is preferable that the duration of the contracts match the duration of the price offers.

Some members of the Working Group believe that agency agreements do not need to be converted. Others recommend that agency agreements be converted in one of the following three ways.

**Working Group Alternative: Existing agency agreements converted to service/commodity sales contracts.** The maximum term of these contracts must be limited to the greater of the term of a fixed price accepted by the customer or one year. Sixty days prior to the end of the new contracts, the gas marketer must advise customers that the contracts are coming to an end and explain their options for terminating or extending the contract. Contract renewals would also be limited to the greater of the term of a fixed price accepted by the customer or one year.

**Working Group Alternative: Existing agreements honoured but new agreements limited to one year or the length of a fixed-price agreement.** The term of a fixed-price agreement must be explicitly chosen by the customer if it exceeds one year. At the expiry of an agency agreement, it should automatically revert to a year-to-year arrangement unless the customer explicitly chooses to renew with a longer term fixed-price agreement.

**Working Group Alternative: If the gas marketer wants to convert an existing agreement to a service/commodity sales contract as described above, the customer can opt out.** Most buy/sell customers signed up on the promise of a guaranteed discount off the utility gas prices. Under the new gas supply contracts, customers will lose the regulatory security they enjoyed under the buy/sell (which could be no more costly than regulated gas supply). This is not at all what they agreed to when they signed buy/sell agency agreements. Customers must not be forced into unregulated supply because of a contract they signed under entirely different circumstances. They should be allowed to make informed choices in the new supply market.

If the buy/sell mechanism is phased out, customers with existing buy/sell agency agreements could make explicit positive selection of a different supply option. If they do not make such a selection, they could be transferred to a Board-approved equivalent service or system supply (or the mechanism used to phase out system supply, if applicable).

## 5.6 ACCESS TO CUSTOMER INFORMATION

Some Working Group members argued that the natural gas market requires no greater protection of privacy than any other industry, and should be governed by general privacy rules. Others

argued for specific additional requirements, such as customers having a right to control the disclosure of any information (e.g., the name and address of the customer) to a third party. In this scenario, parties wanting to disclose customer information must obtain a specific release from the customer.

The Working Group agreed that information in aggregate non-attributable form may be useful to the market as a whole and is necessary for the LDC's efficient operation. Therefore customer information in aggregate non-attributable form can be disseminated in a non-discriminatory manner to market participants.

## 5.7 ACCESS TO SERVICE

The Working Group recognized that the principle of non-discriminatory access to supply applies to like customer groups (for example a residential customer may not have access to industrial service rates). The Group identified two main issues arising from the principle of non-discriminatory access to supply in a non-regulated natural gas commodity market.

**Security Deposits.** There was no consensus as to whether or not gas marketers would be required to serve customers who are poor credit risks. Some members of the Working Group believe that a refusal to serve such customers, if they are prepared to provide security deposits, would be discriminatory. They noted that the reason for a security deposit is to protect a gas marketer against possible non-payment. Each gas marketer's security deposit policy, which may be set on an industry-wide basis, should be applied uniformly to all of its customers within each class.

Other members believe that suppliers of natural gas should be under no greater obligation than the suppliers of any other product to serve poor credit risk customers. Some members of the Working Group noted that, depending on the structure selected, the poor credit risk customers who are not served by competitive gas marketers might be served by the default supply pool.

**Shut-off/Termination of service.** The Working Group agreed that the current ability of the regulated LDC to shut off service under the *Public Utilities Act* should be retained. The LDC would be able to terminate gas service only in the event that a customer did not pay the monopoly distribution charge. The Working Group agreed that the powers under the *Public Utilities Act* are related to monopoly services provided by a LDC and that the regulated LDC should not use the threat of shut-off to collect money owing to a third party gas marketer for

commodity sales. The right to refuse to pay for the commodity without losing access to the distribution system provides customers with an important counter-lever in disputes with gas marketers and therefore aids in developing market discipline.

If the gas marketer is liable for collecting the end-use customer's distribution charge and remitting it to the LDC, then the gas marketer must be given the right to instruct the LDC to shut off service in a manner consistent with current shut-off policy.

In the event that a customer whose gas supply was terminated by the gas marketer (e.g., for non-payment) did not arrange for alternative gas supply, shut-off would be allowed only as currently provided for. Commodity provided to a customer who is without contracted supply during the winter months could be supplied under the backstopping provisions outlined in Section 5.4. Alternatively, other parties believe that, after all reasonable efforts have been made to collect bad debts, the portion that accrues in winter beyond the normal shut-off point could be recovered through a charge included in distribution rates, independent of any backstopping mechanism.

