

Chapter 1

Section 1.07

Ontario Energy Board— Natural Gas Regulation

Follow-Up on VFM Section 3.07, 2014 Annual Report

RECOMMENDATION STATUS OVERVIEW					
	# of Actions Recommended	Status of Actions Recommended			
		Fully Implemented	In Process of Being Implemented	Little or No Progress	Will Not Be Implemented
Recommendation 1	4	1	3		
Recommendation 2	2	2			
Recommendation 3	2	1	1		
Recommendation 4	1		1		
Recommendation 5	1		1		
Recommendation 6	2		1	1	
Total	12	4	7	1	0
%	100	33	58	9	0

Background

The Ontario Energy Board (Board) is responsible for ensuring that natural gas market participants comply with the *Energy Consumer Protection Act, 2010* which pertains specifically to those selling to low-volume users, such as households. Under the *Ontario Energy Board Act, 1998* the Board's objectives include facilitating competition in the sale of gas to consumers and protecting the interests of consumers with respect to prices and the reliability and quality of gas services. In carrying out its mandate, the Board sets prices for natural gas and its delivery and storage. It also licenses and oversees natural gas market participants, including gas utilities and gas marketers.

In Ontario, residential consumers have the option of purchasing natural gas from either a gas utility or one of 12 gas marketers actively selling natural gas in Ontario. There are three utilities that own the pipes and equipment that deliver the natural gas to homes and businesses, plus two municipal utilities that also distribute natural gas. Each utility serves different areas of the province.

The Board regulates the rate that the three utilities charge their consumers, but not those that the gas marketers charge. The gas marketers operate as brokers, locating natural gas on the market to sell competitively. When consumers buy gas from marketers, they sign fixed-term contracts for periods of one to five years. Otherwise, they get their gas supply from their utility, which is the default supplier. For the year ended March 31, 2016, there

were 3.5 million natural gas customers in Ontario. Of these, over 3 million purchased their gas from one of the three utilities (these were the same numbers as we last reported for the year ended March 31, 2014).

The Board conducts its oversight through a quasi-judicial process that includes public participation. Panels of Board members hold proceedings and their decisions must uphold the broad public interest, including the protection of consumers, the financial integrity of the utilities, and other legislated goals, such as the safe operation of storage and energy conservation.

The Board uses a three-stage process in regulating natural gas rates. In the first stage, utilities must submit cost-of-service applications approximately every five years to establish the base rate to charge consumers. In the second stage, the Board reviews and adjusts gas rates annually between cost-of-service reviews, typically using a formula that considers inflation adjusted by the utilities' productivity figures. In the third stage, gas rates are adjusted four times a year to smooth out fluctuations in billing rates and to reflect current market prices for natural gas, as well as changes in transportation rates and inventory valuations.

Our 2014 audit found that the Board had adequate systems and processes in place to protect the interests of natural gas consumers and ensure that the natural gas sector provided energy at a reasonable cost. However, Board staff could more fully assess the cases utilities make when they apply to the Board for rate changes.

Some significant issues included the following:

- Gas utilities are not allowed to charge consumers more than the purchase cost of gas, but Board staff seldom obtained source documents to verify the information the utilities provided in rate change applications. We noted that in the preceding 10 years only one audit of gas cost adjustment accounts and accounting processes was done—in 2011—and on only one utility.

- Utilities applied different approaches to recover their Board-approved revenue requirements, but Board staff had not assessed the impact that these differences have on consumers.
- Although complaints against gas marketers decreased by 81% from 2009 to 2013, contract cancellation and renewal issues were still the sources of many complaints when consumers discovered they could pay lower prices with other gas providers. The Board could facilitate providing consumers with rate information from the various gas providers on its website to help them make more informed decisions before they entered into a contract.

In our *2014 Annual Report*, we recommended that the Board compare the different cost recovery approaches used by utilities and identify best practices in purchase, transport and storage of gas that could affect consumer rates; periodically select source documents from utilities for review to assess the reasonableness of the information on rate-change applications; and consider including on its public website information on the gas rates offered by various gas marketers.

