

REPORT ON LEGISLATIVE CHANGE

December 16, 1997

EXECUTIVE SUMMARY

PREAMBLE

The Board issued its Report on the Ten Year Market Review of Natural Gas Deregulation in September 1996. The Report set out the issues that the Board felt needed to be examined concerning the development of a more efficient natural gas market in Ontario. A Working Group¹ on Natural Gas Markets was established and delivered its Report (WGR) in May 1997. The WGR set out a desirable end-state for a deregulated market and, although unable to reach a full consensus on a pathway to the end-state, the stakeholders reached agreement on two key areas:

- there should be immediate action to remove legislative impediments to gas commodity title transfers; and
- the Ontario Energy Board (OEB) should not regulate in areas of the market where there is full and effective competition.

The Board has considered the WGR and the views of the Working Group stakeholders and is of the view that the removal of impediments to gas commodity title transfers will facilitate a move to full retail access and competition in the Ontario natural gas commodity market. The Board also believes that the public interest will be best served by a managed process to encourage market restructuring while protecting gas customers during the transition.

The key features of the transition should include:

- enabling gas commodity title transfers in Ontario;
- continued regulation of the monopoly storage, transportation and distribution functions of the local distribution companies (LDCs);
- a transitional regulated LDC supply option to replace system gas supply;
- redefinition of some LDC services, including load balancing and backstopping;
- establishment of a licensing scheme and Self-Management Organization (SMO) for gas marketers and suppliers; and
- strengthening consumer protection and enhancing consumer education.

The Board's current legislation needs amendment to facilitate the above changes and allow the Board to oversee the deregulation process and the maintenance of an effective natural gas market.

¹ A Glossary of Abbreviations and Technical Terms is appended at the end of this Report.

THE LEGISLATIVE REVIEW PROCESS

The Board was advised in mid 1997 that the Ministry of Environment and Energy (now the Ministry of Energy, Science and Technology) would be assisted by the Board's views on amendments to the *Ontario Energy Board Act* ("OEB Act").

The Board determined that it would seek to develop a set of enabling amendments to the relevant legislation to give effect to the WGR recommendations and pave the way for further deregulation of gas supply-related services, while ensuring protection of Ontario gas consumers and the public interest.

Accordingly the Board formulated a set of questions to inform its consideration of the required legislative changes and conducted a public consultation process with the key stakeholders during August 1997. The stakeholders expressed diverse views on the structure of the market, the roles of the various players, the form of regulation, the necessary legislative changes and the implementation schedule of the proposed changes.

I ENHANCING RETAIL ACCESS AND COMPETITION IN THE ONTARIO GAS MARKET

The Board agrees with the WGR that direct purchase gas supply arrangements authorized by the Board such as T-Service, Buy/Sell and ABC T-service have provided many of the benefits of a competitive natural gas commodity market to Ontario gas consumers. However, as some stakeholders pointed out, these mechanisms are administratively complex and confusing for gas consumers.

Some stakeholders expressed the view that further efficiencies could be gained through restructuring of the market by allowing full retail commodity competition and unbundling of some utility services.

The Board finds that removal of current legislative barriers to gas commodity title transfers is a necessary step to restructuring the Ontario natural gas retail market for full retail competition.

The Board does not believe that this should be done without a managed change process that will ensure customers continue to have safe, reliable supply and delivery of natural gas (i.e. system integrity) and that will enhance the overall level of market protection afforded to residential and other small volume gas users. The Board believes that the most effective means to achieve such protection would be through a suitably structured market which would include an industry Self-Management Organization ("SMO") operating under administrative agreement(s) with the Board and the Ministry of Consumer and Commercial Relations ("MCCR").

While the Board agrees that regulatory impediments to natural gas commodity title transfers in Ontario be removed as soon as possible, it believes that the effective implementation date should be when the retail gas market can be serviced by appropriately licensed Agents,

Brokers and Marketers (["ABMs"]). Licensing would be the responsibility of the Board. The SMO under the Board's delegation of authority could administer the licences.

The Board's recommended legislative changes to facilitate title transfers are for amendments to the OEB Act to:

- change the definition of a "distributor" and include an obligation to deliver;
- add a definition of a "gas supplier" and the obligations of gas suppliers; and
- corresponding amendments to the *Municipal Franchises Act* (["MFA"]) and the *Public Utilities Act* (["PUA"]).

In parallel the Board recommends:

- establishment of a licensing scheme for ABM's under a new "Sale of Gas" provision in the *OEB Act* and with reference to the *Consumer Protection Act* (["CPA"]) and the *Business Practices Act* (["BPA"]); and
- an administration agreement with a gas suppliers' SMO which will operate as the first line administrator of the industry and oversee codes and standards related to system integrity and marketing practices.

Given the separation of supply and distribution functions recommended above, there will be a need to reconsider certain practices in relation to discontinuing gas service. The Board recommends that the end-use customer's relationship with the franchised utility be maintained separately from the customer's relationship with the gas supplier. This would allow a customer to access the distribution system even when in default or dispute with a gas supplier so long as alternative supply can be arranged in an orderly manner consistent with distribution operational requirements. As a practical matter this requirement should not prohibit gas suppliers from packaging services and billing for both distribution and supply.

The Board expects the necessary operational details of maintaining the end-use customer's relationship with the monopoly distributor to be addressed by a market design Task Force and/or SMO.

II REGULATING THE MONOPOLY DELIVERY FUNCTIONS

The Board finds the existing *OEB Act* ill-suited to the proposed new retail market. A restructured market requires new regulatory tools to effectively supervise the redefinition of the LDC's monopoly services, to provide for more effective regulation of the remaining monopoly functions, and to allow the Board to refrain from regulation where this is appropriate. The regulator must have the power to order certain LDC functions to be unbundled or to be removed from the ambit of regulation, and to order a redefinition of, or the provision of, utility services where appropriate and in the public interest.

The Board is also concerned that it may not currently have the necessary powers to adequately supervise the restructuring of LDC services which rely on the system gas portfolio. To address these issues the Board recommends that a revised statute provide the

authority to:

- order either the removal from regulation, or redefinition of, current LDC gas transportation, storage and distribution functions and services;
- supervise the restructuring of utility services and rates so as to separate load balancing, backstopping and supplier of last resort service requirements from a regulated LDC standard gas supply option;
- establish and enforce rules governing gas suppliers' access and interconnection to the monopoly assets and services of the LDCs;
- enforce LDC Codes of Conduct; and
- choose the most appropriate and cost effective means of regulating monopoly services.

These powers are similar to those in recent legislation dealing with similar matters in other jurisdictions such as, for example, the new Nova Scotia *Gas Distribution Act*.

III CONSUMER PROTECTION AND MARKET OVERSIGHT

It is essential that the protection afforded to Ontario gas consumers during and after the transition to full retail access and competition is maintained and enhanced. Without consumer confidence in the change process and the restructured market, the competitive retail gas market will not reach its potential and will result in ongoing problems for consumers, industry and government. In the Board's view maintaining access to a safe, reliable supply of gas, customer choice and educating consumers about the changes occurring in the market are vital prerequisites to the success of a restructured retail gas market. The Board currently has no direct jurisdiction or oversight over the ABMs and no authority to protect gas users in the direct purchase market.

The Board finds that it should, in conjunction with MCCR and other government agencies, be given the authority to ensure sellers of gas operating in the Ontario marketplace meet certain standards of service. The Board should also act in an advisory capacity to the government during, and after, the transition to full retail competition.

The Board further finds that an increased level of customer information about the deregulated retail market will be required and believes that all stakeholders should actively participate in the required educational program.

A particularly contentious issue is possible discontinuation of the regulated LDC system gas supply option as advocated by the LDCs and ABMs. The Board notes current consumer disquiet with certain gas marketing and sales practices and cautions that more problems could result if customers currently receiving gas supply service from the LDCs were forced off this option prematurely.

To date, the market has been characterized by relatively low risk but with the recent substantial increase in the number of direct purchase residential customers on ABC T-Service, more customers may be exposed to increased price risk. There is also a potential risk from the possible reduction of the LDC's ability to provide functions which ensure system integrity.

The Board finds, on balance, that during the market transition following removal of impediments to direct retail sales of gas by ABMs, a restructured regulated supply offering by the LDCs is desirable to protect small volume customers, act as a benchmark of price and service quality, maintain consumer choice and ensure system integrity.

In addition to the recommendation that a licensing scheme for ABMs and an industry SMO be established to provide common industry standards and enhanced consumer protection, the Board also recommends legislation to ensure that:

- the regulator has the authority to order the LDC to provide or cease to provide a service so as to enable a regulated standard LDC gas service to be maintained by the LDC until the Board finds that market conditions, including consumer awareness, competition and industry self-management are sufficiently developed and/or the competitive gas market has grown to the point that a regulated standard LDC gas service option is no longer in the public interest.

These recommendations are intended to allow for the replacement of the regulated system supply with a regulated standard gas sale offering by the franchised distribution utility. In the transition to full retail competition the Board will require the authority to ensure the unbundling of system services, like backstopping and load balancing, from the standard gas sale offering. When the appropriate market conditions exist the Board would also have the authority to order the standard offering to be ended.

IV REGULATORY FRAMEWORK

The Board has so far outlined the direction of legislative amendments which will encourage restructuring of natural gas markets towards full retail access and enhanced competition while ensuring consumer protection and system integrity.

The Board has given some consideration to the appropriate regulatory framework which would not only enable the initial restructuring of the Ontario retail market, but also provide the ability to both deregulate other parts of the market which are currently monopoly functions and streamline the regulation of the remaining monopoly services where this can be demonstrated to be in the public interest and to the benefit of gas customers.

Continued deregulation of the market and effective regulation of the remaining utility monopoly functions will require the use of new regulatory tools such as performance based regulation, rule making and forbearance from regulation. In the rationalization process, the provisions of the existing Undertakings of the utilities and their shareholders designed to protect ratepayers should be incorporated into the new *OEB Act*.

The Board has also considered how changes in the gas supply and delivery sectors would affect the Board's other legislated and delegated powers to oversee the development of natural gas storage, transportation and distribution systems in the province.

The Board recommends that a new *OEB Act* include, in addition to the specific authority outlined above, the following requirements:

- a clear structure and plain language;
- authority for the Board to forbear, to implement performance based regulation and to exercise rule making;
- authority to inquire into and advise the Minister on matters related to the governance of the natural gas delivery system and market;
- powers and responsibilities related to natural gas storage;
- those aspects of the LDCs' Undertakings which require ongoing oversight and administration by the Board;
- a purpose section to assist in interpreting the Board's main responsibilities and public interest objectives; and
- other provisions necessary to provide symmetry between the gas and electricity sectors.

V. NEXT STEPS

1. Confirmation of policy directions.
2. Decision on the legislative approach and amendments or a new *OEB Act*.
3. Development of the detailed regulatory framework and legislative provisions.
4. Establishment of a market design Task Force to address operational issues and development of the industry SMO.
5. Development of comprehensive consumer information program(s).
6. Board proceedings to resolve outstanding issues.

