REGULATORY AND POLICY DEVELOPMENTS

THE CRTC SPECIALTY SERVICES DECISIONS: WHEN AND TO WHAT EXTENT WILL THEY BE IMPLEMENTED?

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On November 30, 1987, the Canadian Radio-television and Telecommunications Commission licensed five new English-language and five new French-language special interest satellite-to-cable television programming services to be made available to Canadian cable subscribers. All but one, a family movie channel consisting in large part of American Disney programming, were licensed to be distributed in any given cable franchise at the option of the individual cable licensee but on a compulsory basis to cable subscribers, for a regulated fee added to the monthly charge levied for basic access to cable television services.

On the same date, the Commission authorized the migration of MuchMusic and TSN, the Canadian sports network, at the option of the licensees of those services, from a discretionary, user-pay tier, to the basic service, for a regulated monthly add-on to the basic access fee paid by all subscribers. The CRTC also authorized the distribution of five new U.S. stations by cable companies as part of a package including Canadian pay telvision services and announced related proposed amendments to the cable rate regulations.

The CRTC Decisions which issued licences for new specialty services on November 30, 1987, except for the licence issued to TV 5, the international French-language service, and which established new distribution rules for TSN and MuchMusic, were made effective September 1, 1988. The rationale for this timing would appear to have been the desire to ensure that the negotiations between specialty network licensees and cable operators toward a new lineup of cable services for the 1988-89 broadcasting season would proceed in the same timeframe for all the new services. The nine month period between the issuance of the decisions and their implementation appeared sufficient for all licensees to be in a position to participate fully in the new environment created. The distribution, packaging, marketing and promotion plans of participating licensees would proceed toward September 1, 1988, on the basis of the availability at that time of the full panoply of licensed specialty network services.

As logical as the CRTC's licensing strategy may have seemed, it may not unfold as planned.

The CBC All New Licence

One of the decisions issued by the CRTC on November 30, 1987, approved an application by the Canadian Broadcasting Corporation to provide a national English-language news and information specialty service to be offered by cable operators on the basic cable service. The CBC application had been heard in competition with an application by Alarcom Limited to operate a national news specialty service. Alarcom Limited is an Edmonton-based company already licensed to operate a television station in Edmonton and a general interest pay television service in western Canada.

The decision to authorize the CBC to provide an all-news television service across Canada proved controversial. First, it was a "majority decision," the usual indication in CRTC parlance that the decision was not consensual but that members of the Commission were divided on the issue. Secondly, some critics immediately argued that the decision constituted the extension of a near monopoly over news to the Crown Corporation and authorized it, without

Parliamentary authority, to charge a compulsory fee to all subscribers of cable television services thereby levying what amounts to a tax. Others, led by Alarcom and the Edmonton Chamber of Commerce, felt that an opportunity to decentralize and diversify electronic news and information had been missed, leaving central Canada with a stranglehold on national electronic journalism.

The legal right of the CBC, under the provisions of the *Broadcasting Act*, to launch a satellite-to-cable, unilingual news service without the sanction of Parliament was also questioned, as was the ability of the CBC to track costs efficiently enough to satisfy the CRTC requirement in the licensing decision that the all-news service not be subsidized from Parliamentary allocations indended to sustain the four radio and two television networks already licensed to the Crown Corporation.

Petitions to Cabinet were filed, pursuant to a provision of the *Broadcasting Act* which empowers the Governor in Council, within 60 days after the issue of any broadcasting licence, to set it aside or to refer it back to the Commission for reconsideration and rehearing. Petitions sought government review, not only of the decision granting the CBC a new network licence, but also of the decisions authorizing the distribution of eight new specialty services and of TSN and MuchMusic on basic service.

Shortly after the November 30, 1987, decisions were issued, Jim Edwards, Conservative M.P. for Edmonton-South, announced his resignation as the Chairman of the House of Commons Committee on Communications and Culture in order to devote his energies toward securing a Cabinet review of the all-news CRTC Decision.

A debate ensued with regard to the date on which the Cabinet could act, in light of the wording of the CRTC Decisions. Various legal opinions were offered as to whether the relevant 60 days was the period immediately following November 30, 1987, or that following September 1, 1988, the date on which some of the licences, according to the CRTC Decisions, "will be issued and be effective." The debate has been characterized by some as one over "when a licence is not a licence." It involves a determination of whether, under the provisions of the *Broadcasting Act* read as a whole, the Commision speaks either in a legally and conclusive fashion in the decisions it issues which are required by law to be published in the *Canada Gazette*, or through the licence forwarded to each licensee to reflect the decision taken earlier and published.

On January 27, 1988, the Honourable Flora MacDonald, Minister of Communications, issued a news release to which was attached a letter addressed to the President of the CBC. The Minister took the position that the Cabinet could not make a legally-binding decision on the CRTC Decisions issued November 30, 1987, which come into effect September 1, 1988, until September 1, 1988. This is the date on which, according to the advice provided by the Department of Justice, the 60-day review period will start running.

