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Ontario Energy Board

**SPEECH**

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Thank you \*\*\*\*

And thank you to the Northwind Professional Institute for organizing this thought provoking Forum and for your great hospitality.

I think one of the great advantages of this kind of Forum is that it brings together so many different people and perspectives and we can learn a great deal from one another through the interchange of ideas and insights.

Now, I know you've all had a very full day already, dealing with some of the big issues related to the electricity sector. So this evening, I thought I would come at this from a slightly different angle and talk to you about natural gas.

You may be wondering why I would come to an electricity forum and talk about gas! But the fact is that the interface between gas and electricity is, I believe, going to be one of the most important issues facing all of us in the years ahead.

Now why do I say that?

As you know, the Provincial Government is committed to a policy of phasing out Ontario's coal-fired power plants by the end of 2007. Replacing that supply - about a quarter of the generating capacity in this province - is going to be a big challenge.

The Government targets - to reduce electricity demand and increase supply of renewable energy - will certainly help to reduce the gap, but given the tight time lines, natural gas-fired generation will likely account for most of the replacement capacity.

The first step in acquiring that capacity - a Request for Proposals for 2500 MW - is already underway.

And so the relationship between gas and electricity - both of which are regulated to varying degrees by the OEB - is intertwined more closely than ever.

The good news is that even as gas becomes more and more important to the supply of electricity in this province, we at the OEB are well placed to oversee key aspects of that evolution, indeed to provide a public process for it.

When it comes to gas, this is an area where we have a great deal of experience. After all, we've been regulating gas for over forty years. We know the sector. We understand its dynamics. And, by and large, it's a sector that works very well - gas is traded in open markets, responsive to market demands and subject to true market pressures.

So what is it about these gas-fired generators that attracts the interest of the OEB?

Well, first of all, they're large - individually and together. Each one will be among the largest consumers of gas in the province. Combined, they might increase demand for gas in Ontario by as much as 25%. And on a very cold winter day, when our demand for natural gas is peaking, we can expect that these plants will be operating flat out - just as coal plants are at this very moment. Under these conditions, the peak demand for gas in Ontario could increase by a third for example from about 3 BCF to 4 BCF per day.

What that suggests to us is that we are going to need more gas infrastructure to ensure reliable gas supply. Indeed, the reliability of our electricity supply is going to depend on it.

So that's the first reason for our interest - much greater demand for gas in the province. Second, the way these customers use gas is much different from the traditional loads that the gas system has been serving.

Most retail gas customers use the majority of their gas for heating in the winter, creating a highly seasonal demand. Large industrial customers, by contrast, have a relatively steady demand year-round.

And because these new gas plants are expected to operate as midload or peakload plants, they'll be busy both summer and winter. As such, they'll want to have the ability to acquire and dispose of gas at very short notice as prices in the electricity market move up and down.

We're fortunate that Ontario is at the confluence of several major pipelines that, combined with gas storage facilities in southwestern Ontario, has led to the development of the Dawn Hub. This is an important source of flexibility for gas trading - and gas consumers - in Ontario. We need to ensure that this flexibility continues.

So additional infrastructure is likely to be needed, additional flexibility in our markets is going to be needed and all this has to happen in the next two years - by 2007.

Going forward, we will also need to consider who will bear the costs associated with increased reliance on gas-fired generation. Generators? Electricity consumers? Gas consumers? or a combination?

So what is the OEB doing about these matters?

Well, quite a bit. In fact, we've already started. When I became Chair, I recognized that the Board needed to re-examine the regulation of the natural gas sector in Ontario. We launched the Natural Gas Forum - the most comprehensive review of that sector in over 8 years - as a means of determining any regulatory mismatch. Regulatory failure can flow from the failure to match the tool to the problem ahead. So we must ask ourselves what is the right response to an expected market change?

One of the key issues to emerge from the Natural Gas Forum is the expected growth of gas-fired generation. It is clearly of concern to our stakeholders and it will form an important part of our final report which we should be publishing in the next month or so.

One of the areas we're taking a very close look at is storage.

As you know, storage in this province is one of those "heritage" assets. Much of it is deeply depreciated and seasonal storage service is being provided to customers at rates well below its current market price.

Needless to say, that arrangement serves existing customers very well. But we are less certain it will continue to serve them well in the future. Power generators have told us that they will be looking for additional storage - and will want to draw from it much more frequently than traditional gas consumers.

The problem is that transmission limitations, particularly within Ontario, make it difficult for the generators to move gas when and where they need it. One submission to the Natural Gas Forum noted that gas-fired generators need services such as intra-day nominations, higher deliverability and increased flexibility on consumption - none of which are currently available in Ontario's gas market.