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1. INTRODUCTION

1.1 THE TEN YEAR MARKET REVIEW

- 1.1.1 The Ontario Energy Board (the "Board") issued its Report on the Ten Year Market Review of Natural Gas Deregulation in September 1996. The Report addressed issues the Board believed should be examined in an effort to develop a more efficient natural gas market in Ontario. In response to that Report, a working group of stakeholders (the "Working Group") began a consultative that culminated in May 1997 with the submission to the Board of a report entitled: Toward a Fully Competitive Natural Gas Commodity Market in Ontario (the "WGR").
- 1.1.2 Subsequent to the filing of the WGR, the Board was advised that the Ministry of Environment and Energy (subsequently the Ministry of Energy, Science and Technology) would be reviewing provincial energy legislation. The Board was asked to assist the Ministry by providing its recommendations for changes to legislation governing the natural gas industry.
- 1.1.3 In a July 11, 1997 letter to members of the Working Group, the Board sought responses to questions related to legislative changes. The Board subsequently held a stakeholder consultative in August 1997.

1.2 THE WORKING GROUP CONSENSUS

1.2.1 The WGR contains a number of proposals for change to the natural gas market in Ontario. Two of these proposals received the support of all of the stakeholders: that legislative impediments to the transfer of title, or sale, of natural gas by anyone other than a local distribution company (‘‘LDC’’) should be removed as soon as possible; and, that the OEB not regulate whenever there is full and effective competition.

1.2.2 The Working Group noted:

- under the *Ontario Energy Board Act* (‘‘OEB Act’’) a person wishing to sell gas to an end-use customer must first obtain a rate order from the Board;
- under the *Municipal Franchises Act* (‘‘MFA’’) the term ‘‘supply’’ has been interpreted as incorporating both the supply and distribution of gas; therefore a party wishing to buy or sell natural gas within the province would also be required to meet the requirements of this *Act*; and
- under the *Public Utilities Act* (‘‘PUA’’), the term ‘‘public utility’’ is interpreted as incorporating both the supply and distribution of natural gas; therefore the obligation to supply is imposed on both distributors and vendors of gas.

1.2.3 The Working Group’s view was that new legislation separating distribution from supply would allow parties to exchange title to natural gas without having to seek from the Board a Certificate of Public Convenience and Necessity and approval of franchise agreements with local municipalities. Such amendments would also relieve the regulated LDC of its obligation to provide the commodity of natural gas.

1.3 ELECTRICITY WHITE PAPER

1.3.1 The Government has recently issued its policy paper Direction for Change: Charting a Course for Competitive Electricity and Jobs in Ontario (‘‘Direction for Change’’). The Board has endeavoured to achieve symmetry between the public policy objectives articulated in the Direction for Change for electricity and its recommendations on further gas deregulation, while recognizing that differences exist between the two sectors and that gas deregulation is considerably more advanced. Some of the Board’s recommendations, like those on licensing, may be applicable to the electricity sector.

2. THE STATE OF NATURAL GAS RETAIL COMPETITION

2.1 THE DEVELOPMENT OF DIRECT PURCHASE MARKET IN ONTARIO

- 2.1.1 The development of the direct purchase market in natural gas began with the signing of The Agreement on Natural Gas Markets and Prices by the Governments of Canada, Alberta, British Columbia and Saskatchewan on October 31, 1985 ("the Halloween Agreement"). The intent of the Halloween Agreement was to de-regulate well-head natural gas prices.
- 2.1.2 At the time of the Halloween Agreement TransCanada Pipelines Limited ("TCPL") was the main long-term supplier, transporter and marketer of natural gas in eastern Canada. The Ontario LDCs had long-term contractual obligations to TCPL for the supply and transportation of natural gas to Ontario.
- 2.1.3 Early in the development of the direct purchase market the Board determined that the restrictions on the supply of gas contained in the *OEB Act* and the *MFA* applied to agents, brokers and marketers ("ABMs"). The requirements and obligations under these two *Acts* and the *PUA* are imposed on any person or company that supplies gas. The word "supply" is not defined in the legislation. The Board had found in an earlier decision that the supply of gas in the regulatory scheme of these *Acts* means passing title and/or physically delivering the commodity to a place in Ontario. The *Acts* therefore apply to anyone who either sells gas within the Province or who delivers gas within the Province. Thus ABMs who wish to sell gas within the Province are required to hold a valid Certificate of Public Convenience and Necessity (section 8 of the *MFA*) and be operating under a valid bylaw of the municipalities in which they supply gas (sections 3 and 9 of the *MFA*).
- 2.1.4 As a practical matter, the requirements of the *MFA* may be too onerous for most

ABMs, who simply seek to be able to transfer title of gas to their customers and/or to trade supplies to balance the needs of their customers. To avoid the need for ABMS to meet such requirements, the Ontario LDCs, stakeholders and the Board worked to develop mechanisms which would allow end-use customers to directly purchase natural gas from suppliers other than the LDC (□direct purchase□).

- 2.1.5 One direct purchase mechanism allows the customers to take title to gas outside of the province and arrange for transportation of the gas to the LDC□s distribution/transmission system via an upstream pipeline. Under this transportation service, or □T-service,□ title to the gas commodity is held by the customer and never transferred to the LDC. T-service comes in two forms; unbundled T-service where customers simply pay for transportation of their gas and pay separately for LDC services such as storage; and bundled T-service where customers pay a bundled rate for all of the LDC's services except for the commodity. The sophistication required to manage supply and demand, and the administration cost of providing these forms of T-service limit their appeal only to large volume (e.g. industrial) customers.
- 2.1.6 Another form of direct purchase is the □buy/sell.□ The buy/sell involves customers or their ABMs purchasing gas and reselling it to LDCs outside the Province. The price paid by an LDC to an ABM is known as the buy/sell reference price and is directly related to the weighted average cost of the LDC□s regulated system gas supply. Buy/sell customers remain sales customers of the LDC and continue to pay the regulated sales rate for the provision of full gas services.
- 2.1.7 Until recently the buy/sell was the most popular direct purchase mechanism for small volume customers. Using agency agreements, ABMs are able to aggregate a number of small volume customers and purchase gas on their behalf. The customer generally receives a portion of the difference between the price that the ABM pays for gas and the price paid by the LDC to the ABM for the gas. Within certain operational constraints an ABM may release customers back to the LDC□s system gas supply. Therefore price risk to the customer under the buy/sell is generally limited to the regulated LDC weighted average cost of gas.
- 2.1.8 A more recent innovation is Agent, Billing and Collection-Transportation service (□ABC T-service□). ABC T-service allows an ABM buying gas on behalf of a customer to bill the customer directly for the cost of gas. Today, this separate billing occurs as a line item on the utility bill, the amount of which is collected by the LDC on behalf of the ABM. ABMs are paid monthly by the LDCs for the gas supplied to the LDC for ABC T-service customers, less an administrative charge. The price a customer pays for gas has no defined relationship to the regulated price of gas and

may vary significantly from the prevailing regulated price.

2.2 CURRENT LIMITATIONS OF DIRECT PURCHASE

2.2.1 T-Service, buy/sell and ABC T-services have provided consumers with access to the competitive upstream natural gas market. Gas customers today have a broader range of price offerings than were available prior to deregulation when only the regulated approved LDC sales rate was available. Nevertheless, there are significant deficiencies in today's direct purchase mechanisms and the market that has subsequently developed.

2.2.2 The buy/sell has been characterized by small rebate programs and the absence of a transparent relationship between the customer and the gas supplier. A customer's actual savings under the buy/sell are a portion of the difference between the LDC's approved price and the ABM's purchase price. Consequently as the LDCs moved from long-term contracts to more market sensitive indexed prices, the benefits of using buy/sell have diminished.

2.2.3 The volatility of natural gas prices has also made it increasingly difficult for the LDC to accurately forecast the buy/sell reference price. This, in turn, has led to more active intervention by ABMs in regulatory proceedings concerned with the setting of the buy/sell reference price. The fact that the setting by the regulator of the buy/sell reference price has become so important and contentious is evidence that the buy/sell is not a true market offering. Buy/sell is, in fact, a creature of the statutory impediments to gas transactions by gas marketers within the Province.

2.2.4 ABC T-service has not solved the fundamental problem imposed by the limitations of the current legislation. Gas suppliers are still unable to freely transact within the Province to balance their customers' demands with supplies. This too has led to contentious intervention in regulatory proceedings by parties concerned with the price and manner in which the LDC provides services.

2.2.5 ABC T-service has introduced two new concerns. First, it has precipitated the entry of affiliates of the regulated LDCs into the market. The *OEB Act* does not provide clear authority to review this affiliate relationship. Second, ABC T-service has increased the price risk to customers who may find themselves paying significantly more than the regulated sales rate. The Board recognizes that many residential customers have already selected direct purchase. However, it is unclear the extent to which these consumers understand the price they will pay or the terms of their arrangements.

2.2.6 The development within the current legislative constraints of the direct purchase market has also affected the manner in which the LDCs operate. In addition to supplying gas for end-use consumption, the LDCs use their gas portfolio to perform a number of tasks key to the reliable functioning of the natural gas system in Ontario. As their system gas portfolios have decreased, the LDCs have had less flexibility to play the role of market facilitator by balancing, backstopping and accommodating the movement of customers to and from the direct purchase market. The LDCs' facilitation role in this hybrid market of competitive and regulated supply has also increasingly become the matter of costly regulatory proceedings.

2.2.7 Ontario natural gas producers have complained that the current impediments to the transfer of title to natural gas mean they must contract to notionally ship their gas outside of the Province in order to sell it directly to customers within the Province other than LDCs. The cost of this requirement lowers the competitiveness of Ontario natural gas production.

2.3 THE BENEFITS OF FURTHER RETAIL COMPETITION

2.3.1 The Working Group Report argued that removing the impediments to transactions for gas within the Province would assist in the further development of a competitive retail market in Ontario. Many stakeholders believe that the development of "liquid trading points" for gas in Ontario is a necessary step to a full retail commodity market. The Board also believes that building transparent and liquid markets is key to an effective retail market. An effective market offers the possibility of new and innovative services from gas suppliers. Such choices, in turn, provide customers with an efficient and environmentally sound way of managing their consumption of natural gas.

2.3.2 Many Working Group stakeholders noted that, since natural gas is currently bought at a competitive well-head market price, the price impact of the proposed changes will be minor. In any event, the volatility of natural gas prices is likely to mask small changes in gas prices that may occur as a result of further deregulation. Nevertheless, stakeholders expected greater efficiencies and reductions in regulatory costs as a result of the removal of the impediments to title transfers.

2.3.3 Some Working Group stakeholders argued that significant benefits to end-use customers will result from the deregulation of all LDC non-monopoly functions, but not from the deregulation of its merchant function alone.