The CRTC Decision with respect to MuchMusic and TSN, as well as the decision licensing TV 5, were upheld. The Minister indicated, based on the evidence received at that date, the government had no reservation regarding the November 30, 1987, decisions other than the decision licensing the all-news service to the CBC. She emphasized, however, that further petitions could be received by the Governor in Council with respect to those decisions until October 30, 1988.

With regard to the decision granting a specialty network licence to the CBC, the Minister outlined in her letter to the President of the CBC the concerns that the government would take into account when the November 30, 1987, decision is given formal consideration following September 1, 1988. The first concern was characterized as the degree to which the proposed service would contribute to excessive concentration in news programming. The second focused on the appropriateness of the CBC offering an all-news service in English before steps have been taken to address the needs of French Canada. The Minister also pointed out that the government would be guided in its eventual review of the decision by the results of its current fundamental reexamination of broadcasting policy which may lead to a redefinition of the role and mandate of the CBC.

In the letter accompanying the press communiqué, the Minister explained that she was conveying the Cabinet's preliminary view to the CBC "in order to allow for prudent planning by those affected." The letter also advised the corporation that it would be unwise for it to undertake any major expenditures or structural reorganization to implement the proposed service until a final Cabinet decision is issued. The letter invited the CBC to use the period until October, 1988, to examine alternative approaches to providing a news service, including approaches which would embrace both the private and public sectors of the Canadian broadcasting system.

Amended Linkage Rules

Within days of the issuance of the specialty service decisions, there were also problems with regard to a related CRTC decision to amend its linkage rules for pay TV/U.S. signal packaging. This amendment adds to the list of the non-Canadian services eligible for distribution by cable systems anywhere in Canada. These new services are four so-called "superstations" distributed by satellite (WTBS-TV Atlanta, WGN-TV Chicago, WOR-TV and WPIX-TV New York) and one pay television network (the USA Network). As noted, the CRTC decided that these five services could henceforth be distributed by any cable system, although only on a discretionary basis and only linked or packaged with a Canadian pay television service. Their distribution was designed to replace the advantage or "lift" in packaging and marketing that may be lost for Canadian discretionary pay television services if TSN and MuchMusic are moved, on any given cable system, from a discretionary tier, in combination with Canadian pay television, to basic service.

The particular debate concerning the distribution of the four superstations and the USA Network centers on whether the owners of the American services concerned have cleared, or may clear, for the benefit of program producers, the rights for Canada attaching to some of the programming the services contain. In fact, in many cases, such rights may already have been assigned or "sold", on an exclusive basis, to Canadian conventional over-the-air broadcasters whose signals form part of basic cable service in Canada. Even in cases where the rights are available, copyright experts have suggested that problems associated with American copyright law may preclude their being cleared for the purpose of cable distribution in Canada since, in Canada, existing copyright legislation does not, as it does in the United States, contain a mechanism for the payment of program royalties by cable companies to the satellite services whose programs they retransmit for eventual remittance to the producers of the programs through a Copyright Royalty Tribunal. In its decision the Commission had basically skirted the copyright problems with the following advice:

> The Commission suggests that pending amendments to Canadian copyright legislation, cable licensers choosing to offer any of these 5 services should negotiate with the foreign carriers of these services with a view to including in the fee to be paid to the carrier an appropriate amount of compensation for copyright liability.

The benefit that was presumably intended to accrue to Canadian pay television from the distribution of five new American services by Canadian cable licensees may therefore not materialize for some time. In fact, it has been suggested that the problem may not be resolved until Canadian copyright law is revised, a commitment which forms part of the recent bilateral trade agreement between Canada and the United States.

Migration of TSN and MuchMusic to Basic

A third problem surfaced with respect to one of the major regulatory changes announced on November 30, 1987 - the decision to authorize, at the discretion of their owners, the distribution of TSN and MuchMusic on basic cable service. The two services had been authorized until then for distribution on a discretionary tier only. From November 30, 1987, onward, any cable company opting to distribute TSN or MuchMusic would have to do so on basic service, for a regulated fee, unless TSN or MuchMusic consented in writing to be distributed on a discretionary basis on that company's system.

Large cable companies serving urban markets are on record as saying that they see little advantage in changing the distribution of TSN and MuchMusic to basic service. Some have stated that the contracts for discretionary carriage entered into between them and TSN and/or MuchMusic constitute a fetter on the latter's discretion to demand basic carriage until the expiry of the contract, in some cases in three years time. Questions have been raised as to whether a regulatory decision of the CRTC can supersede or frustrate the provisions of a private commercial contract between parties.