## **5.8 COMPLAINTS PROCESS / LICENSING**

The issues of licensing and an effective complaints process are closely related. If customer complaints are backed up by enforceable sanctions, then a certain type of licensing regime is mandated as described below. The Working Group attempted to reach consensus on the complaints process before it turned to the issue of licensing. However, no agreement was reached on the best form of complaints regime in the transition and/or the DME.

### **5.8.1 Customer Complaints**

The Working Group agreed that a fair complaints process was essential to building public confidence in the new commodity market. However, opinion varied in the Working Group as to what constitutes a fair complaints process, and whether or not a new process was necessary.

**Working Group Alternative: Voluntary Compliance.** This is a best efforts dispute resolution. This measure is modelled after government or private sector customer protection agencies (e.g., DPIC), which use “moral suasion” to arbitrate disputes. The complaints process would have no statutory authority, and the only power of enforcement would be the removal of an offender from a voluntary industry association. Customers

would have recourse to the same legal protections (i.e., courts of law) as in any other markets. Supporters of this option noted that an additional legislated complaints process would be duplicative and an unnecessary added expense.

**Working Group Alternative: Enforceable Complaints Process.** The complaints process may be handled through an independent ombudsperson, the OEB or representatives of all stakeholders (industry, customers and government). While each variation had its advocates, there was agreement as to the need for legislation-backed, enforceable sanctions. Some parties believe that if there is an enforceable complaints process, it should exclude financial disputes. The enforceable complaints processes favoured by Working Group members were one of the following:

1. OEB Complaints Role. The OEB would be given legislative powers to resolve customer complaints. Many regulators have explicit complaints processes including, in some jurisdictions, the ability to hold hearings on a complaint that affects the public interest. A complaints process would allow the Board to monitor the evolving market and correct gross market failures that might occur in the transition phase.

2. Ombudsperson Stakeholder. Industry, customer and government representatives form a complaints triad. Legislative changes would give the panel enforcement powers. This solution is modelled on the Australian ombudsman office.

3. Ombudsperson Government Agency. In this model, the Government's existing Office of the Ombudsman would be empowered to settle industry-customer disputes. Supporters of this variation argued that not only must the complaints process be neutral, it must also be seen to be neutral, in order to have legitimacy with the public.

### **5.8.2 Licensing and Bonding**

The Working Group agreed that, at a minimum, registration of all gas marketers was necessary to building a competitive commodity market. The Working Group did not discuss in detail what specific elements of the gas marketers' activities would be covered through each of the licensing regimes. The discussions focused on the extent to which licensing is required.

There was no agreement as to whether or not gas marketers should be bonded. It was agreed, however, that if bonding were a condition of market participation, it should not be so severe as to

form a substantial barrier to entry.

The Working Group identified three “regulatory” regimes for gas marketers. From least to most onerous they are: voluntary industry association; industry self regulation; or, a third-party regulatory regime. Bonding requirements, if deemed to be appropriate, could operate in conjunction with any of the alternatives listed below.

**Working Group Alternative: Voluntary Industry Association.** Gas marketers could choose to join an industry association. The association would set rules of conduct, and standards of service, for its members. A gas marketer could still participate in the market without joining the association.

**Working Group Alternative: Industry Self-Regulation (Licensing or Registration).** Gas marketers would be required to join a self-regulating industry association, which would set rules of conduct and standards of service for its members. Those rules and standards must address all the above customer protection issues and principles. Mandatory licensing of all gas marketers, while likely, would be left in the hands of the association. Legislative changes might also be needed to give the association the power to enforce its rules and standards.

**Working Group Alternative: Third-Party Licensing.** The OEB or other Government agency is charged with the (annual) licensing of gas marketers. Third-party licensing ensures that the complaints arbitrator is neutral (or at least seen to be neutral). The body doing the licensing and setting the conditions of that licensing would also be responsible for dealing with complaints.

## 6. CODE OF CONDUCT

In its Market Review Report, the OEB noted that one of the Working Group's initial tasks should be to prepare, for the Board's consideration, a Code of Conduct that could be used to define acceptable operating rules between the LDCs and their marketing affiliates. That code was to be submitted to the Board for final review as soon as possible prior to April 30, 1997. The Board stated that it expected the code to deal with "issues such as the degree of separation between the LDC and its marketing affiliate, the appropriate use of LDC resources and access to customer information and monopoly services" (Market Review Report, page 13).

After considerable effort, the Working Group found that it was not possible to complete a Code of Conduct prior to a full discussion of the underpinning issues. Therefore, the Working Group advised the OEB in February 1997 that it had deferred its report on the Code of Conduct to the completion of the WGR.

Subsequently, the Working Group's plans for discussions on a Code of Conduct were changed. By letter dated March 12, 1997, the OEB requested that the Working Group consider a broader Code of Conduct that could apply to all diversified activities, not just the merchant function. This is referred to as the "General Code" so as to distinguish it from the gas marketer code.