We received commitment from the Board that it would take action to address our recommendations.

Status of Actions Taken on Recommendations

The Board provided us with information in the spring and summer of 2016 on the current status of our recommendations. According to this information, one-third of the actions we recommended in our *2014 Annual Report* had been fully implemented. For example, since our last audit, the Board had audited three natural gas utilities, including the two that supply 99% of the gas consumed in Ontario. During these audits, Board staff examined contracts and source documents related to gas purchase details and gas price adjustment accounts. As

well, another 58% of actions we recommended were in the process of being implemented; for instance, the Board was in the early stage of comparing the cost recovery approaches used by the two largest utilities, although they will not fully submit their base rate application until December 2017 for implementation by January 2019. The Board is also working toward publishing gas marketer prices and their price comparisons on a Board-supervised website, which is expected to be completed by June 2017.

There has been little or no progress on the remaining recommendation we made. At the time of our follow-up, the Ministry of Energy had not tabled the Agency's annual report within the required legislative timeline.

The status of actions taken on each of our recommendations is described in the following sections.

Regulating Gas Utilities

Recommendation 1

To ensure that its regulatory decisions protect the interests of natural gas consumers and the public interest, and that the natural gas sector provides gas to consumers at a reasonable cost, the Ontario Energy Board should:

- *compare the different cost recovery approaches applied by the regulated utilities;*

Status: In the process of being implemented by January 2019.

Details

Our 2014 audit noted that the two gas utilities that supply over 99% of the gas consumed in Ontario applied different approaches to recover their Board-approved revenue requirement. However, Board staff had not assessed the impact that these differences have on consumers.

During this follow-up, the Board was reviewing and updating the filing requirements for the next cost-of-service application process. The Board is also in the process of preparing a rate handbook to guide utilities, including natural gas utilities, on applications to the Board for rate approvals. The Board

expects to issue the updated filing requirements and the rate handbook in Fall 2016. These documents will enable utilities to provide information that the Board needs to compare the cost recovery approaches they apply. However, the next cost-of-service applications do not occur until December 2017, so the Board will not conduct any detailed comparison of the cost recovery approaches until the applications are made at that time.

- *compare information submitted by the utilities and identify best practices in purchase, transport and storage of gas that could have an impact on consumer rates;*

Status: In the process of being implemented by July 2017.

Details

Our 2014 audit found that, in their review of cost-of-service applications, Board staff did not sufficiently evaluate and compare differences in the information and practices of the two utilities that could have had an impact on consumers' gas bills, or that would help identify best practices. These included, for example, the different ways the utilities purchased, transported and stored gas.

Since our last audit, Board staff conducted two stakeholder consultations—one in December 2015 and another in March 2016—to further discuss and review the utilities' gas supply plans. During this process, staff compared the utilities' information on purchase, transport and storage of gas, but was unable to identify any areas of best practices for the utilities to consider because of the tradeoffs in different approaches. According to the Board staff, the consultations did lead to a better understanding of the risk and cost tradeoffs that the utilities considered when they developed their plans. After the first consultation, the two largest gas utilities prepared a side-by-side comparison of their respective gas supply plans.

In August 2016, Board staff issued a discussion paper on the existing approval and review processes for gas supply planning and recommended

the following changes to the processes for the Board to consider:

- Gas utilities should apply for pre-approval of their gas supply planning framework separate from rate applications.
- Gas utilities should submit the framework at the same time, and in the same format, to be reviewed jointly by the same Board panel.
- Separate from the gas supply planning framework, each gas utility should submit a gas supply memorandum annually that includes an evaluation of the performance of its gas supply plan over a six-year period—looking back three years as well as looking forward another three years. Similar to the preparation of the gas supply planning framework, gas utilities should use the same format and submit them at the same time. These requirements will enable the Board to compare the information simultaneously.

At the time of our follow-up, the Board was in the process of implementing the recommendations, with an expected completion date of July 2017.