TSN and MuchMusic themselves may not prove anxious to migrate to basic cable service. Both services have achieved significant penetration levels on a discretionary basis. Moreover, it appears that the level of Canadian content required of TSN by condition of licence may be affected as a result of distribution on basic service. The November 30, 1987, decision amended the condition of licence requiring TSN to devote 35% overall, 50% between 6:00 p.m. and midnight and 50% between 7:30 and 10:30 p.m. of the hours devoted to all programming to the distribution of Canadian programming, substituting therefor a condition of licence requiring TSN, "as of the date of commencement of distribution as part of the basic service on cable," to devote not less than 60% of the broadcast year and not less than 50% of the evening broadcast period to the distribution of Canadian programs.

Cable Company Compensation

In the meantime, the cable companies have publicly expressed their dissatisfaction with the regulated one cent mark-up from the regulated wholesale per subscriber fee to accrue to them for each of the two services carried on basic service. They have argued, through their industry association, that such a low mark-up is unrealistic as a means of recovering the increased operating costs associated with the expansion of the basic service, be they related to administration, billing adjustments or marketing. It has also been suggested that the level of the mark-up does not reflect the enhanced value of the basic service that will result from the addition of specialty services to it and that it will serve as a disincentive for cable licensees to distribute the new services.

It is to be remembered that the cable licensees in English Canada remain the arbiter of which specialty services they are prepared to distribute, whether on a mandatory or on a discretionary basis. In French Canada, the cable licensees are more limited, since, in a francophone market, where a licensee elects to distribute any specialty service, they are required for a period of three years, to distribute all available French-language specialty services on basic service.

The Commission's objective in licensing new specialty services on November 30, 1987, was first and foremost the expansion of the choice of Canadian television fare available to Canadian viewers. The attainment of that objective requires that the services, once licensed, be distributed by most cable companies and that the terms of distribution be conducive to widespread availability of all services at reasonable cost to subscribers. In the last analysis, the Commission's objective will be attained only if, on the one hand, viewers are reached and, on the other, the subscriber revenues and advertising projections on the basis of which programming commitments were made, and financial stability and viability of each service were assessed, are realized.

There appears already to be some serious obstacles to the realization of the Commission's carefully conceived distribution environment for specialty services by September 1, 1988.

ONTARIO LEGISLATION TO REGULATE AUTOMOBILE INSURANCE PASSED

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On February 11, 1988, Royal Assent was given to the *Ontario Automobile Insurance Board Act*. Under the *Act* the Ontario Cabinet may prescribe classes of risk exposures that may be considered in determining the premiums for various coverages and categories of automobile

insurance and the procedures to be followed in assigning drivers and vehicles in any such class of risk exposure.

Once this classification system is established the Automobile Insurance Board, following an industry-wide hearing, is required to set a rate or range of rates with respect to each such class of risk exposure. The Board may also hold industry-wide hearings to review any rates or range of rates set by it, and, following such a hearing, may vary any such rate or range of rates. In setting rates the Board is required only to ensure that the approved rates are in its opinion just and reasonable and not excessive or inadequate. In doing so it may consider any financial or other matter directly or indirectly affecting rates.

Insurers are, however, able to apply to the Board for approval to charge rates outside the range approved by the Board. In such an application the onus lies on the insured to demonstrate that the proposed rate is just and reasonable and not excessive or inadequate and that the circumstances of the insurer justified the use of the proposed rate.

On February 16, 1988, the Ontario Government released a consultation draft of a classification system for automobile insurance from which it intends to develop and implement by regulation after public comment, the uniform classification system under the *Act*.

REGULATION OF FINANCIAL INSTITUTIONS

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Federal Trusts and Loan Company Legislation

The long awaited federal trust and loan company legislation was released by Minister of State for Finance, Thomas Hockin, on December 21, 1987. It was issued as a discussion draft with public responses to be in the hands of the Department by February 15. Ministers and officials have lost no time in contacting interested parties and hope to have a revised bill before Parliament by early spring.

The draft bill closely follows the proposals in the Minister's Blue Paper of December 18, 1986, with a few exceptions. The principal change is the grandfathering of commercially linked financial institutions to ensure that they have the same competitive prospects as other federally regulated institutions. Unfortunately, the drafting in this section is particularly difficult, raising concern that the government's objective may not be adequately reflected. With this exception, the government has preserved its policy opposing commercial links.

Some of the less significant changes from the Blue Paper follow:

- The Blue Paper proposed to extend fiduciary powers to other financial institutions with some exceptions. One of these was the power to act as a stock transfer agent. This exception has disappeared so that all federally regulated institutions will be able to act as stock transfer agents.
- The Blue Paper encouraged a "build, not buy" policy for institutions entering new business areas, and particularly for large institutions and foreign owned institutions. This broad policy has been dropped except that large institutions will be discouraged from buying large institutions other than large securities firms. The definition of "large" will be at ministerial discretion.
- Under the complex sections dealing with the definition of "significant interest", the draft legislation gives greater importance to *de facto* control and less importance to 10-50 per cent investments where ownership links are traced through a chain of institutions.
- The Blue Paper required that the conduct review committee of a financial institution's board consist solely of independent directors. The requirement now is that independent directors must only be a majority of the committee.
- Finally, the Blue Paper required institutions to maintain a panel of experienced auditors from which shareholders would make their appointments. This requirement has been dropped.