Thereafter, ABC-T service matters, relating specifically to Consumers Gas Energy Inc., Consumers Gas and Consumersfirst Ltd., and generally to all participants in the Working Group, led the OEB to request, by letter dated March 26, 1997, that Consumers Gas, in consultation with the Working Group, report by April 18, 1997 on a Code of Conduct respecting its gas marketing affiliates. In a subsequent letter to Union/Centra, dated April 9, 1997, the Board indicated that it required a Code of Conduct, similar to the one being prepared by Consumers Gas, for transactions between Union/Centra and their marketing affiliate, Union Energy. The Board expected Union/Centra to participate in the development of the LDC Code and to file their code by the later of April 18, 1997, or their implementation date for ABC-T service. Extensive review and consultation with the Working Group participants ensued. In these discussions, the parties had reference to the OEB's Advisory Report to the Minister on Utility Diversification (May 15, 1996).

Consumers Gas and Union/Centra worked together to develop a Code of Conduct for LDC Relationships With Gas Marketers (including gas marketing affiliates) for review by the



Working Group. Consumers Gas filed a Code of Conduct with the Board on April 21, 1997. The next day, Union/Centra filed a letter with the Board indicating that they supported the Code. While the filed Code of Conduct represented Consumers Gas' position, it included input from the Working Group members. In addition, Consumers Gas filed a document on behalf of other parties, listing the deficiencies with the LDC Code from their perspective.

The OEB held a hearing into gas marketer code of conduct issues on April 29-May 1, 1997. The Board issued its Decision With Reasons, dated May 15, 1997, on an interim code.

In the letter of March 12, 1997, the Board had asked the Working Group to consider broadening its scope to develop a Code of Conduct that could apply to all diversified activities. The Working Group was unable to complete its discussions on the General Code because of the necessary time spent consulting with the LDCs on their gas marketer code of conduct.

## 7. LEGISLATIVE CHANGE

### 7.0 INTRODUCTION

This chapter describes the legislative changes that are required to remove the impediments to gas commodity title transfers in Ontario. Such changes are necessary for the development of the DME.

The Working Group agreed that full and effective competition is preferable to regulation. In light of the ever-changing and evolving marketplace and the inter-related nature of the issues presented in the WGR, the Working Group agreed that, at a conceptual level, in order to achieve the DME the OEB should not regulate whenever there is full and effective competition.

There is consensus on the legislative changes that must be made to eliminate impediments to gas commodity title transfers in Ontario. There is consensus that there ought to be a period during which gas commodity sales by the LDCs remain regulated. There was no consensus on when or whether regulated LDC gas commodity sales ought to end, or with respect to who ought to make that determination. There was no consensus as to the scope of the OEB's current powers to direct, supervise and enforce effective separation of monopoly and competitive functions and, as a result, whether legislative change is necessary to provide the OEB with such powers.

The legislative impediments to gas commodity title transfers within Ontario are described in Section 7.1. The legislative changes needed to eliminate those impediments are described in Section 7.2.

The range of views with respect to legislative changes is as follows:

**Working Group Alternative: "A"**. The following legislative changes should be made:

- C the legislative impediments to title transfers by end-use customers and gas marketers, but not LDCs, should be removed as soon as possible;
- C the legislative obligation to supply gas should be repealed or, in the alternative, should be converted to a legislative obligation to deliver, whereby the LDCs would deliver system supply and gas made available for delivery by end-use customers and gas marketers;

- C the OEB should continue to regulate the LDCs' rates for commodity sales, as well as for the transmission, distribution, and storage of gas, unless and until the OEB decides to forbear from the regulation of all or any of such functions;
- C the OEB should be given the discretion to forbear, in whole or in part and conditionally or unconditionally, from such regulation where the OEB finds, as a question of fact, that competition is or will be sufficient to protect the public interest; and,
- C conversely, the OEB should be precluded from so forbearing where the OEB finds, as a question of fact, that to do so would likely impair unduly the establishment or continuation of a competitive market.

**Working Group Alternative: "B"**. Alternative "A" is acceptable subject to the following:

- C the OEB is now sufficiently empowered to direct, supervise, and enforce effective separation of monopoly and competitive functions, but if the OEB is not, then further legislative changes will be necessary to provide the OEB with such powers; and,
- C when the regulation of LDC commodity sales ceases, the LDCs will not continue to sell the commodity and their participation in the gas merchant business will be through non-subsidiary affiliates, subject to an OEB-approved code of conduct.

