Stakeholders Alliance for Electricity Competition & Customer Choice

Policy Backgrounder

The Stakeholders' Alliance for Electricity Competition & Customer Choice (SAC) believes that the introduction of competition, customer choice and a new regulatory system for Ontario's electricity sector has put the province on the right track to achieve a wide array of benefits for Ontarians. A competitive electricity market ensures competition in price, competition in customer service and results in more product innovation. A reliable, cost-competitive electricity marketplace, with the supporting infrastructure necessary to generate, transmit and distribute electricity across Ontario, is the best way to achieve this wide array of benefits for Ontarians.

The launch of a competitive electricity market on May 1, 2002 was not an end in itself. Rather, the opening of the electricity marketplace provided the opportunity and a catalyst for market stakeholders to work to achieve the economic, environmental and social benefits that come from a well functioning competitive market.

These benefits, however, will only be secured if Ontario creates a predictable and independent regulatory regime with minimal government interference, while facilitating the development and operation of truly competitive energy markets. When appropriate government and regulatory policy is combined with the drive for innovation that a competitive environment creates, Ontario will become a key hub for the North American energy market with broad benefits for all customers.

SAC came into being in the fall of 1996, after the release of the Macdonald report (A Framework for Competition), to ensure that the momentum for change outlined in the Macdonald report continued, and that a voice representing the interests of major electricity stakeholders, including business customers large and small, was heard in the debate.

SAC was concerned that Ontario Hydro would implement its own self-interested and bureaucratic vision of a token competitive system – a continuation of its effective monopoly over generation and transmission in Ontario and increasing presence in retail electricity markets.

SAC believed in 1997 that "A Framework for Competition" was a reasonable blueprint for an orderly transition to a competitive market. The advice given in this landmark report is as relevant today as it was in 1997.

The Macdonald recommendations called for transition from a large integrated monopoly system to a market-driven system, based on the well-established fact that competition forces companies to be more efficient and their performance to be more customer-oriented. The recommendations also provided for customer choice and included measures to ensure that Ontario Hydro's debt and other potential stranded costs would not be a burden on the public purse.

At the core of SAC's position is the belief that customers' primary interest will remain the dollar amount of their bills and the reliability of supply. SAC believes that, had the market been opened in a manner articulated in the Macdonald Committee's blueprint[1], the resultant competitive pressures would eventually lead to lower operating costs than might otherwise be the case, and give all customers options for choice. SAC argued that power cost and reliability are fundamental to the success of efforts intended to modernize and revitalize Ontario's electricity sector.

This is why SAC remains steadfastly focused on competition, believing that the right forms of ownership will evolve over time once a truly competitive market is in place. SAC maintains that ownership changes should be negotiated only when they are in the best interest of the stakeholders, including taxpayers.

SAC's Positioning is Consistent
For almost seven years SAC's broadly based alliance of stakeholders representing major industry, generators, marketers, customers large and small, electrical utilities, and boards of trade and chambers of commerce, has firmly held and advocated the following positions on electricity restructuring in Ontario:

1. Separate the transmission system including the independent system operator, from Ontario Hydro's generation assets, and establish it under its own governance.
2. Set a time frame for Municipal Utilities and Ontario Hydro Retail, established as a municipal utility under its own governance, to work out the restructuring of local distribution through regional studies.
3. Establish a Transition Agency independent of Ontario Hydro with the mandate and authority to effect the changes needed to introduce a competitive electricity market.

These positions have guided SAC's involvement in discussions around restructuring in Ontario's electricity sector, including asset decontrol, stranded debt, the Bruce Power transaction, the MEU transfer tax, market opening, the Hydro One IPO and minority sale, and the events around and after the introduction of Ontario's "Action Plan to Lower Hydro Rates" on November

The Way Ahead

There remain a number of serious impediments to achieving success. In order to achieve the full benefits of electricity restructuring in Ontario, SAC recommends action on the following issues.