The draft bill considerably enhances the operational flexibility and the business powers of trust and loan companies. For the first time they will have the capacity of a natural person and significantly broadened powers to make personal and commercial loans and to invest. Prohibitions are, however, retained on their ability to retail insurance and to lease automobiles.

Balancing this new flexibility is a host of rules related to self governance. The regime relating to boards of directors is an example. No more than 15 per cent of an institution's board can be officers and employees of the company and its affiliates; 75 per cent of the board must be Canadian citizens normally resident in Canada; one third of the board must not be on the board of affiliated companies; and where a financial institution has a significant interest in another regulated institution, one third of the directors must not be "related parties." The definitions of "affiliated" and "related party" are broad.

Furthermore, a board will be required to have an audit committee and a conduct review committee, both of which are given significant responsibilities. The conduct review committee is required to report directly on an annual basis to the Superintendent of Financial Institutions.

Harmonization of federal and provincial legislation has apparently been given little, if any, consideration. This will surely be an important item on the agenda for the next revisions of financial institutions legislation. Meanwhile, significant differences will exist in the treatment of federally chartered and, for example, Ontario chartered institutions. Two very different examples will suffice. Ontario has rejected the federal policy on commercial links. Consequently, commercially linked companies will be able to both purchase and start-up trust companies. Such companies will not be discriminated against by Ontario. In a more technically legal area, deposits in Ontario trust companies will continue to be trust instruments, while deposits in federal companies will be liabilities of the company, as has historically been the case for banks.

Ontario took the lead in revising its trust and loan legislation, introducing its Bill 116 in July, 1986, and giving it royal assent in June, 1987. It is now expected to be proclaimed in March, 1988. Until harmonization occurs, entrepreneurs will have some interesting alternatives in choosing a chartering jurisdiction.

The amount of discretion provided the Minister of Finance in the draft bill is also a cause for concern, particularly the number of provisions permitting the Minister to approve or disallow a transaction according to the criterion of "the best interest of the Canadian financial system." A related concern is the number of provisions requiring new regulations, drafts of which are not yet available. The 1988 Federal Regulatory Plan issued by the Office of Privatization and Regulatory Affairs gives a whole section to the Office of Superintendent of Financial Affairs, an indication of an active year for the issuance of new federal financial regulations.

Despite the drafting problems and the reach of both ministerial discretion and regulation, there appears to be considerable support for the rapid introduction in Parliament and passage of this legislation. The chance of seeing this legislation passed and proclaimed in this Parliament grows less as the fall of 1988 looks increasingly attractive for an election.

Other Developments

The last *Canadian Competition Policy Record* discussed the Quebec White Paper, *Reform of Financial Institutions in Quebec*. Since then the Quebec government has introduced and passed a new *Savings and Trust Act*. It is faithful to the White Paper. A number of technical errors are being corrected before the *Act* is finally published.

Finally, there have been some recent developments in the U.S. regulatory scene of interest to Canadians.

There is a growing belief on the part of U.S. leaders that the country is beginning to lag behind the rest of the world in financial reform. The U.S. Administration continues to push for the elimination of the four pillars and now has in place in the major regulatory agencies (Federal Reserve Board, Comptroller of the Currency and Federal Deposit Insurance Corporation) officials who actively support this objective. They are having an impact on Congress as exemplified by

the conversion of Senator William Proxmire and the recent Proxmire-Garn Bill. This is occurring despite Black Monday with its fallout in the securities business, and despite continuing large reserves and new write-offs by banks against third world loans and western oil-related business. While the battle may not be won, particularly in the House of Representatives, real progress is being made.

There is, therefore, reason for optimism that:

a) the Congressionally imposed moratorium on new banking products and services that were gradually being permitted by the regulators and which is due to expire in March will not be renewed; and

b) the *Proxmire-Garn Financial Modernization Act* of 1987 will eventually be passed as 'middle-of-the-road' legislation. (Democratic Senator William Proxmire is the Chairman of the prestigious Senate Banking Committee and Senator Jake Garn is the senior Republican on the Committee).

This bill amends the *Glass-Steagall Act* to permit the affiliation of commercial and investment banking in a holding company structure. Commercial banking organizations would be allowed to have a securities affiliate, and a holding company that is 80 per cent in the securities business would be able to acquire a commercial bank.

New securities affiliates are required to be separately capitalized and that capital would not be counted as part of the bank's required capital.

Entrants into the securities business will be monitored closely to ensure that the firms have the requisite managerial talent and financial strength. The bill also prohibits the merger of the 15 largest bank holding companies with the 15 largest securities firms, measured by asset size (banks with total assets of more than $30 billion will not be permitted to merge with securities firms with total assets of more than $15 billion).