**Working Group Alternative: "C"**. The following legislative changes should be made:

- C remove legislative impediments to title transfers and delete reference to sales of gas in section 19 of the *OEB Act*, but suspend application of amendments to LDCs until a date to be determined by the Lieutenant Governor-in-Council;

- C the legislative obligation to supply gas should be repealed or, in the alternative, should be converted to a legislative obligation to deliver, whereby the LDCs would deliver system supply and gas made available for delivery by end-use customers and gas marketers; and,
- C under this alternative forbearance is unnecessary, but should Alternative “A” be adopted, forbearance should be mandatory if “competition is or will be sufficient to protect the interests of end users.”

## **7.1 LEGISLATIVE BARRIERS TO THE SALE OF NATURAL GAS**

### **7.1.1 Ontario Energy Board Act**

Subsection 19(8) provides that “... no ... distributor... shall sell gas ... except in accordance with an order of the Board ...”. Such an order is presumably a rate order under subsection 19(1), which provides that “... the Board may make orders approving just and reasonable rates and other charges for the sale of gas by ... distributors ...”. Subsection 1(1) provides that a “distributor” is “a person who supplies gas ... to a consumer.” Although the term “supply” is not defined, the Board has held that it comprehends both delivery (transport) and sale (title transfer) of gas.

These provisions, taken together, require that a person who wishes to sell gas to an end-use customer must first obtain a rate order from the Board. These provisions do not require a rate order for sales to persons who are not end-use customers. As a result, title transfers to intermediaries are not regulated under this statute.

Section 25 provides that “... in the absence of an agreement to the contrary ... no distributor shall voluntarily discontinue distributing gas by pipeline to a consumer without the leave of the Board.” Distributing means “supplying” by virtue of subsection 1(1) and, as a result, section 25 governs vendors of gas as well as the LDCs.

### **7.1.2 Municipal Franchises Act**

Subsection 3(1) provides that a person may not supply gas to the inhabitants of a municipality without first obtaining a by-law granting a franchise to do so. Under section 9, the Board must approve such a by-law before it is submitted to the municipal electors for their assent. The

Board may also dispense with such assent.

In subsection 3(1), the term “supply” connotes the sale as well as the delivery of natural gas. The subsection refers to two distinct functions: first, operating natural gas works (transporting gas) and, second, supplying or selling gas to municipal inhabitants.

Subsection 8(1) provides that “... no person shall construct any works to supply or supply ... natural gas in any municipality” without the Board's approval; that is, without a certificate of public convenience and necessity issued under subsection 8(2). As with subsection 3(1), subsection 8(1) makes a distinction between the facilities used to supply gas, on the one hand, and the supply of gas on the other, such that the term “supply” connotes a sale or another form of title transfer as well as a delivery. The requirements of subsection 8(1) therefore apply to the sale or other form of title transfer as well as to the transportation of gas.

### **7.1.3 Public Utilities Act**

Section 55 imposes a supply obligation on corporations owning or operating “public utilities” (e.g., natural gas). It is noteworthy that section 55 does not appear to tie the supply obligation to the operator of the pipeline, because the section imposes the obligation on a corporation with “a sufficient supply of the public utility,” using “any supply pipe,” rather than the corporation's supply pipe. In other words, the obligation to supply is not confined to LDCs but, instead, would govern vendors of gas as well.

Subsection 58(1) imposes a by-law requirement on companies that supply a public utility, which includes natural gas.

## **7.2 LEGISLATIVE CHANGES**

### **7.2.1 Ontario Energy Board Act**

The definition of “distributor” in subsection 1(1) should be amended by substituting the word “delivers” or “transports” for the word “supplies.” This would be sufficient to exclude vendors of gas from the definition of “distributor” and therefore from regulation under section 19.<sup>13</sup>

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<sup>13</sup> Working Group Alternative “C” also contemplates changes to section 19.

Section 25 should be repealed or, in the alternative, amended to make it clear that there is no delivery obligation in the absence of a concomitant supply of the commodity.

Part II contains a definition of “distributor” that would include vendors of gas. Part II has not been proclaimed in force. In an era of deregulation of sales of the commodity, perhaps Part II should be repealed in its entirety on the ground that the marketplace will set priorities and allocate supply in the event of gas shortages. Otherwise, it will be necessary to carefully work through the provisions to determine the role of vendors of gas as well as the LDCs in the context of gas shortages and allocation plans.

### **7.2.2 Municipal Franchises Act**

Subsection 3(1) should be amended by deleting the phrase “or to supply to the corporation or to the inhabitants of the municipality or any of them, gas, steam or electric light, heat or power,” such that subsection 3(1) would apply only to physical works. This amendment would require an amendment to subsection 5(1), in order to delete the words “or services.” However, references to supplying gas in subsection 6(1) can remain.

