# Natural Gas Regulation in Ontario:

# A Renewed Policy Framework

## Report on the Ontario Energy Board

## Natural Gas Forum

**March 30, 2005**

The Board will not go beyond unbundling to pursue functional separation at this time. While some stakeholders were of the view that the synergies between the supply and distribution functions underpin the utilities' ability to provide certain services, the Board does not agree that the integration of functions is absolutely necessary. The utilities could act as system operators and continue to provide their current services without having an integrated customer supply portfolio. However, the Board does not intend to pursue functional or structural separation of the supply and distribution functions. Further analysis is necessary to ensure that the benefits of such a change exceed the costs, and the Board does not consider this issue to be a priority at this time.

***The Board will examine the issues related to further unbundling as part of the generic cost allocation hearing. This process will incorporate the work already under way on this topic.***

## The Pricing Mechanism

**Stakeholders' Views**

Most stakeholders expressed the view that there should be greater standardization of the QRAM process across utilities and that the QRAM should be more formulaic. Both Union and Enbridge expressed interest in further harmonizing the QRAM process, and Enbridge expressed the belief that consistency could be enhanced.

However, stakeholders expressed a variety of views about the pricing structure of the regulated gas supply option. Some stakeholders said that the existing quarterly revisions are appropriate, while others suggested that monthly revisions would better reflect the true cost of gas. The residential customer groups and the utilities supported quarterly price updates. The residential customer groups argued that quarterly price updates contribute to price stability, while the utilities said that quarterly updates help strike the correct balance between the desire for accurate price signals and the desire for reduced price volatility.

On the other hand, most of the marketers believed that the price should be revised monthly, to more accurately reflect gas price volatility and to reduce the PGVA and associated carrying costs. One stakeholder expressed the belief that a quarterly adjustment dampened the daily and monthly price fluctuations. This dampening reduced the difference between the marketers' fixed-price options and the regulated gas supply option, and possibly created a barrier to entry of new competitors into the market.

In terms of pricing, there was some support among stakeholders, including Union and Enbridge, for a regulated-utility, fixed-price, one-year contract offer to customers. However, the majority of stakeholders said that the utilities should not have the flexibility to provide fixed-term, fixed-price gas contracts. In particular, stakeholders argued that a fixed-term, fixed-price offer could:

- impede customer mobility;
- create a vested interest for utilities to maintain a minimum number of customers;
- create barriers to entry for new competitors; and
- compete directly with marketers.

Some support also existed for a spot price pass-through, to eliminate the utilities' risk-management activities and to accurately reflect the market price of gas.

**The Board's Conclusions**

In determining the appropriate pricing structure for regulated gas supply, the Board must consider the trade-off between a price signal that accurately reflects market prices and price stability. The current pricing process, whereby the price is set every three months on the basis of a 12-month price forecast, represents a balance between market-price signals and price stability. Therefore, from one perspective, the regulated gas supply price could be said to reflect a rolling one-year price.

The Board needs to consider whether the current balance between price signals and price stability is appropriate. In particular, it needs to address two key concerns:

- Is a 12-month price outlook appropriate as the basis for pricing the regulated gas supply option?
- Is the frequency of the price adjustment appropriate?

On the first issue, it may be appropriate for the price to reflect some other level of variation. In other words, instead of reflecting a rolling one-year price, the price could reflect a different time period. The question is, over what time period should the price outlook be based? The Board is not of the view that a spot price pass-through would be appropriate, because of the potential for volatility that would result. On the other hand, a reflection of seasonal price fluctuations could strike a reasonable balance among market price signals, administrative simplicity and customer acceptance. The Board would also need to consider the impact of such a change on the PGVA.

On the second issue, the Board recognizes the link between the utilities' actual procurement costs and the price set through the QRAM process. The utilities acquire supply in the marketplace primarily through monthly indexed contracts. The difference between the actual procurement costs and the price set through the QRAM process is collected in the PGVA. The amount in the PGVA is then recovered from customers. Customers, therefore, receive a supply that is priced monthly, although the price they see is smoothed over a specific time frame. At this time, the Board sees no compelling reason to depart from a quarterly price adjustment. However, if the time period of the price outlook were redefined, then the frequency of the price adjustment would need to be re-examined.

The Board believes that the QRAM price should be a transparent benchmark that reflects market prices, and, therefore, the methodology for calculating this price should be similar for all utilities. The market needs an accurate and consistent price signal, most stakeholders agree. Therefore, the Board believes, the method for determining the reference prices should be formulaic and consistent and, similarly, the methods for determining the PGVA and for disposing of PGVA balances should also be formulaic and consistent.

***The Board will develop guidelines for the standardization of the quarterly rate adjustment mechanism, with the above objectives in mind. As part of this activity, the Board will consult in more detail on the underlying pricing that should be incorporated.***

With respect to whether utilities should be able to offer fixed-term, fixed-price contracts, the Board concludes that it would not be appropriate at this time. The regulated gas supply option should be seen as a default supply – a no-written-contract, no-obligation, market-priced choice – where the mobility of the customer is essential. The Board believes that introducing a utility-provided fixed-term, fixed-price contract offer at this time would present two risks. First, the fixed-term aspect could reduce the utility's ability to ensure full customer mobility. Second, the fixed-price aspect would compete with the product offered by the retail marketers. It would move the regulated supply away from being a default supply, and result in more direct competition between the utility and competitive suppliers. A fixed-term, fixed-price contract offer would require substantial additional regulatory oversight related to the underlying contracting, the customer-utility interface and the allocation of risk. The Board does not believe that this is the appropriate direction to take, and most stakeholders shared this view.

***The Board believes that a utility-provided fixed-term, fixed-price contract offer is inappropriate at this time.***

## Long-Term Supply and Transportation Contracts

### Stakeholders' Views

Many of the stakeholders (including customers, upstream players and utilities) asserted that the regulated gas supply is implicitly used to underpin future infrastructure development in the natural gas market. Some emphasized the importance of the utilities' creditworthiness, noting that utilities are among the few parties able to enter into the long-term contracts needed for infrastructure development. Views on the appropriate