Numerous consumer, safety and soundness safeguards are included. For example:

- Securities affiliates must disclose to consumers that their obligations are in no way backed by their affiliated bank or insured by FDIC;
- A bank cannot express an opinion on securities being sold by its securities affiliate without disclosing that its affiliate is selling that security;
- Lending between a bank and its securities affiliate is prohibited except for fully secured intra-day loans for the clearing of government securities;
- The securities affiliate cannot sell securities to the bank or its trust accounts during the underwriting period or for 30 days thereafter. Any sale to an affiliate must be at an established market price;
- No bank, insured institution, or subsidiary can disclose to its securities affiliate or *vice versa* any non public customer information without the consent of that customer.

The bill also overrides state legislation and facilitates the establishment of new holding companies.

If this legislation is passed, Canadian banks and their affiliated securities firms operating in the United States will benefit from it under the terms of the Canada-U.S. Free Trade Agreement.

Following the October 19, 1987, stock market crash, U.S. President Ronald Reagan established a task force to study the causes of the crash and to make recommendations. The task force was chaired by Nicholas F. Brady, Chairman of Dillon, Read and Co., a highly regarded Wall Street investment banking firm.

The Brady Task Force has now reported, concluding that on the Tuesday following the Monday crash "the securities markets and the financial system approached breakdown."

This forceful and frightening conclusion will guarantee close consideration of its recommendations by a reluctant Administration, philosophically geared instead to deregulation. Furthermore, its impact will spread around the world, as did the crash itself, stimulating a much greater effort among governments to coordinate standards and enhance cooperation among the regulators. This process is well underway among the major industrial countries in the field of banking. A small bilateral step in that direction was the recent signing of a Memorandum of Understanding by the three largest Canadian securities regulators and the U.S. Securities

Exchange Commission. When the required amending legislation is passed, joint investigations of securities law infractions will be possible.

The Brady Task Force recommended:

1) Supervision of the financial markets, including the futures markets, by one agency, preferably the Federal Reserve Board;
2) A unified clearing system as part of its one market approach;
3) Consistent margin requirements (whereas margin requirements for stocks are 50 per cent, they may be as low as 8-12 per cent for futures transactions);
4) Circuit breakers limiting price surveys in a single day by closing the market and allowing a cooling off period; and,
5) New information systems to monitor transactions and market conditions.

NATIONAL POTATO AGENCY REPORT RELEASED

On February 17, 1988, the Federal Minister of Agriculture, John Wise, released the report of the National Farm Products Marketing Council on the merits of establishing a National Potato Marketing Agency. At that time the Minister indicated his support for the Council's recommendations.

This is the second time that the NFPMC had considered a proposal for a marketing agency for potatoes. In 1980, the Council held hearings on a proposal for the establishment of a regional agency in Eastern Canada to coordinate the production and marketing of all potatoes (table stock, seed and processing potatoes) through a marketing quota system and to set minimum farm prices based on cost of production plus a reasonable return. The 1980 proposal also entailed establishing a central selling policy, improved distribution of market information, and research and promotion programs. At that time the Council recommended that the agency be established but that it should not be given supply management and price control powers.

The Council's more recent inquiry took as its focal point a report of a National Potato Marketing Agency Task Force made up of representatives of provincial growers associations. While this report was not a detailed marketing plan as had been presented in 1980, it did set out five essential elements which producers desired to be included in a marketing plan for a national agency:

- supply management;
- allocation of marketing quotas;
- price setting;
- surplus removal; and
- import controls.

The NFPMC conducted wide-ranging public hearings on this proposal and alternatives presented by various intervenors over the course of 1987. Alternatives to a proposed agency presented by intervenors included:

(a) a national tri-partite price and income stabilization program;
(b) a national agency to deal with questions of improved production and marketing practices, market intelligence, market promotion and industry consultation and coordination;
(c) establishment of an industry consultation process; and
(d) a national potato commission.

The NFPMC's main conclusions were as follows:

- The task force did not establish that it needed all of its proposed powers to ensure market stability, profitability and the long term growth of the whole potato industry and therefore that the proposed elements of a national marketing plan for all potatoes could not be supported at this time.
- There is merit in, and producer support for, the establishment of a national potato agency with the power to prepare a strategy for the longer term development of the potato industry and to implement programs of market information, promotion, domestic and export market development and research.
- The processing sector should not be part of any future supply control marketing plan

since processing growers with pre-plant contracts do not experience the severe marketing problems found in the table stock and seed sectors.

- All sectors of the industry and consumers should be represented on the board of a national agency.
- If supply controls for table stock and seed potatoes (which the NFPMC favoured) are adopted in the future there should, however, be no cost of production based pricing formula. There must also be quota available for processing potato suppliers to produce seed and table potatoes if they lose their pre-plant contracts. Reciprocal access to both the Canadian and U.S. markets must be provided and the national marketing plan would have to be developed with full consultation from consumers and processors.