Continuing with the franchise provisions of the statute, subsection 9(1) should be amended as follows:

- C clause (b) should be deleted in its entirety,
- C in clause (c), the phrase “or the services mentioned in clause (b)” should be deleted, and
- C in clause (d), the phrase “any right mentioned in clause (a) or (b)” should be revised to read “the right mentioned in clause (a).”

Similarly, subsection 10(1) should be amended by deleting the phrase “or to supply gas to a municipal corporation or to the inhabitants of a municipality.”

Turning to the certificate provisions of the statute, subsection 8(1) should be amended by deleting the words “or supply” immediately before clause (a). For greater certainty, consideration should be given to amending clause (a) by substituting the phrase “operating works to supply gas” for the phrase “supplying gas.”

### 7.2.3 Public Utilities Act

Section 55 currently applies to vendors of gas as well as the LDCs and, as a result, section 55 should be repealed or, in the alternative, amended to apply only to the LDCs and not to vendors of gas. As described earlier, the by-law requirement in subsection 58(1) constrains the sale of gas. In the light of the “statutory mechanics” of the statute, however, it will take more than a simple amendment to subsection 58(1) to eliminate the constraint.

The problem arises in section 57, which makes Part V applicable to “every company incorporated for the purpose of supplying any public utility.” This provision could be amended to read (consistent with the parlance of the statute) “every company incorporated for the purpose of operating works to supply any public utility.” In this event, subsection 58(1) would no longer constrain title transfers, but the other two subsections of section 58 could continue to function as they do now.

Section 59 would then apply only to the LDCs, because the term “company,” as defined in section 57, would not include vendors of gas.

Section 60 is an anachronism and should be repealed.

## **8. CONCLUSION**

The OEB should proceed as soon as possible to examine the issues in a hearing and/or such other process as the OEB deems appropriate. The Board should provide the Government of Ontario with a set of recommendations to aid the removal of barriers to gas commodity title transfer in Ontario, including necessary legislative changes.

The OEB should proceed within its jurisdiction to facilitate movement toward a fully competitive natural gas commodity market in Ontario.



**APPENDIX A: WORKING GROUP CONTRIBUTING PARTIES**

<p>A.E. Sharp Limited                  Alliance Gas Services                  Association of Municipalities of Ontario                  CanEnerco Limited                  CENGAS                  Centra Gas Ontario Inc.                  Cibola Canada Energy Marketing Company                  City of Kitchener                  Comsatec Inc.                  Consumers' Association of Canada                  The Consumers' Gas Company Ltd.                  Direct Energy Marketing Limited                  ECNG Inc.                  Energy Probe                  Enershare Technologies                  Engage Energy Canada                  Enron Capital &amp; Trade Resources Canada                  HVAC Coalition                  Industrial Gas Users Association                  London GasSave                  London School Board Consortium</p>	<p>Mutual Gas Association                  NGC Canada Inc.                  NGW                  Ont. Assoc. of Physical Plant Administrators                  Ontario Coalition Against Poverty                  Ontario Natural Gas Association                  Ontario Petroleum Institute                  PanEnergy Marketing Limited Partnership                  Shell Canada                  Sunoco Inc.                  TransCanada Gas Services a Division of                      TransCanada Energy Ltd.                  TransCanada Pipelines Limited                  Union Gas Limited                  Westcoast Gas Services Inc.</p> <p>* Ontario Energy Board                  * Ministry of Environment and Energy</p> <p>* OEB technical staff participated by assisting the contributing parties. MOEE staff supported the Working Group's Phase 1 discussions, to obtain a better understanding of issues related to further deregulation, and to assist the Group in the interpretation of government policy as appropriate. The Ministry did not participate in the discussion of the Group's positions on the issues for recommendation to the Board.</p>
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**APPENDIX B: GLOSSARY — Definitions as used in the Working Group Report**

**ABC-T Service:** the combination of bundled T-service, including load balancing, and Agency Billing and Collection (ABC) Service. The LDC provides bundled T-service to an ABM, as agent for customers, whereby the LDC transports and delivers the gas that customers have purchased through the agent. The agent sets the terms and conditions of gas supply with the customer. The LDC also provides ABC service to the ABM as principal whereby the LDC bills and collects the costs of such gas supply.

**ABM:** an agent, broker or marketer of natural gas.

**Agency Agreement:** contractual arrangement between an end use customer and gas marketer, to enable the gas marketer to act as an agent on behalf of the end-use customer for the purchase of gas supplies.

**Ancillary Services:** those activities other than those directly related to the distribution function.

**Assignment:** contractual arrangement for transportation capacity (and/or gas supply) and associated obligations, between two parties, which may be facilitated by the LDC. Unlike what occurs with a **Release**, some of the contract obligations of the assigning party would remain with that party.