- *implement any needed changes arising from its review of the quarterly gas rate adjustment process that it began in June 2014; and*

Status: In the process of being implemented by July 2017.

Details

Following our audit fieldwork, in June 2014, the Board began a two-phase review of the quarterly rate adjustment mechanism for natural gas utilities to address any similar situations where consumer prices could be impacted significantly, such as during the record cold in the winter of 2013/14. The review took place in two phases:

- The first phase included a review of the process covering the filing requirements and supporting evidence for the application, events that would trigger a substantive review, and the required timelines for review and comments. This phase also involved a review of the Board's policy on smoothing rate increases

for consumers and its protocols for communicating rate increases to consumers.

- The second phase included a review of the cost and risk trade-offs of the different utilities' gas supply planning approaches.

Based on the first phase of the review, which was completed in August 2014, the Board issued an Order (instruction), effective January 2015, that required gas utilities to calculate a preliminary estimate of the change in the commodity portion of residential consumers' bill one month before the normal quarterly rate adjustment mechanism filing date. Any anticipated decrease or increase of 25% or more on this portion of the bill would require advance notification by utilities to the Board and the customers who would be affected.

In October 2015, the Board initiated the second phase of the review and, in August 2016, Board staff proposed a number of recommendations for the Board to consider. As mentioned in the details under the second action of Recommendation 1, the Board was in the process of implementing the proposed recommendations, with expected completion by July 2017.

- *assess whether the settlement proposal represents an acceptable outcome from a public-interest perspective, and whether the accompanying explanation and rationale are adequate to support the settlement proposal.*

Status: Fully implemented.

Details

In our 2014 report, we noted that the percentage of a utility's costs that the utility was permitted to recover through customer billings was determined in a settlement process involving the utility and intervenors. Board hearings are held only on issues where agreement has not been reached. However, we noted that there were no Board staff submissions commenting on whether the settlement proposals represented an acceptable outcome from a public interest perspective, and whether the accompanying explanation and rationale were adequate to support the settlement proposal.

In April 2014, the Board amended its Practice Direction on Settlement Conferences (Direction) to reflect the role of Board staff in representing the public interest by requiring that staff be active participants in settlement conferences and signatory to settlement proposals in some cases. The Direction now requires staff, when not a party to the settlement conference, to file a submission on whether any settlement proposal represents an acceptable outcome from a public interest perspective and whether the accompanying explanation and rationale is adequate to support the settlement proposal. During this follow-up, we reviewed all eight applications since April 2014, relating to natural gas for which there was a settlement conference and noted that the staff submission was included in each one and the submissions did not note any significant issues.

Additional Review Needed for Accuracy and Validity of Information Submitted to the Board

Recommendation 2

To ensure that information submitted to the Ontario Energy Board (Board) by the gas utilities that it regulates is accurate and valid and that consumers are being charged for only the actual costs incurred by utilities to purchase gas, Board staff should:

- *periodically select source documents from utilities for review, such as contracts, gas purchasing details and management reports, to assess the validity and reasonableness of utilities' application information; and*
- *periodically review price adjustment accounts and assess the appropriateness of items and entries included in these accounts.*

Status: Fully implemented.

Details

Our 2014 review of the quarterly gas rate adjustment application process noted that utilities

provided different levels of support for their pricing requests and applied different approaches in arriving at the information they were required to submit. Also, Board staff seldom obtained source documents to determine whether the information in the applications was accurate and valid. As well, we noted that the two utilities that supplied over 99% of the gas consumed in Ontario had affiliated companies that also provided gas in other jurisdictions. Without sufficiently examining actual purchase records of these two utilities, the Board might not have taken sufficient care to protect Ontario consumers from the possibility that inappropriate charges were passed on to them.

In its 2016 response, the Board indicated that, during the 2014/15 and 2015/16 fiscal years, it had audited three natural gas utilities, including the two that supply 99% of the gas consumed in Ontario. To assess the validity and reasonableness of utilities' application information, Board staff examined contracts, gas purchasing details and management reports. They also reviewed and assessed the appropriateness of items and entries made to the price adjustment accounts.