The effect of these conclusions would appear to be to adopt a wait and see approach with respect to the need to add inter-provincial supply management powers over the market information and product promotion activities of the new agency. It should be kept in mind that an amendment to the *Farm Products Marketing Agencies Act* would be required for the agency to exercise supply management or inter-provincial quota setting powers. Any detailed marketing plan involving supply management powers would again have to be submitted to the NFPMC for further hearings prior to the introduction of this necessary amendment to the *Act*.

The net result may be the establishment of a national agency which would seek to stabilize producer incomes primarily through the provision of better market information and by encouraging export development and import substitution measures.

The NFPMC would appear to have accepted many of the technical criticisms of quota setting powers advanced by the intervenors at the hearings. These criticisms included:

- If supply management were directed at improving producers' incomes, it would not be possible to prevent regulated production quotas from taking on a capital value which in turn would add to the cost of production.
- There is no generally acceptable formula for allocating quota among table, seed, processing and export products.
- There is no consensus among producers from various provinces on how initial overall Canadian quota should be established.
- Surplus removal costs could be relatively high in a sector whose production depends on climate and the variety of potato selected for growing in a given year, and highly unpredictable, as a result of climatic variations, relative to more factory oriented supply managed products such as eggs and chickens.
- Import controls, necessary to manage a national quota policy, were expected to result in retaliatory action against Canadian potato exports to the United States and were regarded as inconsistent with the Canada-U.S. Free Trade Agreement.

It is difficult to see how a viable interprovincial quota system acceptable to producers could be established without a cost of production based system and border controls to ensure a satisfactory and stable net income after producers have given up the right to plant as much potato crop as they wish. Equally, it is difficult to envisage a workable national supply management program for potatoes which does not close the Canadian border against U.S. imports. Without border measures, as exist for poultry and eggs, Canadian consumption of at-quota production cannot be assured and governments would likely be faced with unacceptable continuing surplus removal costs or direct income support subsidies - the very measures which supply management programs are intended to supplant.

J.F.B.

NATURAL GAS DEREGULATION - RECENT REGULATORY DEVELOPMENTS

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Introduction

Two and a half years ago, on October 31, 1985, the governments of Canada, Alberta, British Columbia and Saskatchewan signed an Agreement on Natural Gas Markets and Prices (the "Halloween Agreement"). Since that date, a partially deregulated market has developed in Canada. (For a brief history of natural gas deregulation see "Deregulation of Domestic Natural Gas Markets" *CCPR* Vol.8, No.1, March 1987.)

There remains, however, an unresolved agenda of deregulation which relates to the inherent tension in balancing the interests of TransCanada PipeLines Limited (TCPL) and Western Gas Marketing Limited (WGML) on one side with the interests of producers and purchasers in the deregulated marketplace on the other. The interests of WGML, which is the gas marketing arm of TransCanada PipeLines Limited, are central to each of the major matters discussed below, that is:

- the January 1988 Ontario Energy Board decisions dealing with gas costs for the three major Ontario gas distribution utilities;
- the recent Alberta joint Public Utilities Board/Energy Resources Conservation Board decision dealing with the core market issue; and
- the upcoming National Energy Board decision dealing with the tariff and tolls of TransCanada PipeLines Limited.

While hundreds of Ontario and Québec industries, commercial and institutional gas users have benefited from direct gas purchases to date, there remain serious impediments to full implementation of gas deregulation as originally envisaged.

Ontario Regulatory Developments

Following the signing of the Halloween Agreement in 1985 it was necessary for the Ontario Energy Board and the Ontario distributors to develop appropriate mechanisms to facilitate the implementation of direct purchases by end-users of gas. In April, 1986, the Board issued its decision with respect to interim contract carriage arrangements. A further decision with respect to Ontario direct purchase arrangements was issued in March, 1987.

As a result of these decisions, Ontario end-users may make buy/sell or transportation arrangements with respect to delivery of direct purchase gas acquired in the deregulated market. Under a buy/sell arrangement the local distributor buys back from an end-user the gas acquired by the end-user at a free market price (current prices are in the area of $1.30-$1.60 per gigajoule). The distributor will generally pay a price equal to the price it would otherwise have paid to TCPL under the existing long term contracts (currently approximately $2.59 per gigajoule).

The Board, also in the 1987 contract carriage decision (EBRO 410-411-412), defined "core market" by a tautology - in effect the core market was defined as simply those gas users which did not purchase gas directly. The Board in effect decided it was not going to put any restrictions on the class of end-user who could enter into a direct purchase. The core market will be discussed later in this article.

In November and December, 1987, the Ontario Energy Board examined the agreement signed by three Ontario Utilities (Consumers Gas, Union Gas and ICG [Ontario] Utilities) and TCPL, with respect to the price of system gas to be included in their rates. The Board, in three separate panels, heard evidence as to whether these agreements should be accepted.

