

# THE ELECTRICITY PRICING, CONSERVATION AND SUPPLY ACT

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It has been almost five months since the Ontario Government introduced the Electricity Pricing, Conservation and Supply Act (Act). The Act and the associated regulations brought in a number of controversial amendments to the existing provincial regulatory regime and significantly changed the landscape for everyone participating in the Ontario power market.

Most notably, the commodity price of electricity was fixed at 4.3 cents per kWh for certain customers, effectively destroying the retail market. The Ontario Electricity Finance Corporation (OEF) was charged with the responsibility of funding the difference between the spot price and the 4.3-cent fixed price.

As the weather grows warmer and power demand slows, the heated debates around the Act are beginning to cool down — and dangerously so. The adverse impact that the Act continues to have on Ontario's electricity market has not been frozen along with electricity prices. The effect of the changes will be felt by government coffers and many industry players, even before the province's summer peak hits.

The changes to Ontario's legislation were significant and many, and not all the detail can be discussed in this review. Here are some of the highlights and a brief discussion of the impacts upon Ontario's electricity market.

## WHOLESALE AND RETAIL MARKET

The new legislation creates the concepts of "designated consumer" and "low-volume consumer" by adding new definitions to the Ontario Energy Board Act (OEB Act). The definition of a designated consumer includes a number of governmental institutions, schools, charities, hospitals and similar entities. A low-volume consumer means a consumer who annually uses less than 250,000 kWh of electricity.

The Act amends the OEB Act to prescribe a fixed electricity price for low-volume and designated consumers. In essence, this caps the electricity price

for low-volume and designated consumers at 4.3 cents per kWh. The cap is retroactive to May 1, 2002 when the Ontario market opened and remains until 2006. The provincial government, through the OEF, is responsible to make up the difference between the market price, established by the Independent Electricity Market Operator (IMO) and the fixed price of 4.3 cents. Industry experts indicate that the cost to the government for this difference has amounted to nearly \$1 billion since May 1st, 2002 and continues to grow.

The legislation effectively overrides any power purchase agreements entered into by low-volume and designated consumers for a fixed price for power. In other words, consumers who had agreements for a fixed-power price can still enjoy the 4.3-cent cap.

For the remainder of the province's electricity consumers (e.g., non-low-volume or designated consumers), the spot price of power applies, unless that customer has hedged through a fixed-price contract.

Local distribution companies (LDCs), retailers and the IMO all have new responsibilities vis-à-vis administering the 4.3-cent price cap to ensure that qualifying customers pay no more than 4.3 cents per kWh. The actual cost of making up the price difference is, however, ultimately borne by the OEF.

The provincial Crown and its agents are not liable to compensate any person for any past, present or future losses or expenses relating to, or resulting from, the amendments in the Act or from the actions taken pursuant to those amendments or the associated regulations. The Crown was careful to shelter itself from claims arising from their actions in the provincial electricity marketplace.

## THE ONTARIO ENERGY BOARD

The Minister has been given substantial new powers to issue directives to the OEB. These powers bring uncertainty to the Board's jurisdiction.

The Minister may now issue directives regarding:

- 1) the promotion of energy conservation, energy-efficiency, load management and alternative and renewable energy sources; and
- 2) the conditions contained in Ontario Power Generation Company Inc.'s generation licence regarding the Market Power Mitigation Plan rebate.

The OEB may no longer commence a transmission and distribution rate order proceeding on its own motion. Applications for distribution and transmission rate orders can only be made with the written approval of the Minister. The Minister may also require the Board to review and amend a rate order, in a manner specified by the Minister, without a hearing.

## LOCAL DISTRIBUTION COMPANIES

LDCs were required to issue the \$75 rebate cheques to qualified consumers in December 2002, as part of the retroactive rebate for the 4.3-cent price cap. This represented an unprecedented move by the government and an overwhelming expense to LDCs for the significant administrative fees associated with distributing the rebates.

For an existing LDC to continue operating as a for-profit entity, the municipal council controlling the LDC was required to pass a resolution affirming its intent to keep the LDC a for-profit corporation under the Ontario Business Corporations Act.

For a LDC whose council does not pass such a resolution, it continues to earn the OEB-fixed debt rate of between 6.8 per cent and 7.25 per cent on its deemed debt component of capital (which varies from 65 per cent of rate base for large LDCs to 50 per cent of rate base for smaller LDCs). The LDC will, however, earn zero per cent on its equity component.