Overall, the audits found that the utilities' natural gas purchase and recording processes, while very complex, appeared to appropriately capture the costs of natural gas, and charged these costs to customers in accordance with proper regulatory principles. However, the audit reports did note issues of potential non-compliance with regulatory filing requirements, inadequate documentation to support actions taken by the utilities and practices not consistent with the intent of Board decisions and orders. For instance, the Board identified that a utility used an incorrect methodology to calculate the forecast price used in its quarterly rate adjustment applications, which did not have a significant impact on gas charges to customers. For two of the largest utilities, the Board further commented that the utilities' internal audits had performed limited work on the gas cost adjustment account balances or the quarterly rate adjustment mechanism process for setting rates.

In October 2015, the Board performed a follow-up of a utility's audit completed in March 2015, to ensure that findings, including the issue noted above on the use of forecasting methodology, had been addressed. The Board was also planning to follow up on two other 2015 audits during the 2016/17 fiscal year. On an annual basis, Board staff prepares a risk-based audit assessment plan that is used to determine the timing and frequency of future audits.

Regulating Gas Marketers

Recommendation 3

To provide consumers with the information they need to make informed decisions in selecting a gas marketer and to protect consumers' interests, and to be in a position to assess consumer complaints regarding gas marketers, the Ontario Energy Board (Board) should:

- *consider including on its public website information on the gas rates offered by the various gas marketers for consumers to consult before entering into a contract; and*

Status: In the process of being implemented by June 2017.

Details

In our 2014 report, we found that although the Board had, since 2010, received information from various natural gas marketers' on their contract rates, it had not published these rates for the public to see. Consumers who had such information would be able to make more informed decisions before entering into contracts. We also noted that regulatory bodies in other jurisdictions provide data on their websites on the rates charged by their gas marketers.

In May 2015, the Board issued a research report to the Minister of Energy, which included 14 recommendations to enhance consumer protection, one of which was to post prices and price comparisons on a Board-supervised website to improve consumer understanding and provide consumers with

the information needed to make informed decisions about retail energy contracts. The report noted that other jurisdictions, including Texas, Pennsylvania, Ohio and New York, had websites where energy retailer prices were posted. The Board indicated that this initiative is expected to be completed by June 2017.

- *define the types of issues to be classified as consumer complaints for reporting purposes, so that the Board can compare the data on complaints it receives directly from consumers to the data on complaints that gas marketers report to the Board, in order to identify any anomalies and other areas of concern for further follow-up.*

Status: Fully implemented.

Details

Even though gas marketers in Ontario are required to submit to the Board consumer complaints the gas marketers receive and address each quarter, our 2014 audit found that Board staff did not review this complaint data for trends or compare it against data on complaints received directly by the Board, which would help identify anomalies for further investigation. We compared the two sources of data and found significant anomalies in a number of complaints received. Board staff indicated that the anomalies occurred because the Board does not define what constitutes a complaint that must be reported to it, and each gas marketer uses a different definition.

In December 2014, the Board issued a bulletin to all gas marketers and clarified the definition of "consumer complaints" and said: "all low-volume consumer contacts that raise an issue or concern with an aspect of the supplier's operations, regardless of the supplier's internal process for classifying these contacts (e.g., complaint, contract, retention call and inquiry) are to be included in the number of consumer complaints" for reporting purposes. In this follow-up, we noted that the number of complaints received directly by the Board has decreased by 58%, from 506 complaints in fiscal 2013/14 to

210 in 2015/16. The number of complaints reported by gas marketers to the Board almost tripled, from 924 in 2013/14 to 2,590 in 2015/16. According to Board staff, the significant increase in complaints reported by gas marketers can be attributed to the December 2014 bulletin that clarified and broadened the definition of complaints. We also noted that the number of low-volume customers who purchased gas from gas marketers had decreased by 160,300, or 40%, from 404,000 in March 2014 to about 242,700 in March 2016. While the definition has been clarified and broadened, the Board relies more on the complaints received directly from the consumers in its analysis.