2.3.4

In general, the Board agrees with the sentiments expressed by the Working Group that the development of an effective retail market will be an evolving process and that removal of the impediments to title transfer is an important step in the direction of full retail competition. Revisions to legislation must allow the industry, stakeholders and the regulator the flexibility to manage this market transition and to seek the path that offers the greatest benefits to consumers.

3. FACILITATING FULL RETAIL COMPETITION IN THE NATURAL GAS MARKET

3.1 THE WORKING GROUP REPORT

3.1.1 In its examination of retail commodity competition in natural gas, the Working Group identified four core issues:

- timing and conditions of LDC exit from the gas merchant function;
- marketplace governance in a deregulated environment;
- transitional issues in moving from a regulated to a deregulated market; and
- issues pertaining to broader deregulation of LDC functions.

3.1.2 The Working Group used as its planning objective a hypothetical competitive market end-state with the following features:

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

3.1.3 The Working Group separated the LDC role in the provision of natural gas service

into sixteen functions. The Working Group then examined these LDC functions as they operate in today's partially deregulated market, their potential operation in a fully deregulated market, and the necessary transition from one phase to the other.

3.1.4 By consensus, the Working Group recommended elimination of current impediments to transacting directly for the purchase and resale of gas in Ontario and that the OEB should not regulate whenever there is full and effective competition. There also appeared to be some consensus that in order to comply with the latter of these recommendations, the Board should have powers to forbear from regulation.

3.1.5 Many Working Group stakeholders also believed there to be a necessity to further unbundle services currently offered by the LDC, especially storage and transportation functions relating to the development of an effective competitive market. The Board was informed at the consultative meeting that stakeholders were continuing to work to resolve outstanding issues.

3.1.6 The Board believes stakeholders should continue to be active in the design of the mechanisms and structures necessary to build an effective retail market. In that regard, the Board intends to establish a market design Task Force consisting of affected stakeholders, including consumer interest groups, which would propose appropriate market structures for full and effective retail commodity competition and which would ensure the safe, reliable and secure provision of natural gas to Ontario consumers.

3.2 THE ONTARIO ENERGY BOARD ACT AND THE MUNICIPAL FRANCHISES ACT

3.2.1 As noted in the WGR, the *OEB Act* and the *MFA* set requirements relating to both the delivery asset (pipe) and the delivered product (natural gas). At the time of the original drafting of the statutes, it is unlikely that the separation of supply from distribution was considered. For example, section 1(1) of the *OEB Act* describes a "distributor" as a person who supplies gas. Today, the distinction between a gas supplier and a gas distributor is critical. The word "supply" in the legislation has been interpreted as including sale and/or delivery of the commodity.

3.2.2 In this Report, the Board uses the word "supply" to mean the sale of gas. The word "distributor" in the *OEB Act* is defined as someone who supplies gas, but in this Report, "distributor" and "distribution" are used to refer only to the delivery of gas, not its sale.

3.2.3 If the removal of the impediments to title transfer were the sole objective, this might

more simply be achieved by clarification that "gas supplier" and "gas supply" relate only to the sale of gas. However, the Board is of the view that this single change would not address many of the substantive issues raised by the Working Group in its Report.

- 3.2.4 The Board agrees with the intent, if not the specific drafting, of the WGR recommendations made at pages 72 through 75, for changes to the *OEB Act* and *MFA*. New legislation separating distribution from supply would allow parties to exchange title to natural gas without having to seek from the Board a Certificate of Public Convenience and Necessity and approval of franchise agreements with local municipalities. Such amendments would also relieve the regulated LDC of its obligation to sell the commodity of natural gas. The effect of these amendments would be that the relevant statutes would apply only to the providers of distribution services and not to suppliers of the commodity. The Board is concerned, however, that if such amendments were undertaken in the manner proposed, it would become possible for the regulated utility to choose not to offer a regulated gas supply. While in the long-run this may be a desirable objective, in the immediate-term there are practical concerns related to customer choice and the integrity of the natural gas system in Ontario that need to be addressed.
- 3.2.5 The Board concludes that the relevant legislation should be amended so as to remove the current impediments to the transfer of title to natural gas in Ontario. This change should be achieved by making a distinction between the supply (i.e. the sale) and the distribution of natural gas in the *OEB Act* and in the *MFA*, but should also be accompanied by the other changes as set out later in this Report, especially those related to maintaining, during a transition, a regulated gas sales service offering.

3.3 THE PUBLIC UTILITIES ACT

- 3.3.1 The WGR proposed that, in order to eliminate the restriction to title transfer, sections 55 and 58(1) of the *PUA* would require amendment.

Specifically, section 55 of *PUA* reads:

Where there is a sufficient supply of the public utility, the corporation shall supply all buildings within the municipality situate upon land lying along the line of any supply pipe, wire or rod, upon request in writing of the owner, occupant or other person in charge of any such building. R.S.O. 1990, c. P.52, s.55.

- 3.3.2 The WGR states that this section imposes a supply obligation on corporations

owning or operating "public utilities." Stakeholders also argued that section 55 does not tie the supply obligation to the operator of the pipeline, because it 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. The WGR interpreted this to imply that the obligation to supply is not confined to LDCs, but would govern vendors of gas as well.

3.3.3 Regardless of the merits of the Working Group's interpretation, the Board agrees with what it sees as the intent of the Working Group proposals, which is to change the obligation to supply gas (sale and distribution) to simply an obligation to deliver. The obligation to deliver would require a franchised LDC to provide distribution service where the pipeline capacity is available.

3.3.4 The Board is also of the view that in a full and effective competitive market there is no need (except in an emergency) to "obligate" a party to supply the commodity. The Board appreciates, however, the important function natural gas plays in the economy of Ontario and in meeting home heating needs. Therefore both gas price and supply reliability are important issues that will need to be considered in the move to further deregulation. Consideration must also be given to the transition of supply responsibilities, like load balancing and backstopping, that are currently undertaken primarily by the LDC.

3.4 TIMETABLE FOR CHANGE

3.4.1 As of December 1996, over 90% of industrial, 66% of commercial and over 30% of residential customers have chosen direct purchase. The Board is aware of a substantial increase in residential direct purchase under ABC T-service since December 1996. It can be argued that this degree of penetration by marketers implies that customers need no regulated supply option. Although the market to date has been characterized by relatively low risk, the introduction of ABC T-service and certainly, further deregulation will, the Board believes, expose customers to greater risks than those generally experienced to date. As customers receive more and better information they will better recognize the consequences of the choices they have made. The Board believes that access to market information is the key to informed choices, and is a necessary precondition to the removal of a regulated supply offering.

3.4.2 The introduction of full retail competition will also introduce other risks to a safe, reliable supply and delivery of natural gas. Before the option of a regulated supply can be eliminated, it must be shown that the retail competitive commodity market

ensures system integrity. It must be evident that all of the functions currently undertaken by the LDC using its system gas portfolio and its title to gas within the distribution system can be provided adequately and reliably by alternative market structures. Additional comments on these issues are made in section 5.2.

3.4.3 The WGR contains various proposals for the elimination (or maintenance) of a regulated system gas service. Many stakeholders, including the LDCs argued that a [date certain] should be set to allow for orderly planning of a transition to a market without a regulated supply offering. Although the Board understands the positions of parties, orderly planning is not in itself, in the Board's view, a strong enough reason for setting a specific date now for ending consumers' access to a regulated supply offering. The issue of the end of regulated sales is further discussed in section 5.3.

3.4.4 The Board believes that the regulator is in the best position to judge if and when the appropriate conditions exist for the cessation of a regulated supply option. Before this can occur four key areas must be addressed: (1) the ability of gas suppliers to access the monopoly distribution system on a fair and equitable basis; (2) the maintenance of system integrity; (3) the maintenance of the safety of the natural gas system; and (4) the ability of gas consumers to make choices within a market offering reliable gas supplies. The Board believes a comprehensive legislative framework providing the means to resolve issues in these areas in the public interest, is vital. Such a framework would provide the regulator with the flexible powers to respond to rapid changes in an evolving retail market.

4. REGULATING THE MONOPOLY FUNCTIONS

4.1 THE LDC MONOPOLY FUNCTIONS

- 4.1.1 Today the LDCs operate an integrated supply and delivery system. Among other things, they provide gas supply, transmission, storage, load balancing, backstopping and billing services; rent appliances; and perform safety checks on gas equipment.
- 4.1.2 The relationship between the monopoly utility and its customers is subject to the existing legislative framework. The inadequacies of this aspect of the legislation are addressed in Chapter 6. As to the relationship between the LDC and gas suppliers the existing legislation is silent. Since a retail gas supplier, other than the LDC, was not contemplated at the time of drafting, the current legislation is primarily concerned with ensuring that the monopoly position of the LDC is not used to extract extraordinary profits, or to set terms and conditions of service that are one-sided. The current legislative framework relies on the LDC to decide which services should, or should not be offered.
- 4.1.3 The Board agrees with stakeholders that the development of an effective retail market necessarily means changes to the design and pricing of services controlled by the LDC. Ensuring that the changes are in the public interest should, in the Board's view, continue to be the responsibility of the regulator. Amendments to the *OEB Act* should not detract from the ability to continue to regulate monopoly functions and should provide clear authority to ensure the development of an effective retail commodity market. The Board has considered three aspects of the regulator's role in governing monopoly activities: (1) ensuring access to the LDC's distribution system; (2) the regulation of monopoly services necessary for a restructured market; and (3) ensuring the monopoly does not unfairly compete, or aid an LDC affiliate to unfairly compete, in the retail market.

4.2 FAIR AND EQUAL ACCESS TO THE MONOPOLY DISTRIBUTION SYSTEM

4.2.1 In *Direction for Change*, the Government called for fair rules for all electricity industry participants. The “level playing field” principle espoused in the White Paper is equally important in determining access to the LDC’s monopoly distribution system for natural gas.

4.2.2 In markets in which there is a competitive supply and a regulated distribution system, open and transparent terms and conditions of interconnection must underpin bilateral contracts. The regulator explicitly approves the terms and conditions of interconnection so as to ensure fair and non-discriminatory access to the distribution system.

4.2.3 The present ability of the Board to explicitly approve the terms and conditions of a gas supplier’s access to the monopoly distribution system is not clear. Section 16 of the *OEB Act* allows the Board, in making an order, to impose terms and conditions; however, this section applies only to those parts of the Act under which an order can be made. The section does not confer new rights. Further, the jurisdiction of the Board based on section 19 does not provide explicit authority to set general terms and conditions. The Board is therefore able only to impose terms and conditions on the basis of its ability to set rates for a service and/or determine the allowance for rate making purposes of particular costs. It has also been argued that the Board may not currently have the jurisdiction to approve the general terms and conditions of LDC service (often simply denoted as the “Terms of Service” in other jurisdictions).