Customer Choice
The government introduced measures in November 2002 to relieve low volume and designated users concerns over prices. This appears to have achieved its goal, but it should not be expanded and must be a temporary device. In order to move ahead, fresh mechanisms are needed to ensure that no call is made for the expansion or continuation of this short-term, temporary (to 2006) solution.

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[1] In particular, the provisions providing for the breakup of OPG, which would have led to an introduction of new supply entrants thus providing for true options from which consumers could choose on the basis of cost, performance and customer service.

SAC's view is that the original vision for restructuring in Ontario, i.e., to drive choice and a market-based electricity system as an overarching principle down to the retail level remains a core principle for restructuring in Ontario.

Default supply
SAC takes the view that large volume consumers are sophisticated and can continue to be active participants under current and proposed arrangements. However, mid-size electricity users (largely small- and medium-size businesses) which are categorized as 'large users' for the current price cap regime, are clearly not in the same league and this group will need special analysis, attention and support if they are to successfully participate in the market.

At the other end of the spectrum, SAC maintains that a critical issue that must be addressed before 2006 if Ontario is to successfully re-launch a competitive electricity marketplace is the introduction of measures that serve to balance the practical need for low volume customer protection against extreme price volatility, while providing for customer choice.

In 2002, the spot market pass-through price arrangement became a triggering event. Clearly this needs review, and a least cost solution that is politically acceptable must be brought forward on the clear understanding that the status quo (i.e. a continuation of the 4.3 cent rate cap, financed by Ontario taxpayers, is not an option).

SAC believes that future actions on standard supply service must be guided by five principles:

1. The successful 'restart' of a competitive electricity marketplace at the low volume customer level will require an informed consumer. Consequently, Ontario should strive to ensure low volume consumers are well informed about why change in the electricity sector is required, what the available options are, and what the end benefits will be.
2. Measures to provide less price volatility over time must be available to low volume consumers. This price stability must be facilitated through commercial means, not a price cap at today's rates.
3. Low volume customers should be able to choose from whatever choices the market offers. Customers who decide to take no action would be considered standard supply customers. Standard supply customers would be supplied at a fixed price over a specific period of time, similar to current arrangements for standard supply customers for natural gas. The power for standard supply customers would be secured through a portfolio of power purchase agreements arranged by one or more appropriate agencies, such as the Ontario Electricity Financial Corporation. Customers could also opt to secure their power on the spot market and take ongoing responsibility for the management of their electricity costs, or they could opt to sign contracts with retailers to buy their power at fixed prices over a longer period of time.
4. There should continue to be freedom of entry into retail markets for all interested retail participants.
5. Demand side management and energy conservation must be encouraged as a key component of meeting Ontario's environmental objectives and the future energy demands of Ontario. Once again, this will require informed customers who can both understand and thus choose from various options that might be

offered. However, these programs must have commercial and market discipline to ensure their long-term viability and must be financed in a way that does not compromise Ontario's fiscal and economic health.

Beyond price caps
SAC believes that a well-managed transition into a competitive market by 2006 is key to future successful electricity restructuring in Ontario, and key to public acceptance of these vital reforms.

The events of 2002 and 2003 have damaged both the concept of restructuring and the credibility of many participants, including governments. The need for change and its wide benefits must be better demonstrated, in an open and transparent fashion, including public debate about the various options available to Ontario going forward.

Ontario cannot wait until 2006 to begin this debate. We must begin discussing now the longer-term context in which these reforms are being developed and engage Ontarians in a vision of the future in which competition and customer choice are key principles of a robust, full-cost, consumer focused electricity system. This will require all participants to do a much better job of preparing consumers for the way ahead. A better understanding of consumer needs and wants, and much better communication of the motives and benefits of restructuring through increased public advocacy among all proponents will be required if this effort is to be successful.