Monitoring Compliance and Enforcement

Recommendation 4

To more effectively oversee the regulated gas utilities in the interest of consumers, and to ensure the validity and accuracy of information they are required to provide to the Ontario Energy Board (Board) to protect the interests of consumers, the Board should conduct more frequent inspections and audits of the regulated utilities that supply more than 99% of the gas consumed in Ontario, especially in areas that significantly impact consumer rates, such as price adjustment accounts, purchasing processes and capital expenditures.

Status: In the process of being implemented by December 2018.

Details

The difference between what a utility forecasts it will have to pay for gas and what it actually pays is tracked by what are known as price adjustment accounts. These accounts are critical because gas purchase costs, as well as contracts for transportation of gas, are adjusted through them. In our 2014 report, we found that over a 10-year period, the Board had conducted only one audit—in 2011—of a utility’s purchase gas variance account, and no

other such reviews had been done for the other two regulated utilities.

During our follow-up, we found the Board had audited, during the 2014/15 and 2015/16 fiscal years, Ontario’s three regulated natural gas utilities. The audits covered areas that significantly impact consumer rates, including price adjustment accounts and purchasing processes. However, we noted that these audits did not include a review of the capital expenditures. Although it is not an audit, the Board indicated that in the next cost of service application process it will assess variances between what the utilities planned for capital expenditures to what was actually completed, to help inform what is included into the rate base. For one of the audits completed in March 2015, the Board did a follow-up audit to ensure that findings from its previous audit had been addressed. The Board also plans to follow-up the audits of the other two utilities during the 2016/17 fiscal year. On an annual basis, Board staff prepares a risk-based audit assessment plan that is used to determine the timing and frequency of future audits. During this follow-up, we reviewed the 2016/17 plan and noted that in addition to the follow-up audits, the Board plans to review the internal processes of tracking, measuring, managing and analyzing the differences between the amount of gas purchased by each utility and the actual gas consumed by its customers (unaccounted for gas). These reviews are important to consumers because the cost of the unaccounted for gas is included in the gas distributor’s base rate. The Board also plans to review the process of tracking and measuring of gas leakages for compliance with the regulation for greenhouse gas emission reporting that will come into effect on January 1, 2017.

Improvement Needed in Assessing Performance of Gas Utilities

Recommendation 5

To more effectively oversee the regulated gas utilities in the interest of consumers, the Ontario Energy

Board should establish additional gas-utility-specific performance measures needed to assess utility performance on an ongoing basis and to identify trends over time.

Status: In the process of being implemented by December 2018.

Details

In our 2014 report, we noted that the Board had only a few performance measures that focused on the quality of service that the gas utilities provide to their customers, and it had no performance measures for operational effectiveness, financial performance or public-policy responsiveness, as exist for the electricity sector.

At the time of our follow-up, we noted that one of the two major natural gas distributors had begun reporting on some additional performance metrics relating to operational effectiveness. The Board told us it intends to bring the natural gas sector in alignment with the Renewed Regulatory Framework for Electricity Distributors by introducing a performance-based approach, as well as measures against which performance is monitored. The Board also indicated that it intends to establish benchmarking requirements, asset management planning and customer engagement as part of utilities' filing requirements, as well as implement an initiative to broaden access to performance measurement information to all interested parties and consumers.

Monitoring the Board's Performance

Recommendation 6

To determine whether the Ontario Energy Board (Board) is achieving its mandated objectives, the Board should use available evaluation tools, including its Policy Evaluation Framework, and work with the Ministry of Energy to assess the effectiveness of its policies and initiatives in achieving desired outcomes and mandated objectives, including protection of consumer interests and facilitating competition in the sale of natural gas.

Status: In the process of being implemented by March 2019.