4.2.4 While some stakeholders have argued that the Board has the necessary powers under the current legislation, the *OEB Act* was drafted with the intent of ensuring fair rates rather than fair and open access of gas marketers to the monopoly distribution system. Many of the stakeholders, in particular gas marketers, argued that investors are more likely to invest in the retail market if they are assured of an unbiased arbitrator. The Board concurs with this position. The ambiguity in the current legislation works to the detriment of establishing an open and fair retail commodity market in Ontario. The precedent for the additional powers that would be required by the regulator can be found, for example, at section 32(b) of the *Telecommunications Act* which allows the Canadian Radio-television and Telecommunications Commission (“CRTC”) to determine standards in respect of the technical aspects of the services offered by the monopoly distributor.

4.2.5 The Board concludes that the *OEB Act* should be amended to provide the regulator

with clear and sufficient authority to govern the relationship between the franchised LDC and gas suppliers transporting gas on the distribution system, including the approval of terms and conditions of access.

4.3 SEPARATION AND UNBUNDLING OF LDC MONOPOLY SERVICES

4.3.1 Many stakeholders have argued that building an effective retail market will require the LDC to fully unbundle its monopoly services. In this vision of a wholesale market, end-use customers interact only with the gas supplier who arranges, on their behalf, all of the necessary transportation, backstopping, and balancing services in addition to the commodity supply. In the Board's view it is premature to anticipate what form of market might develop. The purpose of a revised legislative framework should be to provide sufficient regulatory flexibility to react to the needs of the market. Later in this Report, the Board details a number of services it views as essential to the integrity of the natural gas system, and which the LDC will be required to continue to provide.

4.3.2 The Board is of the view that to manage the change to an effective retail commodity market in which the interests of gas suppliers and the monopoly distributor may be in conflict, the regulator must have the authority to direct the utilities to offer a specific service or to unbundle services. Some Working Group stakeholders argued that the Board can currently order a new service or disallow an old service through its authority under section 19 of the *OEB Act*. In any event, it is not clear that the Board has the ability to order the regulated utility to cease, or maintain, certain functions or separate these from the regulated entity. In the Board's view, the absence of assurance to investors or potential investors in the gas supply market of fair and equitable treatment by the monopoly distributor is likely to impede the development of full retail competition. In addition, the conclusions reached below concerning the transition from regulated commodity supply are underpinned by the assumption that the regulator has clear and unambiguous authority to order the sale of gas by the LDC. Section 35 of the *Telecommunications Act*, entitled "Order to Provide Services", provides an example of the type of legislative framework the Board believes necessary to effectively manage the transition to a retail competitive natural gas market.

4.3.3 The Board concludes that the legislation should be amended to provide the regulator with the authority to order the LDC to provide services, or cease providing services, such as load balancing and backstopping, where such authority is required to ensure the development and/or maintenance of a competitive market.

4.4 SEPARATION OF MONOPOLY FUNCTIONS AND THE GOVERNING OF AFFILIATE RELATIONSHIPS

4.4.1 Related to the unbundling of monopoly distribution services is the issue of separating non-monopoly functions from the LDC and the consequent relationships between the LDC and its affiliates. In the Working Group consultative, the Board sought input on elimination of the LDC's merchant function but not on the broader issue of removing other activities of the regulated utility from the ambit of regulation. It was argued by some at the consultative meeting that the Board would be constrained in its ability to deal with cross-subsidization unless it could consider the competitive impacts of the monopoly operations and exercise authority to require, direct, supervise and enforce the separation of LDC monopoly and competitive functions. Other stakeholders held the view that only through the separation of non-monopoly functions would consumers receive significant benefits of retail competition.

4.4.2 In a competitive market in which affiliates of the monopoly distribution utility are active participants, there is a need to prevent cross-subsidization, preferential treatment and other anti-competitive behaviour that might result from inappropriate actions between the monopoly LDC and its affiliates. The Board's authority to set terms and conditions of these relationships has been subject to differences in interpretation. In the hearing which resulted in the Board's Interim Decision on a Code of Conduct, the LDCs took the position that some aspects of the Code were beyond the Board's jurisdiction. The Board disagrees with this characterization, but the difference in views demonstrates the need for a clear articulation of regulatory authority to set the terms and conditions of the relationship between the LDC and its affiliates.

4.4.3 In Direction for Change the Government articulated its plan to "separate monopoly operations from competitive businesses throughout the electricity sector." The Board agrees that in the natural gas sector as well, further separation of non-monopoly functions is likely to be necessary if consumers are to fully benefit from deregulation. The regulator should be given the tools to ensure that financial, physical and human resource assets of the monopoly distribution utility are not used to inappropriately support non-monopoly ventures of the LDC, its affiliates or parent.

4.4.4 The Board concludes that the *OEB Act* should be amended to provide explicit authority to determine, adjudicate and enforce codes of conduct that govern the relationships between franchised distribution utilities and their affiliates.

5. PROTECTION OF ONTARIO NATURAL GAS CONSUMERS

5.1 CONSUMER PROTECTION - MARKETING PRACTICES

- 5.1.1 The Board believes a distinction can, and should, be made between the issue of consumer safeguards related to marketing practices and the issue of ensuring customers continue to have access to the safe, reliable supply and delivery of natural gas. Traditionally, the Board has not been directly involved in protecting consumers from misleading or fraudulent business practices. The Ministry of Consumer and Commercial Relations (MCCR) has experience in this area which the Board believes would be both costly and inefficient to reproduce. The Board also agrees with many stakeholders that the natural gas commodity retail market should, to the extent possible, be governed by the same laws, rules and regulations as are other goods and services.
- 5.1.2 The Board believes its role in protection of gas consumers should be focused on maintaining the integrity of the natural gas distribution system. At the same time the Board is cognizant of special considerations, including the need for consumer education, that are required when moving from a regulated to a competitive retail market. The Board believes that the legislative framework must be one in which the expertise of both the Board and MCCR can be used together to help customers bridge the transition from one form of market to the other.
- 5.1.3 As a practical matter, many of the Board's recommendations regarding consumer protection apply principally to the small volume residential gas market. Large volume gas customers have both the resources and expertise to adequately protect their own interests. Nevertheless the integrated nature of the natural gas system does not allow a complete distinction between these markets. The Board has dealt more fully with the issues of consumer protection in Chapter 6.

5.2 RATEPAYER PROTECTION - SYSTEM INTEGRITY

- 5.2.1 In a retail commodity market where the merchant role of the LDC has ended, system integrity will need to be maintained. The Board believes that the regulator must ensure that the market mechanisms developed are conducive to system integrity. Such key functions may be provided by contractual agreements, or as part of industry market structures, or through a combination of both bilateral and industry-wide solutions.
- 5.2.2 Once attached, customers depend upon the integrity of the natural gas system. Gas must arrive on a cold winter's day. Like electricity, natural gas cannot, as a practical matter, be stored by the end-use customer. If an end-use customer changes supplier, the change must not disrupt the orderly operation of the distribution system. Also if a supplier fails to deliver, mechanisms must be in place to ensure appropriate actions are taken to ensure a reliable supply of gas. In today's market the LDC plays a vital role in maintaining these functions, in part through its use of gas acquired for its customers (i.e. system supply). These functions include: backstopping, load balancing, supplier of last resort and safety.
- 5.2.3 Backstopping is integral to the operation of the system. In a fully deregulated market, while large volume customers might be expected to make contractual arrangements to ensure a secure source of gas, small volume customers must rely on their gas supplier and the arrangements made between the supplier and the regulated utility. The Working Group suggested a number of alternative ways in which this service could be offered. Some stakeholders have suggested that in a competitive market customers should themselves take responsibility for ensuring a reliable supply. If this becomes the case then appropriate industry mechanisms, like insurance supply pools, or other options as explored in the WGR, must be developed.
- 5.2.4 The Board believes that the existing LDC supply related functions that protect small volume customers must remain in place for the time being. In the event the market develops to such a point as to provide the necessary services, the LDC may no longer be required to offer them. In the interim, if amendments to the current legislation eliminate the utility's obligation to deliver, the Board must have the authority to direct the utilities to continue to provide a backstopping service.
- 5.2.5 To a large extent, the LDC's system gas portfolio also provides the load balancing needs of the entire distribution system. Load balancing ensures that customers' demands are met with supplies on a day-to-day basis. In a deregulated market, in

which the utility potentially does not own title to the gas, the question of how load balancing will be achieved must be addressed. The WGR at pages 41 through 43 explores a number of options for ensuring load balancing in a restructured retail market, but reaches no consensus on which would be preferable.

- 5.2.6 Some customers also rely on system supply as the supply of last resort. Customers who have credit history problems or who are in areas not served by an ABM can rely on the regulated utility to provide gas at an approved price with an appropriate security deposit. Given the general lack of consumer awareness of the retail market, customer education must be addressed before the Board will consider removing this "safe haven" option.
- 5.2.7 The Board believes the continuance of what are today LDC gas related functions is critical to ensuring Ontario has a safe, reliable natural gas system. The Board believes that stakeholders should continue their efforts to resolve the "mechanics" of deregulation, and is not prepared to recommend the elimination of a regulated sales offering without assurances that market structures exist to provide system integrity.
- 5.2.8 Section 21(1) of the *OEB Act* allows the Minister to ensure that vulnerable (e.g. residential) customers are provided with natural gas in cases of catastrophic force majeure. Section 21(1) has never been proclaimed. To the extent that the Government wishes the Minister to retain this authority, this part of the *OEB Act* would need to be revisited to ensure the appropriate authority over the LDC and gas suppliers is maintained.
- 5.2.9 Safety must also be maintained in a restructured market. The *Energy Act* defines a distributor as "a person who supplies a hydrocarbon to an end user." Section 16 of the *Energy Act* allows a distributor access to a premise to inspect an appliance or meter. Other sections of the *Act* provide for various safety matters such as the licensing and registration of persons installing or repairing "hydrocarbon" appliances. The Board also notes that the *Energy Act* is an act named as a Schedule of the *Safety and Consumer Statutes Administration Act*. An administrative authority named the Technical Standards Safety Authority ("TSSA") has been incorporated for the purpose of maintaining and enhancing public safety in a number of areas including the use of hydrocarbon fuels. The Fuels Safety Division of the TSSA currently promotes the safe transportation, storage, handling and use of hydrocarbons, including natural gas. The Fuels Safety Division also registers contractors and certifies trades people such as gas fitters. The Board does not believe that safety will be compromised by further deregulation of the natural gas industry provided the definition of a distributor continues to include the LDC so as to allow it

access to premises under section 16 of the *Act*.

5.3 MAINTENANCE OF REGULATED COST-BASED LDC GAS SALES SERVICE

5.3.1 In today's commodity market, consumers can purchase natural gas from either an ABM or the LDC. For many small volume customers the LDC's regulated supply avoids the need to find a reliable, price-competitive supplier. The LDC's supply portfolio is purchased at a market price, and passed through to the customer without a profit margin. The LDC's profit is derived from a margin on the delivery of the gas to its customers.