**Backstopping:** a service whereby alternate supplies of gas are available in the event a buyer's gas supply fails to be delivered as contracted.

**Bcf:** billion standard cubic feet, a measure of natural gas volumes, approximately equal to 28 million cubic meters ( $28 \times 10^6 \text{m}^3$ ).

**Bundled Service:** LDC services, including transportation, storage and load balancing, that are aggregated into a single service.

**Burner Tip:** the price discovery point at the end-use customer's meter.

**Burner-tip Price:** price that an end user would pay when all costs are included (i.e., at the user's "burner tip").

**Burner-tip Sales:** this term is a synonym for **Gas Commodity Title Transfers**.

**Buy/Sell:** under a buy/sell arrangement, the user buys its own supply of gas from a producer or marketer at a negotiated price. The user sells the gas to the LDC either at the Alberta border or at a TransGas/TCPL interconnection point (a “Western” Buy/Sell) or at the LDC’s transmission interconnection point (an “Ontario” Buy/Sell). The LDC mixes the gas with the balance of its gas supplies, and then delivers and sells to the user as a sales customer under the appropriate approved rate schedule.

**C1 Service:** short-term storage and transportation service on the Union Gas system.

**Capacity Constrained Interruptible Delivery Service:** an interruptible delivery service offered by the LDC that is designed and available on the basis of capacity, not molecule, constraints.

**City Gate:** physical location where gas is delivered from the pipeline company or LDC’s transmission system to the LDC distribution system .

**Code of Conduct:** a set of rules, regulations or guidelines governing the conduct between parties.

**Consumer:** this is a synonym for **End-use Customer** or **End User**.

**Curtailed Capacity:** customer-designated transportation capacity on a pipeline or LDC system that the customer can elect to curtail.

**Curtailement:** the discontinuance of service for any reason within the bounds of a contract or rate schedule, other than reason of interruption under interruptible service.

**Customer Information Package (CIP):** the information to be made available to all LDC residential and small volume commercial customers, describing the availability of natural gas purchasing options, including ABC-T service, on an LDC specific basis.

**Daily Standby Service:** service pre-contracted with ABMs or customers to provide a contractual means of providing daily balancing of the LDC system.

**Demand Management:** see Demand-Side Management

**Demand Side Management (DSM):** actions taken by an LDC or other agency which is expected to influence the amount or timing of a customer's energy consumption.

**Direct Purchase:** natural gas supply arrangements negotiated directly between suppliers or gas marketers and end users.

**Distribution:** the delivery of gas from the city gate through LDC facilities to end-use customers.

**DME:** see Section 3.1.

**Downstream Storage:** storage that is available downstream of the transportation system, in Ontario. This is as opposed to upstream storage, which is available upstream of the pipeline transportation system, in gas production areas such as Alberta. Storage is used to manage variations in delivery and consumption.

**DPIC:** the Direct Purchase Industry Committee which is a voluntary organization comprising industry participants including ABMs, transporters, government, industrial and consumer group representatives and LDCs.

**ECMAP:** Eastern Canadian Mutual Assistance Plan is a voluntary arrangement between TCPL, Nova Transmission, Centra Gas Manitoba, Centra Gas Ontario, Consumers Gas, Union Gas and Gaz Metropolitan to plan for managing gas supply emergencies in eastern Canada.

**End-Use Customer:** burner of, or feedstock user of, natural gas.

**Ex-franchise:** location outside of the bounds of LDC's approved service territory.

**Firm Transportation (FT):** transportation capacity available from TCPL on a firm basis for a specified maximum daily volume of gas. It cannot be curtailed or interrupted, except under extraordinary circumstances.

**Fully Commoditized:** a market in which the product (natural gas or transportation capacity) is subject to many buyers and sellers and in which no single market player is able to control the price of the product. In the Working Group Report "fully commoditized" also refers to the post-DME period, in which upstream transportation capacity is all held by the gas marketers and/or

end-use customers and is tradeable.

**Fully Unbundled Service:** LDC service whereby all components of the service are made available and charged to customers on an individual basis.

**Gas Commodity Title Transfers:** the sale or other disposition of natural gas by or to any person.

**Gas Marketer:** a party that buys and resells gas. Gas marketers can also perform a variety of related services including arranging transportation, monitoring deliveries and balancing. Gas marketers may include natural gas producers, including those producers located in Ontario.

**Hub:** a geographic location where measurement, storage and/or pipeline interconnections allow multiple participants to trade in physical or financial services.

**Interruptible Service:** contracted transportation or gas service subject to the right of the LDC or pipeline company to interrupt such service.

**ISO:** Independent System Operator (see Section 3.5.2).

**Liquid Trading Points:** trading points characterized by many buyers and sellers and with a high level of trading activity, open interest and timely price discovery.