Details

In our 2014 audit, we noted that the Board had never used its Policy Evaluation Framework, which allows it to monitor and evaluate the effectiveness of its policies, for example, whether the Low-Income Energy Assistance Program has achieved its objectives. The *Ontario Energy Board Act, 1998* requires the Minister of Energy to table a report to the legislature every five years on how effective the Board has been in meeting its mandated objectives. However, no reviews of the Board's effectiveness had been conducted at the time of our last audit.

At the time of our follow-up, the Minister of Energy had still not requested a review of the Board's effectiveness. However, the Board had conducted a number of reviews and made the necessary changes to the policies and frameworks since our 2014 audit. Some of the reviews and changes are as follows:

- The Board completed a review of Part II of the *Energy Consumer Protection Act, 2010* (Act) and reported on its results in July 2015. The Board is in the process of making the necessary changes based on these results. The Act was introduced to ensure that low-volume (residential and small business) consumers have the information they need to make decisions about retail electricity and natural gas contracts, and that they have confidence that they are protected by fair business practices. While the review found that public support for the Act was high, it identified concerns, including that consumers had a hard time understanding their energy bills, so that the impact of energy choices was less clear to them and they had a harder time making accurate price comparisons. It also found that roughly one-third of current residential and non-residential contract holders who were surveyed were unaware that they had a retail

contract. The Board issued a set of recommendations to address these concerns.

- The Board’s evaluation and assessment of the Low-Income Energy Assistance Program in 2014/15 concluded that a number of changes focusing on consumer interests were needed. For instance, the income measure used to determine eligibility for the program had not been updated since 1992 and needed to be reviewed and changed. Also, all adults in a household applying for assistance from the program had to attend an in-person interview to verify household income and personal information; this was viewed as onerous, and was changed so that only the account-holder was required to attend the interview. Based on the review, the changes were included as part of policy and code revisions in the fall of 2015.
- The Board plans to eventually apply the Renewed Regulatory Framework for Electricity, in an updated form, to natural gas utilities.
- The Board completed a review in 2016 of its cost-of-capital policy for all regulated utilities, including natural gas utilities. Based on this, Board staff determined that its methodology had worked as intended and had not resulted in excessive or anomalous volatility in the financial performance of utilities.
- In December 2014, the Board issued a Demand-Side Management Framework for Gas Utilities, developed to meet specific government objectives related to conservation. The utilities are required to develop demand-side management plans to cover six-year terms, coinciding with the time period in the Conservation First framework for electricity, developed by the Ontario Power Authority (now part of the Independent Electricity System Operator) and electricity distributors. The Board said this will encourage greater alignment, co-ordination and integration between the natural gas and electricity sectors’ energy conservation efforts.

In addition, the Minister should table the Board’s annual report within one month of receiving it, as required by law.

Status: Little or no progress.

Details

In our 2014 report, we noted that under the *Ontario Energy Board Act*, the Board is required to submit its annual report to the Minister of Energy within six months of the end of its fiscal year; then, within one month after receiving the annual report, the Minister of Energy must table the report before the Legislative Assembly. Once the tabling requirements are met, the Board is required to publish the annual report on its public website. We found that although the Board filed its 2011/12 and 2012/13 annual reports within the required time, the Minister did not table the reports within one month of receipt in the Legislative Assembly, as required by law, and therefore the reports were not posted on the Board’s website until April 2014.

During our follow-up, we noted that both the 2013/14 and 2014/15 annual reports were posted on the Board’s website as of March 31, 2016. However, neither report was tabled by the Minister of Energy within one month of receipt from the Board. In particular:

- the Board submitted its 2013/14 annual report to the Minister on September 29, 2014, but the Minister did not table it until April 7, 2015, which was more than six months after receipt; and
- the Board submitted its 2014/15 annual report to the Minister on October 22, 2015, which was three weeks past the six-month reporting requirement. The Minister however did not table the report for another three months, on January 28, 2016.

In Chapter 5 of our *2015 Annual Report* titled “Toward Better Accountability,” we also noted that delays within Ministries mainly contributed to the delays in the tabling of Provincial agencies annual reports.