Balanced approach
Any solution contemplated going forward must balance both supply and demand-side concerns and issues, and commercially based market mechanisms must be the preferred choice to meet objectives on both fronts.

Conditions to date have discouraged the entry of new generation in the province and must be addressed in the immediate future to assure adequate generation resources and a truly competitive market.

Competition requires more than just putting a legal and regulatory structure in place. Real competition does not yet exist in Ontario and will not exist for years if present policies are followed. Therefore, strong emphasis must be placed on mitigation of OPG market power to achieve a truly competitive electricity market:

The current decontrol process is not achieving the primary objective of creating effective competition in generation. The continued dominance of Ontario Power (OPG) means there is little real competition in generation. Since generation accounts for some two-thirds of delivered wholesale electricity costs, the opportunities at this time for cost reductions are limited.

SAC continues to believe that competition (and hence supply) can be addressed thorough market based mechanisms. However, this cannot happen until the issue of OPG asset decontrol is fully addressed, and its market power is diminished. In this respect SAC recommends that decontrol be revisited, and its principles and timing be discussed publicly.

SAC advocates a transitional arrangement for OPG assets similar to that espoused by the Macdonald Committee, which would see OPG assets reorganized into several independent generation utilities, but still owned by the province. The proper form of ownership would become apparent through further public debate in the longer term and once Ontario moves beyond 2006 into a fully functioning commercial market.

With respect to demand-side concerns and issues, SAC believes that it is necessary to distinguish between wholesale and retail markets in terms of demand responsiveness and policy development.

While retail market demand-side management (DSM) initiatives may have desirable “social” benefits they will have only limited efficacy in meeting supply concerns over the short term. Because retail prices are currently capped until 2006 low volume consumers are not provided with appropriate price signals or billing mechanisms. Therefore, economic demand response mechanisms would need to operate outside of the market.

Such mechanisms will take time to develop, and must be developed in the context of regulatory requirements and the interests of all retail market participants. However, for these initiatives to ultimately succeed and garner credibility, they must have underlying commercial discipline. SAC believes that retail DSM initiatives should be reflected in consumer prices – not be paid for outside the electricity system, for example through taxes.

The ability of wholesale market participants to respond to market signals is substantively different than retail customers. Wholesale initiatives may indeed provide much needed relief at times of electrical system stress. Specifically, wholesale market participants (industrial loads and generators) are subject to wholesale market prices and can therefore directly respond to market price signals. As such, wholesale market participants represent the best opportunity for demand side initiatives that will benefit the electricity marketplace at times of stress.

It is clear that Ontario would benefit from more flexibility in both supply and demand resources over time to ensure continued system security and reliability. Optimizing system operation can be evaluated based on the cost of bringing on incremental generation, or improving reliability through incenting load reductions, with the associated avoided generation costs. SAC supports market-based solutions to the problem of resource adequacy. In particular, SAC supports improving the incentives provided to all wholesale market participants to address resource adequacy concerns.

The Consequences of Inaction

Lack of forward planning by government with stakeholders’ input in the design of a rate freeze exit strategy in the context of a longer-range energy vision for Ontario risks the following undesirable consequences:

1. Power blackouts owing to lack of arrangements for resource adequacy;

2. Higher than necessary electricity prices for all consumers, large and small;

3. Less than optimal use of available and emerging generation fuel choices and other technologies to both meet and manage energy demand;

4. Lost investment and employment and diminished economic prospects;

5. Rising public debt and a growing intergenerational shift of the tax burden to our children;

6. Weakened capacity to tackle energy-related environmental concerns.

These unpleasant consequences are avoidable if government and industry work together to prepare and implement the changes necessary to avoid them.

About SAC

The Stakeholders Alliance for Electricity Competition & Customer Choice (SAC) is a broad coalition of Ontario associations and organizations representing Ontario electricity producers, customers and service industries, small- and medium-size businesses operating in all sectors, plus electricity distributors who deal directly with residential customers.