**Load Balancing:** Users seldom use the same volume of gas every day of the year due to operational and weather factors, but for operational, reliability and economic reasons they normally purchase daily fixed volumes of transportation and gas supply. Load balancing involves meeting fluctuations in demand and supply that occur. This is typically accomplished by varying total daily supply deliveries or making delivery or withdrawal through underground storage facilities.

**Load Factor:** a mathematical indicator of the way in which a party takes gas over a year. It is expressed as a percentage of the average daily volume of gas taken over a year relative to the maximum daily volume.

**Local Distribution Company (LDC):** company providing distribution services for natural gas. In Ontario, these companies include Centra, Consumers Gas and Union. Other LDC's include

Kingston PUC, Kitchener Utilities and NRG.

**M12 Service:** long-term storage and transportation service on the Union system.

**Merchant Gas Function:** those activities that are essential to the supply of the gas molecules to the LDC's interconnections with upstream pipelines and the subsequent sale to the end-user.

**MMcf:** million standard cubic feet, a measure of natural gas volumes, and approximately equal to 28 thousand cubic meters ( $28 \cdot 10^3 \text{ m}^3$ ).

**MOEE:** Ministry of Environment and Energy

**Multi-point Balancing:** the requirement for Buy/Sell or Bundled T-service customers to match deliveries and actual consumption within specified contractual balancing constraints at multiple times during a contract year.

**Open Season:** a period of time when all parties are given equal consideration in a queue for service.

**Opportunity Capacity:** capacity above the average day requirements available to facilitate transactions. It is available in anticipation of growth and to meet the market's need for flexibility.

**Peaking Customers:** those customers with a need for incremental transportation and gas supply to meet peak day demand where such demands are in excess of FT capacity.

**Peaking Supplies:** supplies that are required on an incremental basis to meet customer requirements for a limited number of days at the period of the customer's maximum demand.

**Post-DME:** the period that occurs after the Discussion Model End-State (DME) has been achieved.

**Price Discovery:** prices determined and disclosed on a timely basis by market forces characterized by many buyers and sellers.

**Price Transparency:** prices determined and disclosed on a timely basis such that neither

individual buyers or sellers nor the magnitude of individual transactions are identified.

**Recall:** the right of the shipper of record on the TCPL system to recall assigned FT capacity to meet operational requirements.

**Regulated Range Rates:** LDC rates which are negotiated within a range of approved rate levels.

**Release:** any legal mechanism by which the benefits and obligations of a contract are terminated.

**Reservation Fee:** fee required to reserve capacity , similar in structure and function to a demand charge.

**Return to System:** the right of an end user who was previously supplied under a direct purchase arrangement to again obtain its gas supply from the LDC.

**Secondary Market:** a market characterized by the reselling of regulated services at unregulated prices. In a true commodity market no secondary market exists.

**Storage:** see **Downstream Storage**.

**Storage Transportation Service (STS):** service available from TCPL that involves deliveries of gas into downstream storage in the summer and withdrawals in the winter, both subject to separate contractual provisions.

**Stranded Benefits:** benefits resulting from the disposal of assets no longer required by the LDC where such benefits are greater than the underlying costs.

**Stranded Costs:** costs associated with certain LDC assets that are no longer required by customers or ABMs under a reorganization of services and where upon disposal, costs are greater than revenues.

**Supplier of Last Resort:** supplier responsible for serving market that others choose not to serve (i.e., the default supplier).

**System Supply:** gas supply that is currently purchased by the LDC and is supplied (and sold) to

all end-use customers who have not made direct purchase arrangements. Sometimes referred to as “system gas” or “system gas supply.”

**Transition:** refers to the period from the present to the DME

**T-Service:** transportation service provided by pipeline companies or LDCs for the transportation of gas not owned by the pipeline or LDC. This service may be either bundled or unbundled.

**UDC:** unabsorbed demand charges. These occur when a shipper utilizes less than its contracted transportation capacity on a pipeline system where demand charges are being incurred.

**Unbundled Service:** LDC services related to transportation and storage that are broken into their smallest operational components such as transportation, storage and load balancing services.

**Upstream Transportation:** transportation required (typically on TCPL) to transport gas from its production area to Ontario.

**WACOG:** Weighted Average Cost of Gas. Formula used to determine the cost of gas underlying the LDC’s sales rate.

**WGR:** The Working Group Report.



**APPENDIX C: WORK PLAN AND MARKET TRANSACTION DIAGRAM**

## APPENDIX D: INDEX OF RESPONSES TO THE BOARD REPORT QUESTIONS

In Appendix “C” of the Board's Market Review Report it laid out a number of questions. This Appendix provides a concordance between the questions in the Board's Market Review Report and the WGR. The Board’s questions have been numbered for ease of reference.