This raises a particular set of questions for us at the OEB. Will Ontario get sufficient investment in storage - not just the quantity, but the deliverability - with the current arrangements? What about the needed investment in the associated transmission? Can we be assured that there will be adequate investment in storage and in the associated transmission to support the development of the Dawn Hub? And will this investment happen more readily if we refrain from regulating storage rates? What mismatches has the Natural Gas Forum identified between the objectives we are seeking and the tools we are employing?

These are the kind of issues we'll be addressing in our report.

We also know that at the end of the day, somebody has to pay for all of this. As the regulator, we are charged with looking out for the public interest, for protecting consumers and fostering a viable energy sector. We will need to ensure regulatory certainty for those wishing to make investments and to ensure for providers and consumers, that costs are recovered in a just and reasonable manner.

Now, just before leaving the Natural Gas Forum, let me make one final point. While restructuring of the natural gas sector - to introduce competitive market forces - has not been perfect, it *has* evolved, over the years, with a minimum of disruption or crisis. Regulation has been carefully designed to remove impediments to competition.

That was possible because the regulator, the industry, consumers and others, worked together. In contrast to the electricity industry, there has been little government involvement in the implementation of market reform. And where there was government involvement, it was primarily to facilitate what industry, stakeholders and the OEB were attempting to achieve.

There is an important lesson to be learned here: that regulation in the public interest is not at odds with achieving substantial policy change and, indeed, using the right regulatory tool can make a major contribution to such policy development.

Let me turn for just a moment to the impact of gas-fired generation on the *reliability* of Ontario's electricity system.

The blackout of August 14, 2003, reminded all of us that we can't take electric reliability for granted. Our electricity system is part of a large, interconnected North American system. As a regulator, we see it as our responsibility to understand what's going on in electric reliability - not just here, but outside Ontario as well. And certainly increased reliance on gas-fired generation is an important phenomenon south of the border.

Indeed, our American friends are looking very closely at the inter-relationship between gas and electricity. The North American Energy Standards Board (NAESB), for example, has formed a gas/electric coordination task force to look at, and I quote, "possible standards creation and revisions of existing standards related to coordination of the interaction between the scheduling of electric and gas transactions ...." end quote. The thrust of that task force is to "ensure that both groups are informed as to the other's progress and goals."

Now, to be sure, there are differences between the American system and our own, but I think it's instructive to see where they are headed and perhaps learn from their experience.

The cold snap that enveloped New England last winter is a case in point. During several days of bitterly cold temperatures, New England's electricity system became much more difficult to forecast and operate because of the increased uncertainty about the supply of gas. The spot market for gas, meanwhile, proved to be both illiquid and volatile and experienced high prices.

This raises an important concern for regulators and that's the possibility that the gas and electricity markets might be more vulnerable to manipulation under extreme winter conditions.

Indeed, the U.S. Federal Energy Regulatory Commission, quite appropriately, investigated the New England cold snap. While it determined that the behaviour of the market participants was, in fact, competitive and that the prices reflected the underlying supply and demand conditions, it was important that the regulator investigated this kind of event.

Now, as I mentioned a moment ago, the situation here in Ontario is somewhat different. We have more pipelines and storage than they have in New England and so we should be in a better position to deal with a cold snap. But as I said, we are also interconnected. So problems with the delivery of gas in the American system not only affect their electric reliability, but could also affect ours here in Ontario as well.

More directly, the New England episode demonstrated that, while there was no manipulation, the two sectors simply were not well coordinated - and in some cases, not really communicating at all. Any holdups in the supply of gas were not being reported to generators, while the electricity market was not providing incentives for generators relying on the spot market to contract for - and hold - gas.

In other places, such as the United Kingdom, the regulator requires the operators of the electricity and natural gas systems to coordinate their efforts to ensure that there is adequate flexibility to deal with abnormally cold conditions.

If we are going to avoid the kinds of problems experienced in New England, we need to ensure adequate gas transportation capacity, appropriate storage arrangements and effective coordination between the gas and electricity sectors.

My message to you tonight is that, as the government moves forward with its policies, the OEB is working hard to shed some light on the gas sector and regulatory issues associated with reliability of supply in Ontario.

At the OEB, we see this as a key responsibility - and a tremendous opportunity. Smart, forward-looking regulation will help to build greater confidence - in the public and in the industry. And greater confidence, in turn, will lead to policy stability because we will have reduced the biggest motivation for making policy change - public dissatisfaction.

As such, examining the relationship between electricity as energy and natural gas as fuel is imperative. We are not looking for transformational change. Rather, we will identify incremental improvements that we can make to the structure of the regulatory treatment of the industry so that energy regulation provides a platform, not a barrier, to the efficient development of these sectors.

Thank you and now I would be happy to try and answer any questions you may have.