The three agreements, while not identical, were substantially similar. All of them continued to provide for substantial discounts to be received from TCPL/WGML's producers directly through the rate schedules of the various utilities. This arrangement obviated the necessity for direct

purchase contracts, contracts which are necessary with any other producer.

The evidence presented against allowing further extension of Competitive Marketing Program (CMP) discounts and similar arrangements was that this mechanism provided an unfair marketing advantage to WGML as against all other producers and marketers. In any event, CMPs permitted TCPL/WGML to provide lower gas prices to larger customers who otherwise would have entered the deregulated market, maintaining higher prices for captive residential and commercial customers.

The Board, in its three parallel decisions, found some sympathy for both these arguments and for the view that the distributors/TCPL agreements did not fully comply with the Board's directions contained in its earlier decision regarding interim contract carriage arrangements.

Essentially, the Ontario utilities, not without some explanation, admitted that the 1987 agreements did not fully meet the Board's earlier directive to bring lower priced gas to Ontario on an "unstreamed" or non discriminatory basis. However, the utilities strongly argued these agreements represented the best deal that could be made under all the circumstances. The position of the province of Alberta was specifically cited by the Board.

It noted, with respect to the distributors' proposed continuation of price discrimination, that:

> ...in assessing the situation, the Board considers that it is the monopoly position of WGML/TCPL with support from the removal permit policy of the Alberta Government, that prevented significant progress toward meeting the criteria. (EBRO 410-III p.38)

Since June, 1987, Alberta has refused to issue removal permits to producers who wished to honour contracts to sell gas to any eastern Canadian end-user which was not an industrial customer consuming in excess of 35,000 gigajoules/year at each facility (approximately 1,000,000 m^3/year). No such restriction had been contemplated in the Halloween Agreement.

The Board which heard testimony during the hearings suggesting that the pricing practices of WGML/TCPL might constitute predatory pricing noted:

> The Board recognizes that acceptance of the 1987 Agreements (to cover pricing through October 31, 1988) may preclude possible action under the *Competition Act*. Similarly, legal action to test if the restrictions imposed by the Alberta Government contravene sections of the Constitution may be delayed. (EBRO 410-III p.40)

Thus, the marketplace is functioning but remains subject to the anticompetitive pressures asserted by WGML/TCPL, and the government of Alberta.

In the Board's Decisions with Reasons issued in January, 1988, the Board accepted the agreements. These agreements continued to permit the Ontario utilities to assist with the marketing of WGML's gas to specific customer groups which WGML wishes to retain as "system gas" customers. However, the Board stated that its decision was made "reluctantly."

The Board did not deal with the removal permit restrictions unilaterally imposed by Alberta but did express its displeasure at Alberta's additional imposition of a "ghost" floor price below which removal permits would not be issued.

In the ICG Decision, the Board stated "[t]he Board is reluctant to accept the cost effect of agreements that result from negotiations which were so constrained." The Board was referring, among other things, to the complicated upstream arrangements and existing contracts and the possible reaction of the Alberta government to an Ontario decision which impacted adversely upon the WGML producers.

The Board's decision was made notwithstanding its finding: "[i]t is clear to the Board that the prices that will result from the 1987 agreement are in fact discriminatory." The Board in effect found that the level of discrimination was acceptable "for the balance of the time that the 1987 agreement is applicable" which is to October 31, 1988. The Board found the agreement discriminatory and concluded: "...accordingly, the Board reluctantly finds that under the current circumstances the 1987 agreement is acceptable."

The Board further stated that its acceptance was subject to the qualification that the term be from November 1, 1987 to October 31, 1988 and that this was to be a "finite transition".

The implication of the Board's finding with respect to the overall agreement was that CMPs were to continue through the transitional period to October 31, 1988 only.

CMPs provide a mechanism for Western Gas Marketing Limited to retain a customer which otherwise might have pursued a direct purchase. They have been implemented with a very simplified form of contract. Unlike a direct purchase transaction, no new removal permit is necessary from Alberta. Therefore, the price of gas to be removed from the province under CMPS is not controlled.

Until recently there was strong evidence that the Alberta Minister of Energy was, in effect, enforcing what became known as a ghost floor price of $1.35 per gigajoule for gas to be removed under short term removal permits for the direct sale market in Ontario and Québec. This price is referred to as a ghost price as there is no reference to such a price in any published Alberta regulations or statutes. It has been suggested that had the price of gas to be sold in the provinces of Ontario and Québec been published and set on a discriminatory basis, then the Alberta Energy Minister would have been acting beyond his constitutional authority.

Subsequent to the Board's decision, Alberta has permitted the ghost floor price to vanish. This comes at a time when spot gas prices have been under very significant upward pressure due to a number of factors including increasing demand, both seasonal and longer term, in the United States. Thus, there may no longer be any necessity, from a revenue protection viewpoint, to enforce a floor price if the market price quickly establishes itself above the $1.35 per gigajoule level.