5.3.2 As noted in the discussion of direct purchase mechanisms, under buy/sell, residential customers are generally offered a price that is related to the regulated price. This has reduced a buy/sell customer's exposure to price risk. Under ABC T-service, and in a full retail competitive market, a customer's price risk is no longer limited by the regulated price.

5.3.3 The Board believes that regulation of gas suppliers with respect to price is inconsistent with retail competition. An effective gas commodity market should provide consumers with alternative choices, and competition, not regulation, should be the ultimate source of price protection. Other desired policy objectives such as assistance for low income customers, are more efficiently achieved outside the ambit of economic regulation.

5.3.4 The Board believes that the special characteristics of the natural gas market, especially the residential space heating market, require that the Government and/or the regulator remain diligent to ensure that an effective competitive market is realized. In the transition to a robust market the Board also believes a regulated gas sale offering provides a benchmark from which consumers can compare a gas marketer's price and quality of service.

5.3.5 During the consultative meeting, the LDCs and most ABMs advocated a [date certain] to end regulated supply, arguing that it was necessary to make a firm commitment to end system supply so as to reduce uncertainty in the marketplace and focus business planning. The LDCs in particular argued that a planning date was required to enable orderly revision of the contracts underpinning system supply.

5.3.6 Other stakeholders appeared to be less certain of the need to pre-determine a date for ending regulated supply. They worried that gas suppliers would use the threat of the elimination of a regulated system supply option to pressure customers into choosing

a gas supplier before customers were able to make an informed decision.

- 5.3.7 The Board does not believe that the orderly restructuring of the retail gas market necessitates a "date certain" end to a regulated sales offering. The Board believes it is more appropriate to plan toward certain conditions that would allow for the cessation of LDC regulated sales. Unlike the electricity sector, the natural gas sales market already gives customers the ability to choose from alternative gas suppliers. While a date certain for the commencement of retail competition may be necessary in the electricity sector, there is no suggestion in Direction for Change of a final date for the elimination of the analogous "merchant function" of electricity distributors. In the Board's view, no stakeholder offered a convincing argument for denying customers the choice of a regulated supply option at this time.
- 5.3.8 In the Board's view, the maintenance of a regulated supply option is unlikely to impede the development of a competitive supply market. The absence of profit derived directly from the sale of gas limits the LDC's incentive to subsidize the service. If a competitor offers a lower price or better service than the LDC, customers will be enticed to move from the LDC to another supplier. The Board concludes that maintenance of a cost-based regulated gas supply will enhance customer choice and will provide a safeguard to consumers in the event the market does not develop as anticipated.
- 5.3.9 The Board also heard a proposal for LDC unregulated gas supply. An unregulated gas supply would offer the LDC the opportunity to profit from the sale of gas commodity and thus provide an incentive to cross-subsidize from its monopoly revenues. Almost all stakeholders argued that an unregulated supply option from the regulated utility could seriously undermine the development of a competitive retail market. The Board agrees with this assessment.

5.4 REPLACING SYSTEM SUPPLY WITH A STANDARD SERVICE SALES OFFERING

5.4.1 The Board agrees with the LDCs that their support of the current direct purchase market mechanisms through the system gas portfolio cannot, in the long-run, be maintained. However, the Board is also of the view that the current difficulties associated with regulated supply necessitate a redefinition, not elimination, of that service. As the Board stated in its original Market Review Report of September 1996: *“... many of the problems related to the dominant market position of the LDCs can be mitigated during the transition if the utilities are limited to providing a standard gas supply service during the transition and an acceptable code of conduct can be put in place to govern transactions between the LDCs and their marketing affiliates”*.

5.4.2 In order to ensure consumers have access to a safe and reliable supply of gas, the Board believes that amendments to remove the impediments to the transfer of title should be done only in conjunction with new legislative powers allowing the regulator to order the LDC to provide a standard gas service and, when appropriate, to order the cessation of that service. These powers would allow for the replacement of the regulated system supply with a regulated standard gas supply offering by the franchised distribution utility. In the transition to full retail competition, the Board will require the authority to order the future unbundling of the components of this offering. When the appropriate market conditions exist, the Board would also have the authority to order the standard offering be ended.

5.4.3 The Board believes a price regulated standard gas service should not compete for market share, but should be a standard service offering (SSO). In order to ensure a smooth transition, the SSO would initially provide the same functions as the current regulated system supply. The costs of functions provided to direct purchase customers would be paid for by those customers. Over a transition period governed by the regulator, the elements provided by the SSO may evolve as more of its elements such as backstopping and load balancing, are offered through other market structures.

5.4.4 The SSO would include a standard gas supply offering, bundled with services such as load balancing and backstopping. In the transition to full retail competition, the Board will require the authority to ensure the unbundling of the elements of the SSO. The LDC might continue to offer these unbundled services to the retail market. When the appropriate market conditions exist, the Board should also have the authority to order the cessation of the SSO or any of its elements by the LDC if these

functions could effectively be provided by the competitive retail market.

- 5.4.5 One sign of an effective retail market should be its ability to offer a diversity of choice and price which will induce customers away from the SSO. The Working Group Report outlined other conditions that should precede the elimination of the regulated supply option: price discovery and transparency, customer mobility, customer education, diversity of choice and an approved set of terms and conditions for gas supplier-distributor interconnection. To these, the Board would add the assurance of system integrity in a restructured market.
- 5.4.6 The conditions precedent listed above are not exhaustive or static. The Board does not believe it is feasible to codify all the conditions that will need to be present before the elimination of a regulated gas sales offering. Such an important matter should be based on the evidence and on an appraisal of the public interest at the time.
- 5.4.7 The Board believes the maintenance of an LDC gas sale offering is consistent with the policy objectives set out in Direction for Change at page 16:

The Government recognizes that not all customers would be interested in choosing suppliers if customer choice is introduced. **Distribution utilities would continue to supply** electrical energy, either directly or under contract with a private firm, so customers would not be required to make any changes if they did not wish to. (emphasis added)

6. MARKET OVERSIGHT

6.0.1 An important feature of the restructured retail gas market will be the manner in which the distributor, the gas supplier and the end-use customer interact. Amendments made to legislation must consider if, and how, the relationships between the customer, the utility and the gas supplier are to be governed.

6.1 MAINTAINING THE CUSTOMER - DISTRIBUTOR RELATIONSHIP

6.1.1 After the LDC's obligation to supply is changed to an obligation only to deliver, the customer must have direct access to monopoly delivery services. Given the proposed separation of supply and distribution functions, there will be a need to reconsider certain delivery practices such as the basis for discontinuing service. In today's direct purchase market, customers with whom ABMs have contracted for the supply of gas are not, as a practical matter, able to instruct the LDC to switch their supplier.

6.1.2 The Board believes that customers have a right, within operational constraints, to maintain their access to the LDC's monopoly distribution services. The Board believes it is important that there be an appropriate balance in the customer-supplier-distributor relationship. A gas marketer, as an agent acting on behalf of the customer, may still manage services for its customers including supply and delivery. Gas marketers and suppliers would, however, only have the necessary rights of access to perform these services and would have no legal title to the customer's delivery service. Gas marketers or suppliers should not have the ability to deny a customer's access to the monopoly distribution system. In principle the Board considers that a restructured market should not allow the reselling or "mark-up" of a monopoly distribution service. As a practical matter this principle should not prohibit gas suppliers from packaging services and billing for both distribution and supply.

- 6.1.3 The Board believes its views on the regulatory treatment of the customers access to the monopoly distribution system are consistent with the Government's policy direction as articulated at page 16 of Direction for Change:

Small businesses and households would also have access starting in the year 2000. They would have the choice of staying with their current utility, having an electricity broker arrange supply on their behalf (as in the gas and telephone industries), **or even buying directly themselves.** (emphasis added)

6.2 CUSTOMERS AND GAS SUPPLIERS

- 6.2.1 The Board believes that, for an effective competitive market to develop, it is necessary that there be a direct and transparent relationship between the gas seller (supplier) and the customer. The introduction of ABC T-service has begun the process of strengthening this relationship by identifying the gas supplier and the price of the commodity charged by the supplier as a separate item on the utility bill. Prior to this service, direct purchase customers were often unaware of the fact that they had a supplier other than the LDC despite having signed a contract with an ABM.
- 6.2.2 None of the legislation governing the Board's authority appears to have contemplated there being a relationship between the end-use customer and a gas supplier, separate from the LDC. Consequently, the Board has no direct jurisdiction over the relationship between the ABM and the end-use customer. Many Working Group stakeholders support the status quo, fearing that new provisions in legislation to govern their industry are tantamount to re-regulation. To these parties, a retail competitive market is characterized in part by the absence of regulations impeding the way in which customer and supplier interact.
- 6.2.3 The Board understands the concerns that the development of a retail natural gas commodity market should not be subject to heavy handed regulation. Yet, as outlined above, there are serious repercussions in terms of system integrity if the gas sales market that develops does not adequately assume the critical responsibilities currently undertaken by the regulated LDC. Even if the price of gas is unregulated, there will be other aspects of the responsibility of a gas marketer in respect of which complaints will need to be addressed and recourse made available to an independent body.

- 6.2.4 Direct purchase was introduced into Ontario without additional legislated customer protections for the small volume market. The Board has no jurisdiction to resolve matters dealing with the market behaviour of ABMs. Nor is it clear that the *Consumer Protection Act* covers gas marketers. To fill this void the Board has made efforts to impose codes of conduct indirectly through its regulatory oversight of the LDCs. The Board has required that the LDC disseminate consumer information explaining direct purchase options. However, the legislative limitations mean that the industry must largely be relied upon to police itself. In Ontario this role has been undertaken by the Direct Purchase Industry Committee (DPIC), a voluntary organization of market stakeholders. In the Board's view, a voluntary approach to business standards without statutory authority makes it difficult to achieve an effective level of consumer protection.
- 6.2.5 The Board believes that, as part of the transition from today's marketplace additional legislated consumer protections need to be put in place. ABM aggregation of residential customers has often occurred through the use of poorly trained salespeople attempting to sign-up poorly informed gas consumers. This has led to situations in which some consumers are signed up to direct purchase arrangements unaware of the implication of the transaction into which they have entered. The Board has become increasingly concerned by complaints of misleading, and, at times, unethical gas marketing practices.
- 6.2.6 Until the advent of ABC T-service, consumers who purchased gas from a broker under a buy/sell arrangement were unlikely to pay any more than the regulated sales rate. With the offering of ABC T-service, customers can now find themselves paying considerably more than either the regulated gas sales rate or the price of gas being offered by other suppliers. This increase in price risk will continue under full retail competition. Discriminatory pricing in one or more segments of the market may also occur in a retail market. These changes are likely to trigger new customer inquiries and complaints. It is especially important, in the transition period, for consumers to have recourse to a clear and understandable mechanism to have complaints regarding marketing practices reviewed.
- 6.2.7 Natural gas consumers should, at a minimum, have the same protection afforded to them as for other products under the *Consumer Protection Act* (CPA) and the *Business Practices Act* (BPA). The Board suggests that the Ministry of Consumer and Commercial Relations (MCCR) be provided with the necessary resources to monitor the marketing practices of ABMs, and to intervene where and when necessary in order to protect consumers.