It should be noted that even in the United States where non-profit electric utilities exist, the utilities are still able to earn a sum of money in lieu of a profit to recover expenses such as capital and operating reserves, capital expansions,

etc. These US utilities are simply not allowed to earn a dividend — which is the true meaning of non-profit. The Ontario Government's notion of non-profit as having a zero per cent return on equity is akin to a "for-loss" concept.

For LDCs whose municipal shareholders pass the specified resolution, rates will still be frozen for the foreseeable future and the value of the utility will, therefore, be lowered.

The Act also amended the Electricity Act, 1998 to prohibit LDCs from disconnecting customers for non-payment until March 31, 2003. For anyone disconnected between November 11, 2002 and April 1, 2003, the LDC was required to restore the connection at no cost and compensate for losses suffered as a result of such disconnection. The moratorium on disconnection has now come to an end.

## TAX INCENTIVES

The Act contains a number of tax exemptions and incentives to encourage the building of new electricity generating capacity and the conservation of electricity at the consumer level. The Government expects that these incentives will encourage private sector development to address Ontario's generation shortfall.

## GENERATORS

- The Act amends the Assessment Act to provide temporary tax exemption from municipal property and school taxes for new/additions to existing generating facilities that generate electricity from an "alternative or renewable source of energy".
- The Act permits a corporation to deduct from income an "incentive" in respect of a qualifying electricity generating facility (a facility that commences generating electricity from an alternative or renewable source of energy after November 25, 2002 and before January 1, 2008 or a facility that is designated by the Minister of Finance and satisfies conditions prescribed by regulations).
- The Act provides a deduction of the capital cost of property used in the generation of electricity from an alternative or renewable energy source.
- The Act provides for a 120-month period, or longer as prescribed by regulation, where there is a deduction from gross revenue resulting from the generation of electricity

from eligible capacity. For hydro-electric generators there is a provision, which allows the government to extend the existing tax exemption beyond the existing 120 months by regulation.

- The Act provides the government with authority to make regulations providing for a rebate to: an owner of an eligible electricity generating facility that generates electricity from an alternative or renewable source of energy; and an owner of a deep lake-water cooling facility.

## CONSUMERS

Consumers who purchase a new "energy efficient appliance" between November 25, 2002 and November 26, 2003 are eligible for a provincial sales tax rebate. "Energy efficient appliance" is defined as an appliance that is "Energy Star Qualified" in the Energuide Appliance Directory published by Natural Resources Canada for 2002 or 2003.

The Act also provides for a tax rebate equal to the PST paid for a solar energy system purchased and incorporated into residential premises between Nov. 25, 2002 and Nov. 26, 2007.

## IMO

IMO, the clearinghouse for all power transmitted through Ontario's electricity transmission grid, is now required to seek the approval of the Minister prior to making its fee submission to the OEB. If the Minister refuses to approve, the fees recoverable by the IMO are frozen at the current fiscal year's rates. There are also changes to the administration of all market rule amendments, which are now subject to ministerial approval or revocation.

## CONCLUSIONS

The impacts of the Act upon the

newly-opened competitive electricity market are many and will continue to be felt by all market participants for some time. Most notably, however, because low-volume and designated consumers enjoy a capped price for power, the provincial government has incurred enormous and as yet untold expense in making up the difference between the capped price and the true price. Though government officials have stated this model is "self-funding", many reports have indicated losses in the hundreds of millions since the market opened on May 1st, 2002.

The full impact upon LDCs has yet to be felt, but it is safe to say that they have been hit hard and continue to struggle to keep their businesses alive.

Perhaps, most importantly, by setting a price cap for a majority of consumers in the province, the government has removed any incentive to reduce power consumption for these consumers. This, coupled with the disincentive to investors to finance the construction of much needed new generation, has created a near-crisis supply shortage in the province.

Although incentives for renewable projects are helpful, such projects will not be enough to address the supply shortages felt during peak periods or when existing generation is offline. Without new generation, the province's dependence on imported power during times of shortages will increase, as will the significant premiums associated therewith.

The government's model may simply become unsustainable as the provincial debt grows along with electricity demand.

*This article is for general information purposes only. It does not consist of a comprehensive review of the substantive matter discussed herein and does not constitute legal advice. ET*



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