

Energy

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Energy Restructuring: What You Should Know.

As of May 1, 2002, buying electricity in Ontario has become more complicated, with a variety of sophisticated options available to corporate consumers. New retailers and brokers have descended on the business community, as well as many familiar ventures in new guises. These providers and middlemen offer a multitude of products and services that are generally outside the experience of their potential customers, but may impact many businesses' bottom line.

This newsletter seeks to provide Goodmans' clients with an outline of the new electricity environment and some of the main issues raised by new electricity options. We focus on three types of offerings: (a) electrons (also known as electricity commodity); (b) metering services and equipment; and (c) the construction of new electricity facilities.

The New Electricity Environment

Ontario's electricity laws have been rewritten, introducing a myriad of rules affecting electricity enterprises and their customers. Understanding the essence of these rules is the first step toward effectively evaluating the multitude of new electricity offerings.

The central tenets of Ontario's restructured electricity industry are the separation of the supply of electricity (generation and retail sale) from the wires used to distribute electricity from where it is generated to where it is consumed and the introduction of competition into the supply sector of the industry. In other words, a corporate customer cannot choose whose wires it uses (with limited exception), but can choose from whom to buy the electricity itself. Whomever a customer chooses to supply its electricity will use the transmission and distribution wires of Hydro One and the local distribution company to deliver the electricity, for which a charge is added to the price.¹ The price of transmission and distribution is regulated by the Ontario Energy Board ("OEB"). This is similar to the manner in which the supply of natural gas is regulated in Ontario.

The Price Of Electricity

The price of electricity itself is not fixed by regulation. Customers have two choices: to purchase electricity from the spot market through the customer's local electricity distributor (called standard or default supply) or from a retailer. If a consumer does not explicitly contract to buy electricity from a retailer it will receive electricity at the standard supply price. Standard supply is priced based on an electronic spot market where generators bid to supply electricity to a power pool at a chosen price every few minutes. Sufficient bids, starting at the lowest bid, are accepted until the electricity demand for that time period is filled. The last accepted bid price for each time period is the spot market price. As a result of this system, the spot market price of electricity can vary dramatically with the effect of supply and demand. Because electricity cannot be stored (with limited exception), increased demand - such as during a hot summer day - must be met imme-

¹ At this time, the price for transmitting electricity from where it is generated to the customer is not contingent on the distance between them. In the future, such distances may result in an added charge, commonly called "locational marginal pricing". Electricity offerings often refer to such future charges.

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diately by increased supply, often at a higher price. Moreover, the Ontario, Quebec and U.S. electricity markets are interconnected and, as a result, Ontario's electricity prices are impacted by events outside the province.

The alternative to standard supply is purchasing electricity from a retailer, often at a fixed price. Retailers are middlemen², buying electricity at wholesale prices from generators, using financial tools³ to hedge against the risk of price spikes⁴ and selling electricity to customers at prices other than the standard supply price - often at a fixed price for a given time period. This usually involves complex financial contracts. Moreover, high-volume corporate consumers at times are offered customized electricity packages that attempt to maximize the potential rewards and minimize the risks for such consumers. Lower volume corporate consumers are sometimes offered the opportunity to join a buying group in an attempt to obtain a volume discount from retailers.

This complexity has resulted in the proliferation of brokers and energy advisors that seek to counsel consumers concerning their electricity needs and the best option available to them. Electricity retailers are licensed by the Ontario Energy Board and are required to have a fair dispute resolution mechanism. Brokers and other advisors are not licensed.

Metering

Electricity consumption can be interval unmetered or metered.⁵ If it is unmetered, the consumer is assumed to have the same consumption or load profile as the average profile of the customers of its local distributor (i.e. how much electricity is consumed at what times of day). Because the standard supply price is affected by the applicable consumption profile, a consumer with a lower consumption profile than the average profile is generally worse off being unmetered than metered. A metered consumer pays for electricity based on the elec-

tricity it actually consumes and when it consumes it. However, the cost of a meter and its installation and monitoring will lower the cost savings associated with metered consumption.

A number of electricity retailers, brokers and others promote retail electricity offerings premised on the conversion of customers from unmetered to metered consumers. Moreover, most of the more sophisticated retail offerings require the consumer to be metered.

New Electricity Facilities

Historically, real estate developers, builders, landlords and other building owners generally paid for the new electricity facilities they required. Under rules set out by the Ontario Energy Board, distributors are now limited in what they can charge their customers to install new expansion facilities. Moreover, in certain circumstances, customers have the right to construct new electricity facilities themselves (controlling the cost and timing of the work). This can be of substantial benefit to parties requiring new electricity facilities and is a major change from the former regime.

Navigating the Rapids

The electricity marketplace in Ontario is evolving quickly. The regulatory environment is constantly changing, new offerings are constantly appearing and the impact of the U.S. electricity market is only starting to be felt. Our Energy Group can help you review retail offerings, proposed contracts and the myriad of electricity regulations. The following members of our Energy Group would be pleased to assist you:

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mitigation agreement with the Ontario government that effectively caps (using a rebate system) in the near future the price of a portion of OPG's expected generation. This should reduce the risk of extraordinary price spikes such as those experienced in California's deregulated electricity market.

⁵ An interval meter records consumption quantum and timing.

² Some retailers are affiliates of the local electricity distribution company.

³ Physical contacts for the purchase of electricity are generally not possible at this time. The purchase of electricity is almost invariably a purely financial transaction.

⁴ The by-far largest generator of power in Ontario, Ontario Power Generation Inc. has entered into a market power