6.2.8 Further, the Board is of the opinion that MCCR should be authorized to establish administrative agreements that allow it to delegate the authority to investigate complaints regarding the marketing practices of competitive natural gas suppliers. As described below, the Board believes an administrative authority (i.e. a self-management organization) ought to be created. This same organization might be delegated authority by MCCR to monitor and act upon complaints concerning marketing practices.

6.3 LICENSING GAS SUPPLIERS (AGENTS, BROKERS, MARKETERS)

6.3.1 Most Working Group stakeholders agreed on the need to license marketers of natural gas. Some stakeholders argued that the sole goal of licensing should be to protect consumers from suppliers who are unable to carry out their obligations. There appears to be consensus on the following points:

- an agency ought to be empowered to issue licences on such terms and conditions as the agency considers to be appropriate;
- an agency ought to be empowered to amend, suspend, reinstate or cancel a licence and, in general, to discipline licensees; and
- a separate agency ought to be constituted as an appeal tribunal from the agency empowered to administer the licensing regime.

6.3.2 There was no agreement among stakeholders as to whether the Board ought to be the licensing agency. Many parties argued that licensing of gas marketers should be by MCCR since it already has expertise in the area of licensing and consumer protection. As discussed in section 6.4, the Board believes it should have authority over licensing.

6.3.3 The Board believes that any party who transacts a sale of gas in the province at either the wholesale or retail level should be licensed under the authority of the *OEB Act*. This recommendation is consistent with the policy direction in Direction for Change for the licensing of all electricity ABMs. In fact, gas marketers and electricity brokers may be a coincident group. The Board also believes that a valid gas supplier's licence should be required in order to have a gas supply interconnection agreement with the LDC. The Board is of the view that membership in a self-management organization as described below, should be a requirement of the licence.

6.3.4 In the Board's view licensing should ensure that:

- clear terms and conditions are established that save harmless the general body of LDC ratepayers from the risks of private gas sale transactions;
- gas suppliers have adequate technical and financial resources so as not to pose a risk to the integrity of the Ontario natural gas system;
- the licensee adheres to a consumer code of conduct;
- the licensee has effectively contracted for backstopping, or is a participant in an industry-developed backstopping pool;
- the licensee has effectively contracted for load balancing, or is a participant in an industry developed load balancing scheme; and
- the Board has the ability to act upon a recommendation of MCCR, or an administrative authority, concerning unethical or misleading marketing practices of a gas marketer.

6.3.5 Licensing should not erect inordinate barriers to entry. Some form of graduated or tiered licensing may also be appropriate. A licence to supply gas to the LDC is likely to have more onerous conditions than a licence to market gas in Ontario; similarly a licence for wholesale transactions is likely to have less onerous requirements than one for retail sales. The Board believes that legislation should provide the ability for the regulator to enforce the standards, terms and conditions of a licence through the application of financial or other penalties.

6.3.6 The Board believes its recommendations for licensing are consistent with the Direction for Change which at page 19, states:

The Board would have an important role in ensuring market participants do not abuse market power or engage in anti-competitive pricing behaviour or other monopolistic practices. In this regard, it would have responsibility for ensuring licensing of all agents, brokers, marketers and generators participating in the market.

6.4 A GAS SUPPLIER SELF-MANAGEMENT ORGANIZATION

- 6.4.1 Some Working Group stakeholders argued for the establishment of a self-regulating organization ("SRO") to ensure consumer protection and the development of the necessary market structures. Others argued for a self-management organization ("SMO") for the same purpose. There is no precise definition which explains the difference between an SRO and an SMO. Generally speaking the Working Group used the term "SMO" to refer to administrative authority akin to that established under the provisions of the Safety and Consumer Statutes Administration Act ("Bill 54") by the Minister of Consumer and Commercial Relations. The Real Estate Council of Ontario is an example of an SMO which is delegated certain responsibilities under the *Real Estate and Business Brokers Act*. An SRO generally refers to a self-regulating body with authority established through a specific enabling statute. The Law Society of Upper Canada is often cited as an example of an SRO.
- 6.4.2 The Director of the Competition Bureau ("the Director") perceived a danger in giving an SRO self-regulating powers, especially over entry conditions and pricing, because of a concern that the SRO's powers may not necessarily be used for furtherance of the public interest. The Director was also generally sceptical that an SRO would prevent market collusion and price fixing.
- 6.4.3 The Board believes that the creation of an SMO would be beneficial and that membership in the SMO for gas suppliers and gas marketers ought to be obligatory. The Board, however, agrees with the Director that a self-regulating SRO is not consistent with a competitive market. Consistent with the model of Independent Market Operator, described in Direction for Change, membership and management of the SMO should reflect a diversity of interests in the gas industry.
- 6.4.4 Also consistent with Direction for Change, the Board believes that ultimate responsibility for the SMO must lie with the Board. In the Board's view it would be impractical for the natural gas regulator not to have the authority to adjudicate matters which affect the terms of interconnection between the regulated LDC and gas suppliers. Similarly, inappropriate action of gas marketers can affect the reliable operation of the natural gas system, and therefore gas marketers should also be subject to licensing provisions under an amended *OEB Act*.
- 6.4.5 The Board believes the SMO should, under the guidance of the Board, work with the LDCs, gas suppliers, gas marketers and other affected stakeholders to ensure a safe, reliable supply and delivery system for natural gas in Ontario. The SMO

should also be delegated the necessary authority under the *OEB Act* to help build and maintain an effective natural gas retail market in Ontario. The SMO should coordinate the efforts of stakeholders to: (1) develop terms and conditions of access to the LDC distribution as outlined in section 4.2; (2) develop the market mechanisms, such as backstopping, necessary to ensure system integrity, as outlined in section 5.2; (3) develop the necessary market mechanism to ensure an effective means for customers to exercise choice as outlined in section 6.1; (4) and otherwise work to develop the market structures necessary to build an effective competitive market. The Board also believes the SMO should have the ability to take disciplinary action against any offending member.

6.4.6 In order to hold a licence, the Board believes gas suppliers and gas marketers should be members in good standing of the SMO. Gas marketers in violation of the business practices code could have their marketing privileges revoked upon a recommendation of MCCR.

6.4.7 As noted in section 6.2, the Board believes that MCCR may find the SMO an equally appropriate forum to which to delegate authority for monitoring and enforcing appropriate marketing standards. The Board believes the SMO should, in conjunction with MCCR, develop a set of marketing standards and codes of conduct for business practices. These codes of business practice, once established, should remain under the purview of MCCR. The Board should have the ability to act upon a recommendation of MCCR or any administrative authority to which it has delegated its powers. The development of an SMO as proposed by the Board will require careful consideration of the appropriate coordination of authority between MCCR and the OEB. As a practical matter there are a number of ways to achieve this coordination of responsibilities, including the issuance of both a [gas supplier] and [gas marketer] licence. The Board has made additional comments on the way in which licensing, an SMO, and the division of authority might be addressed by revised legislation in section 7.2 of the Report.

6.4.8 The Board also believes it is important that consumers be provided with clear and unbiased information concerning the changes occurring in the natural gas retail market. The expertise of the Board, the LDCs and other natural gas industry stakeholders should be combined with the experience of MCCR in matters of consumer protection, to develop an effective educational program.

6.4.9 At page 19 of Direction for Change the Government has outlined a role for the OEB to provide advice on how well the market is performing and to alert the Government to any problems arising from a company's dominant position in electricity

generation. The Board believes that such a role is equally useful in the natural gas industry.

7. A REGULATORY FRAMEWORK

7.1 THE OBJECTIVES OF REGULATION

- 7.1.1 Some Working Group stakeholders characterized regulation as “a surrogate for competition.” In fact, regulation comes in many forms and serves many purposes. The *OEB Act*, in its current form, can be characterized mainly as providing for economic regulation. Its primary purpose is to enable appropriate regulation of a natural monopoly. Other regulators, like the Ontario Securities Commission (“OSC”), are created to help develop and maintain an effective competitive market. The legislative framework for this latter type of regulation provides for monitoring certain aspects of a competitive market to prevent inappropriate market behaviour which could have serious repercussions.
- 7.1.2 The Board believes that competition in energy supply and services will offer the potential for innovative and diverse consumer choices. However, where market imperfections exist that may work to the detriment of consumers, regulation is a means of addressing these imperfections. To be effective the regulator must be provided with the ability to deal with market imperfections, especially when the market is immature and its participants have yet to demonstrate their ability to meet the needs of all Ontario gas consumers.
- 7.1.3 The Board believes that greater regulatory flexibility is needed in a market in the process of deregulation. In many sectors, most recently telecommunications, where changing technology and maturing markets have “de-monopolized” utility functions, the regulator has been provided with the power to forbear from regulation where deemed appropriate. With forbearance has often come a responsibility for market oversight to ensure that what was once a regulated service continues to be adequately provided by the marketplace.

- 7.1.4 In setting out its view of the principles and tools of regulation, the Board is cognizant of many stakeholders' concerns over potentially burdensome new regulation. The intent of the Board's recommendations is not to expand the breadth of regulation, but to improve its effectiveness.
- 7.1.5 Preambles, or purpose sections, in legislation are sometimes used to define the policy objectives to be considered by the regulator in determining the public interest. The *Telecommunications Act*, for example, includes a comprehensive section setting out Canadian telecommunications policy. Other legislation, like Nova Scotia's recently passed *Gas Distribution Act*, has brief purpose sections for each of the main parts of the Act. Both statutes contain references to competition as a policy objective.
- 7.1.6 The Working Group stakeholders held differing views as to the desirability of including a purpose section in amended legislation. Some parties believed such a section would neither improve nor detract from the legislation. Others thought the inclusion of a purpose section might limit the Board's ability to consider the broader public interest. Some stakeholders supported the inclusion of a purpose section and expressed the view that a purpose section is appropriate if it reflects a societal consensus about the purpose of natural gas regulation.
- 7.1.7 Some stakeholders recommended reference to promoting energy efficiency and ensuring that the natural gas industry operates within a context of environmental sustainability. Others wanted an assurance that reliable and affordable natural gas would be accessible on equitable terms. Many parties believed that reference to efficiency and competition should be included in a purpose section.
- 7.1.8 While the *OEB Act* focuses on economic regulatory issues, the setting of rates and the review of the cost consequences of utility activities necessarily involves consideration of the public interest. The public interest is not a defined term, but over the years the Board has formulated certain parameters that should be considered including: impacts on rates, service, employees and communities; the interest of shareholders; and the regulatory implications.
- 7.1.9 In setting the objectives of a new *OEB Act*, there should be a consideration of issues related to the designation of storage pools under sections 20, 21, and 35; the approval of pipeline construction under section 46; the review of utility ownership changes under section 26; and the jurisdiction resulting from five other statutes: the *Municipal Franchises Act*, the *Petroleum Resources Act*, the *Public Utilities Act*, the

Assessment Act, and the *Toronto District Heating Corporation Act*. Revisions to the *OEB Act* should also consider the Board's responsibilities under Provincial Policy Statements, such as the *Wetlands Policy Paper*. The Board notes that other changes will need to be made to statutes which are not directly related to the Board's current jurisdiction. As discussed below, should the Board's recommendations be accepted, there will need to be links between MCCR's powers over the *CPA* and *BPA* and the Board's licensing requirements under the Sale of Gas part of an amended *OEB Act*.