### A. Legislative and Regulatory Issues

A1) What legislative changes are required to remove the monopoly on burner tip sales?

**Response:** See Sections 7.1 and 7.2.

A2) Should the principles that were relied on in previous OEB Decisions be re-examined?

**Response:** The WGR Discussion Model End State was reviewed against the principles described in Section 3.3. These principles are consistent with the principles that were relied on in previous OEB Decisions.

A3) Can separation be permitted or enforced under the current legislation?

A4) What degree of separation or deregulation can be undertaken without legislative change?

**Response:** See Chapter 7.

A5) What are the appropriate roles of the Board and the LDCs during and after the transition?

**Response:** This question is addressed throughout Chapters 4, 5, and 7.

A6) What is the appropriate regulatory approach during and after the transition?

**Response:** This question is addressed throughout Chapters 4, 5, and 7, particularly Sections 4.15 and 7.0.

A7) How should the storage contracts and rates approvals be treated?

**Response:** See Section 4.4.

### B. Security of Supply Issues

B1) How should backstopping and load balancing be provided?

**Response:** See Section 4.5, 4.6. and 5.4.

- B2) Who should act as the supplier of last resort?  
B5) Who should the default supplier be and how should standby services be provided?  
**Response:** These questions are addressed in Sections 4.7 and 5.4.
- B3) How should return to system be handled?  
**Response:** See Section 4.1.4.
- B4) What curtailment provisions are required?  
**Response:** See Sections 4.5.1 and 4.5.2.
- B6) How should the obligation to serve be changed?  
**Response:** See Chapter 7.
- B7) How should assignments and recall rights be used?  
**Response:** See Section 4.2.4.
- B8) What type of non-performance penalties should be used?  
**Response:** See Section 5.4.
- B9) How should emergency supply allocations be conducted?  
**Response:** See Section 4.16.3.

### C. Customer Benefit Issues

- C1) What amount of customer awareness and customer protection is required?  
**Response:** See Chapter 5.
- C2) Would customers need a system supply safety net?  
**Response:** See Sections 4.1.4 and 5.3.
- C3) How should security of supply be ensured?  
**Response:** See Section 5.4.
- C4) How should customers be allocated to non-utility suppliers?  
**Response:** See Section 5.3.2.

C5) Should customers be forced off system gas?

**Response:** See Section 4.1.4.

C6) How should customers be converted?

**Response:** See Section 4.1.4 and 5.3.2.

C7) What public interest concerns should be considered?

**Response:** See Section 3.3.

#### **D. Transitional Issues**

D1) How should a utility's assets be valued and separated between utility and non-utility activities?

**Response:** This question is addressed in general in Section 3.4 and for storage in Section 4.4.5.

D2) How should stranded asset costs be treated?

**Response:** This question is addressed for upstream transportation contracts in Section 4.2 and for gas supply contracts in Section 4.1.2.

D3) What is the preferred timing for the transition?

**Response:** See Sections 4.1 and 4.2.

D4) Should phased introduction to different market segments be used?

**Response:** Transition issues are discussed in the relevant sections of Chapter 4.

D5) How should upstream transmission capacity be allocated?

**Response:** See Sections 4.2 and 4.3.

D6) How should storage capacity be allocated and priced, and who gets the profits?

**Response:** See Section 4.4.

D7) How should system gas supply and the current supply options be phased out?

D8) How should separation be implemented?

**Response:** These questions are addressed in Sections 4.1 and 5.3.

- D9) How should industry disputes and customer complaints be resolved?  
**Response:** See Section 5.8.1.

### **E. Competitive Market Issues**

- E1) What should be contained in the code of conduct?  
**Response:** See Chapter 6.
- E2) What safeguards are required to ensure fair competition?  
E3) How should market power or market consolidation be monitored?  
**Response:** These questions are addressed in Chapter 5.
- E4) What standard rates should LDCs offer?  
E7) How should services be unbundled and rates assigned?  
**Response:** These questions are addressed in Sections 4.4.6, 4.5.3, and 4.6.3.
- E5) How can open access to monopoly services be ensured?  
E11) How would customer who have poor credit ratings be served?  
**Response:** These questions are addressed in Section 5.7.
- E6) Should equal access be provided to customer information?  
**Response:** See Section 5.6
- E8) How should storage be treated?  
**Response:** See Section 4.4.
- E9) Are broker service standards, licensing/certification, bonding required?  
**Response:** See Section 5.8.2.
- E10) What impact would separation have on system efficiency?  
**Response:** See Section 3.4.
- E12) Who will provide the commitment to justify new transmission capacity?  
**Response:** See Section 4.2.5.
- E13) How would DSM programs be sustained? **Response:** See Section 4.13.