7.1.10 The Board supports the inclusion of a purpose section in a revised *OEB Act*. However, natural gas regulation in Ontario has historically been characterized by regard to the broad public interest; a purpose section should not serve to limit a determination of the broader public interest. In Direction For Change, the Government of Ontario has called for a restructured electricity sector which is financially sound, supports investment and jobs, and positions Ontario to take advantage of emerging opportunities in a sustainable environment. The Board believes these principles should apply equally to the natural gas industry in Ontario.

7.1.11 The Board is of the view that the *OEB Act* should include a purpose section with such public interest objectives as: a safe and reliable natural gas system; the promotion of the environmentally sound use of natural gas; the enhancement of competition; and the facilitation of the orderly development of the natural gas pipeline system in Ontario.

7.2 SPECIFIC REGULATORY AUTHORITY

"Sale of Gas" Provision

7.2.1 In Direction for Change the Government has outlined an important role for the Board in ensuring that electricity market participants do not abuse market power or engage in anti-competitive pricing or other monopolistic practices. The Board believes this role is important for the natural gas sector as well. The Board has considered what form of legislative framework would best serve the public interest by examining what form of relationship should exist between market participants.

7.2.2 In order to enact many of the Board recommendations, the Board believes that the *OEB Act* should include a part on the "Sale of Gas". The purpose of this part would be to license agents, brokers, marketers and any supplier of gas so as to ensure customers are provided service in a manner consistent with the continuance of the integrity of the natural gas system in Ontario. The recently passed Nova Scotia *Gas*

Distribution Act provides an example of the type of legislative section recommended by the Board.

- 7.2.3 In the Board's view, the revised *OEB Act* should provide for the delegation of the administration of designated provisions of the "Sale of Gas" part of the *Act* to an administrative authority. The Board also believes that it may be necessary to include in the "Sale of Gas" part the ability of the Board, as licensor, to act upon a recommendation of MCCR concerning the marketing behaviour of an ABM. It may also be necessary to amend the *Safety and Consumers Statutes Administration Act* so as to allow delegation of authority provided under the *BPA* and the *CPA* to an administrative authority established under the *OEB Act*.

Performance Based Regulation

- 7.2.4 In many jurisdictions, regulators, utilities and other stakeholders have worked to find more effective and efficient alternatives to traditional cost-of-service regulation. The *OEB Act*, being highly prescriptive, does not provide for regulatory innovations such as performance based regulation. Changes to section 19 of the *Act* to allow the OEB more ratemaking flexibility are currently before the Legislature. The Board believes amendments that allow performance based rate making can complement deregulation by limiting the motivation of a regulated firm to use its monopoly assets in an anti-competitive fashion and should be incorporated into revised legislation.

Forbearance

- 7.2.5 To manage the transition from a regulated to a competitive market, the regulator requires the discretion not only to act, but to refrain from acting when appropriate. Most recently passed legislation, such as Nova Scotia's *Gas Distribution Act* and the federal *Telecommunications Act*, provides for forbearance from regulatory activities where competition can be shown to exist or where it is reasonable to expect competition to work effectively. Forbearance also helps prevent legislative obsolescence.
- 7.2.6 Although the terms are sometimes used interchangeably, there is a difference between forbearance and exemption. Forbearance allows the regulator to re-regulate if and when it determines that the conditions under which it exercised forbearance no longer exist. Exemptions from the *Act* are generally made by the Government pursuant to a provision of the legislation. The *OEB Act* currently contains a number of exemptions, many related to small local producer/pipeline/customer arrangements. The decision to revoke an exemption lies with the Government.

- 7.2.7 Some Working Group stakeholders have argued that forbearance under these circumstances allows too much discretion to the regulator and introduces uncertainty. In order to forbear, the regulator must have an objective set of criteria, or conditions precedent.
- 7.2.8 The Board believes that provisions for forbearance should be included in a revised *OEB Act* and that these provisions should be applied broadly. The regulator should also be able to forbear conditionally or unconditionally. The Board believes the recent amendments to the Manitoba *Public Utilities Board Act* (section 74.1) provide an example of the form of forbearance power that would provide the needed flexibility to address issues in the evolving retail gas market. The Board also believes that inclusion of an appropriate purpose section in a revised *Act* might serve to focus the regulator's discretion to forbear.

Rule Making

- 7.2.9 Rule making allows regulators to set norms of conduct of general application and set general rules of behaviour as distinct from making an order in the course of a particular application. In Ontario, the OSC, which deals with matters of market governance, has powers of rule making. The rule making process is used extensively in U.S. regulatory jurisdictions. It can be used to set codes of conduct, rules regarding the allocation of storage and transportation capacity, environmental practices and rules for facilities construction. By allowing the regulator the ability to define rules of general application, it enables the underlying legislative framework to be less prescriptive as well as to more easily accommodate changes in government policy.
- 7.2.10 The Board believes that rule making powers will promote consistency in regulatory treatment and offer regulatory efficiencies; they will provide for greater flexibility to implement practices and procedures required to set terms and conditions of interconnection with the monopoly distributor. The Board therefore proposes rule making powers be provided in amended legislation.

Powers of Direction

- 7.2.11 A number of parties argued that the Board will require authority (or a clarification of its authority) to ensure the separation of non-monopoly from monopoly functions. Some stakeholders argued that the Board will be constrained in its ability to deal with issues of cross-subsidization unless it is able to consider the competitive impacts of the monopoly operations. The LDCs, in turn, are wary of allowing the regulator too much discretion over their businesses.
- 7.2.12 Monopoly utilities have legitimate interests to protect, but it should be recognized, when deregulating, that these interests may not coincide with what is required for the development of an effective competitive market. The Board does not believe the rate making provisions of section 19 of the *OEB Act* are an effective means of managing the transition to a restructured retail market. Such oblique means are open to challenge on the basis that the Board is seeking to do indirectly what it cannot do directly. As stated in section 5.4 the Board believes an LDC standard gas sales service offering will be required if changes are made to legislation to remove the impediments to transfer title of gas in Ontario. The LDCs have made it clear that they do not wish to maintain the role of system gas supplier. Many stakeholders have questioned whether the LDCs will offer new services or unbundle existing services appropriate to a restructured market. In the Board's view, it is evident that, for an orderly and managed transition to a retail market, the regulator must be the final arbitrator of what types of monopoly services will be in the public interest.
- 7.2.13 The authority to direct certain services to be provided or withdrawn is found in other regulatory legislation. As a guide, the Board recommends consideration of sections 32 and 35 (Part III Rates, Facilities and Services) of the *Telecommunications Act*. Under section 32 of that *Act* the CRTC has broad jurisdiction over named areas of service. Section 35 explicitly allows the CRTC to order a common carrier to provide a service where the regulator determines that a service or class of services is not subject to a sufficient degree of competition to ensure just and reasonable rates and prevent undue discrimination and undue or unreasonable preference or disadvantage.

7.3 INCORPORATING THE UNDERTAKINGS INTO THE STATUTE

- 7.3.1 Part of the Board's jurisdiction derives from undertakings made at various times by the LDCs and their parent companies to the Government. The undertakings relate to activities as diverse as affiliate transactions and commitments to undertake research and development.

- 7.3.2 There is little reason, in the Board's view, to maintain a list of undertakings separate from those prescribed in legislation except where the provision relates explicitly to a non-regulatory policy function. Therefore, with the exception of undertaking provisions dealing with objectives of Government public policy, the generic aspects of the current undertakings should be codified in the new legislation.
- 7.3.3 The Board has been faced with challenges from both the LDCs and other parties on its jurisdiction over the undertakings. Providing for the authority directly in legislation limits jurisdictional ambiguities and thereby reduces risk to market participants. As discussed earlier in this Report, new entry is less likely if companies are uncertain as to the authority of the regulator to ensure that monopoly power is not used to give unfair advantage to the utility or its affiliates.
- 7.3.4 In May 1996 the Board issued its Advisory Report to the Minister of Environment and Energy on Utility Diversification. In that Report, the Board provided its findings on the necessary controls to ensure that ratepayers who are subject to a monopoly are not put at risk as a result of utility diversification activities. The move to full retail competition will change the manner and form of services offered by the regulated utility. There will be pressures in this evolving market for all parties, including the LDCs and their parents, to seek out new businesses as a way of providing value to shareholders. A new legislative framework should recognize that if, as a group, ratepayers do not share in the rewards of diversification, they should not be required to share in the risks associated with diversification activities.
- 7.3.5 In light of the need to revise legislation the Board believes its recommendations in the Diversification Report should be revisited. In particular the Board believes that the *OEB Act* should allow the regulator to ensure that the LDCs and their parents protect the ratepayer or hold the ratepayer harmless as a result of any diversification activity.

7.4 JURISDICTION

- 7.4.1 In Direction For Change the Government has called for the same rules to apply to publicly-owned and privately-owned companies. The Board believes this policy should equally apply to the natural gas sector. Municipally owned natural gas utilities, such as those in Kingston and Kitchener, should not be allowed to compete in the retail sales market unless regulated on the same basis as other LDCs. These LDCs should, like their private counterparts, be able to provide only a standard sales service.

7.4.2 The Board believes that in light of the policy directions for the electricity sector articulated in *Direction for Change*, a review is warranted of the exclusion from the jurisdiction of the *OEB Act* of certain municipally owned corporations engaged in the supply and delivery of natural gas.

7.5 NEW LEGISLATION

7.5.1 The Board believes that the breadth of the changes required may be best accommodated by a new act rather than a revision of current legislation. Such a course of action is likely to provide a more concise, logical set of statutes. The manner in which the Government seeks to replace the *Power Corporation Act* for the electricity sector will provide guidance for achieving symmetry in the natural gas and electricity sectors. The Board commends the recently passed Nova Scotia *Gas Distribution Act* as an example of regulatory legislation that is comprehensive and flexible, yet structured in a clear and simple form.

7.5.2 The Board believes the following principles should be considered if a new act, rather than amendments to the existing *OEB Act*, is preferable:

- Price regulation of the natural gas commodity should not be undertaken where there is an effective competitive market. Gas suppliers should be able to have wide discretion as to the form of service and prices offered.
- Regulation should allow consideration of the broader public interest in matters such as setting rules for system expansion and other aspects of the natural gas sector in which benefits to one group have to be weighed against any detriment to other groups and the environment.
- Regulation should ensure that ratepayers continue to be protected from possible abuses of monopoly power. Specifically, the regulator should be charged with ensuring cross-subsidization does not occur between monopoly and competitive services.
- Regulation should ensure that any of the proposed changes do not jeopardize the integrity of the natural gas system that has served Ontario well.
- As deregulation of the natural gas commodity market proceeds, the regulator must have the ability to save harmless the general body of LDC ratepayers from the financial risk of private transactions between a particular customer and a gas

supplier or marketer.

8. NEXT STEPS

8.0.1 Many of the recommendations, as set out in Chapter 9, provide the Board with the necessary flexibility to regulate in a manner appropriate with the development of the competitive natural gas market. In the Board's view flexibility is needed because the appropriate regulatory structures cannot be pre-ordained, but depend on the maturity of the market and the manner in which it develops.

8.1 LEGISLATIVE CHANGE AGENDA

8.1.1 The Board intends to establish a market design Task Force consisting of affected stakeholders. The initial objective of the Task Force should be the development of a self-management organization charged with the responsibilities delegated to it by the Government and/or the regulator.

8.1.2 The Government should, in consultation with affected parties, begin drafting new legislation to effect the appropriate changes to *Ontario Energy Board Act*, the *Municipal Franchises Act*, and the *Public Utilities Act*.

8.2 BOARD AGENDA

8.2.1 The Board believes it will be necessary to institute proceedings to resolve a number of outstanding issues related to further deregulation, including:

- finalization of an affiliate Code of Conduct;
- setting of rates, charges and terms and conditions for LDC service to apply during and after the transition;
- the unbundling of LDC services necessary for a retail market;
- the development of a customer education program; and

□ consideration of upstream transportation and storage capacity which the LDCs hold on behalf of customers.

8.2.2 The Board will also have to begin a proceeding to determine an appropriate regulated sale of gas service offering (i.e. the SSO). The proceeding will need to consider the obligations the LDC should maintain in the immediate, short and long-term.

8.2.3 The Board will also need, at some future date, to examine whether the conditions precedent exist to eliminate the need for a Standard Service Offering.

9. THE BOARD'S RECOMMENDATIONS

- (1) **The Board recommends that the relevant legislation be amended so as to remove the current impediments to the transfer of title to natural gas in Ontario. The Board recommends that this change be achieved by making a distinction between the supply and the distribution of natural gas in the *Ontario Energy Board Act* and in the *Municipal Franchise Act*.**
- (2) **The Board recommends the elimination of the obligation to supply natural gas under the *Public Utilities Act* and the inclusion of an obligation on the franchised utilities to provide distribution service where pipeline capacity is available.**
- (3) **In order to ensure consumers have access to a safe and reliable supply of gas, available when required, the Board recommends that amendments to remove the impediments to the transfer of title be done only in conjunction with new legislative powers allowing the regulator in the public interest to order the franchised local distributor to provide services, such as load balancing, backstopping and a sale of gas service, and the cessation of such services.**

These recommendations are intended to allow for the replacement of the regulated system supply with a regulated standard gas supply offering by the franchised distribution utility. In the transition to full retail competition the Board will require the authority to ensure the unbundling of system services, like backstopping and load balancing, from the standard offering. When the appropriate market conditions exist the Board would also have the authority to order the standard offering to be ended.

- (4) **The Board recommends that the *Ontario Energy Board Act* be amended to**

provide explicit authority to determine, adjudicate and enforce codes of conduct between a franchised distribution utility and its affiliates.

- (5) The Board recommends that the *Ontario Energy Board Act* be amended to provide the regulator with clear and sufficient authority to govern the relationship between the franchised distribution utility and gas suppliers transporting gas on the distribution system, including the approval of terms and conditions of access.
- (6) The Board recommends that the *Consumer Protection Act* and the *Business Practices Act* be amended to ensure that the unregulated sale of the natural gas commodity, whether directly to a consumer or through an agent acting on behalf of a consumer, is included in that Act.
- (7) The Board recommends that the Ministry of Consumer and Commercial Relations (MCCR) be provided with authority to actively monitor the marketing practices of natural gas agents brokers and marketers and intervene where and when necessary in order to protect consumers. The Board further recommends that MCCR be allowed to delegate its authority to investigate complaints regarding the marketing practices of natural gas to a self-management organization (SMO) as described below.
- (8) The Board recommends that the *Ontario Energy Board Act* include a purpose section with such public interest objectives as: a safe and reliable natural gas system; the promotion of the environmentally sound use of natural gas; the enhancement of competition; and the facilitation of the orderly development of the natural gas pipeline system in Ontario.
- (9) The Board recommends that the *Ontario Energy Board Act* include a part on the Sale of Gas. The purpose of this part would be to ensure agents, brokers, marketers or any gas supplier to an end-use customers provide service in a manner consistent with the continuance of the integrity of the natural gas system in Ontario.
- (10) The Board recommends that a Sale of Gas section contain provision for the Board to license agents, brokers, end-use suppliers of natural gas or any party wishing to undertake the transfer of title of natural gas within Ontario. In order to minimize regulatory burden, the Board recommends that the licensing authority be of sufficient flexibility to set and enforce standards, terms and conditions that are consistent with the activities of the licensee.

- (11) As an instrument to achieve both customer protection and system integrity objectives the Board recommends the establishment of an industry self-management organization (["SMO"]). The Board also recommends that membership in the SMO be a requirement of licensing. The Board further recommends that there be authority for the Board, or the SMO under the Board's delegation of authority, to act upon a recommendation from MCCR concerning the marketing practices of a seller of natural gas.
- (12) To provide regulatory flexibility to manage the transition to an effective retail gas market the Board makes the following recommendations:
- (a) amendments should allow the regulator to forbear, in whole or in part, conditionally or unconditionally, from regulation where the Board finds there is, or will be, competition sufficient to protect the interests of consumers;
 - (b) amendments to allow the regulator rule making authority for the purpose of carrying out provisions of the Act;
 - (c) amendments to allow the regulator to apply performance based and other incentive forms of regulation; and
 - (d) a review of the Undertakings be made, and where ongoing regulatory administrative oversight is required for the protection of ratepayers that these parts be incorporated into the *Ontario Energy Board Act*.
- (13) The Board recommends the establishment of a market design Task Force consisting of affected stakeholders which would develop appropriate market structures for the establishment of full and effective commodity retail competition and the safe, reliable and secure provision of natural gas to Ontario consumers. The initial objective of the Task Force should be the establishment of the SMO.
- (14) In light of the policy directions for the electricity sector articulated in Direction for Change, the Board recommends a review of the exclusion from the jurisdiction of the *Ontario Energy Board Act* of certain municipally owned corporations engaged in the supply and delivery of natural gas.

GLOSSARY OF ABBREVIATIONS AND TECHNICAL TERMS

ABC-T service:	Agency Billing and Collection Service. Direct purchase mechanism under which the ABM sets the price for a customer's gas and the price is shown directly on the gas utility bill. The LDC collects and remits the customer's payment for gas to the ABM. An ABC Service fee is charged by the LDC.
ABM:	Agents, Brokers and Marketers - providers of gas supply and related services.
Backstopping:	The provision of gas supplies in the case of a failure of supply.
BPA:	Business Practices Act administered by MCCR.
Buy/Sell:	Direct purchase mechanism. ABM sells its customer's gas to an LDC outside Ontario. Gas is delivered and resold by the LDC at an approved rate. Customer may receive rebate from ABM for part of the difference between the LDC buy price and the sale price.
CPA:	Consumer Protection Act administered by MCCR.
LDCs:	Local Distribution Companies □ Consumers Gas, Union Gas, NRG, etc.
Load balancing:	Matching customers' demands with supplies on a daily basis.
MCCR:	Ministry of Consumer and Commercial Relations.
MFA:	Municipal Franchises Act. Specifically Sections 8-10.
PUA:	Public Utilities Act. Specifically Sections 55 and 58.
SMO:	Proposed self-management organization for gas suppliers.
System gas supply:	Supply of gas to some customers by the utility, regulated by the Board, and including services such as backstopping, load balancing, etc.

System integrity:	Maintenance of backstopping, load balancing and other services essential to a safe reliable supply of natural gas.
T-Service:	Transportation-Service. Direct purchase mechanism. Transportation and delivery, by an LDC, of a customers' own gas which is purchased outside Ontario.
Working Group:	Working Group on Natural Gas Markets established by the Board with participation by the direct purchase industry, gas utilities, ratepayer representatives, gas producers and environmental groups.
WGR:	Report of the Working Group Dated May 16, 1997.

**LIST OF PARTICIPANTS IN LEGISLATIVE REVIEW
STAKEHOLDER CONSULTATION**

LEGEND TO PARTICIPANTS LIST

- * Submissions received in August 1997, no additional submissions in September 1997.
- ** Submissions received in September 1997 only.
- *** Submissions received in August 1997 and September 1997.
- + Members of the Working Group

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Alliance Gas Management Inc.+**

Association of Municipalities of Ontario +***

CanEnerco Limited+*

Centra Gas Ontario Inc.+***

Cibola Canada Energy Marketing Co.+

City of Kitchener+***

Coalition of Eastern Natural Gas Aggregators and Sellers +***

Comsatec Inc.+***

Consumers' Association of Canada+***

The Consumers' Gas Company Ltd.+***

Consumersfirst Ltd.***

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Direct Energy Marketing Limited+

ECNG Inc.+***

Energy Probe+**

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Enron Capital and Trade Resources Canada Corp.+***

Green Energy Coalition*

Heating, Ventilation & Air Conditioning Contractors Coalition Inc.+***

Industrial Gas Users Association+***

London Board of Education Gas Purchase Consortium and the Ontario Association of School Business Officials***

London GasSave+

Mutual Gas Association+***

Natural Resource Gas Limited (NRG)***

NGC Canada Inc.+*

Natural Gas Wholesalers

Ontario Association of Physical Plant Administrators+

Ontario Coalition Against Poverty+***
Ontario Hydro*
Ontario Natural Gas Association+
Ontario Petroleum Institute+*
PanCanadian Marketing Limited+***
Pollution Probe***
Shell Canada+
Sunoco Inc.+
Suncor Energy Inc.***
TransCanada Gas Services+***
TransCanada PipeLines Limited+
Union Gas Limited+***
Westcoast Gas Services Inc.+

E.B.O. 202 Parties who did not send submissions and were not involved in the Ten Year Review Working Group.

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