In summary, the Board's decisions permit some of the anti-competitive features of the market which have developed over the course of the past year to continue, but only for a limited transitional period. The Board did not state any change to its position previously expressed that end-users of gas which were successful in making supply arrangements should not be prevented from consummating such arrangements by arbitrary restrictions on the nature of the end use.

Current Alberta Regulatory Situation - the Core Market Issue

As noted above, one issue of significance affecting the deregulated natural gas market which remains substantially unresolved is that of access to market priced gas for what the province of Alberta has called the core market.

When the Agreement on Natural Gas Markets and Prices was signed in October, 1985, there was no provision in the Agreement for restricting access to competitively priced natural gas. Indeed, immediately after the signing of the Agreement, the then Federal Minister of Energy Mines and Resources, the Honourable Patricia Carney, specifically reaffirmed that the Agreement was intended to permit all gas customers who could organize themselves effectively to purchase natural gas priced by the market. Specific mention was made of hospitals and school boards.

Core market has been variously defined and certain observers including the National Energy Board (ref. *Review of Natural Gas Surplus Determination Procedures 1987*, pp. 13-14, 20) have suggested that it is a concept which is not capable of exact definition. However, the definition effectively being employed by the government of Alberta at present, in terms of restricting access to competitively priced gas, is: all gas consumers other than industrial users consuming in excess of 35,000 gigajoules per year at each location. In volumetric terms, this consumption is roughly equal to 1,000,000 cubic metres per year.

The potential absurdity of the position taken to date by the province of Alberta with respect to small plant industrial consumers can be illustrated as follows. Assume that an Ontario or Québec manufacturing concern consuming ten million cubic metres of gas per year has entered into an arrangement for supply of competitively

priced gas for a two year term with provisions for renewal subject to price renegotiation. Assume also that the purchaser has satisfied itself that the selected supplier was a company of substance whose convenant to deliver gas on a firm basis could be relied upon. Assume also that the supplier, unlike some gas marketers which suffered serious curtailments on the NOVA system this winter, had contracted sufficient NOVA firm transportation space to meet its delivery obligations.

Assume also from the seller's perspective that the price at which the gas is to be sold is attractive because it may be higher than the spot price available for sales to the U.S. market. The price is also attractive because the gas may be taken at close to 100% load factor. Comfort can be taken from the fact that firm pipeline transportation arrangements will be in place from the Alberta border to the customer's burner tip. We thus have a willing seller and a willing buyer.

Nevertheless, this is a marriage that is not meant to be. If this customer's annual consumption is spread evenly across eleven plants located across Ontario and Québec, the Alberta Minister of Energy, notwithstanding a determination by the Energy Resources Conservation Board that the gas to be removed from the province was surplus to Alberta's requirements, would refuse to sign the ministerial permission required to finalize the removal permit.

The Minister has been quoted (*Calgary Herald*, August 21, 1987) as making the statement that a customer such as this which consumes less than the magic 35,000 gigajoule consumption at its individual plants cannot be expected to make adequate arrangements for its own gas supply.

Similarly, the Minister has refused to sign removal permits for hospitals, hotels, school boards and other large gas users whatever the level of their consumption.

The effect of these restrictions imposed by the Alberta Minister of Energy is to raise the price paid by all gas users in eastern Canada which have been defined by Alberta as core customers.

There are, however, a certain number of hospitals and other non industrial users of gas which are enjoying access to market priced gas. The downtown Toronto teaching hospitals and even the Ontario Parliament Buildings located at Queen's Park have their energy supplied from market priced Alberta gas. At least one other Toronto hospital had its direct purchase of Alberta gas commence before Alberta imposed, in June, 1987, the market restrictions with respect to core customers.

A small number of other users have been able to access direct purchase gas originating in the province of Saskatchewan as the Ministry of Energy and Mines of that province does not impose similar restrictions upon the end-user. Saskatchewan, however, cannot be a source of gas for the entire Ontario and Québec core market as it has much less excess deliverability from existing gas fields, significantly less long term potential gas supply, and, most importantly at present, an intra-province gas gathering and transmission infrastructure which is not capable of handling greatly increased demands.

In January, 1988, the Public Utilities Board and the Energy Resources Conservation Board of the province of Alberta released their report on core market definition and supply protection issues with respect to the Alberta core market.

The report, delivered to the Alberta Minister of Energy who has not yet provided his reaction, recommended that the core market should be defined to include residential, institutional and commercial consumers. It suggested that these consumers could be permitted to arrange direct sales provided long term commitments including reserves dedication were in place on both sides. Long term was defined as a contract running ten to fifteen years. However, it was recommended that the contract could be based upon the first year's daily volume requirements only. The Board also recommended against the inclusion of small industrial customers in the "protected" category.

It may be expected that, once the Minister provides his reaction to the report with respect to the Alberta situation, his decision regarding those matters will influence Alberta's handling of the core market issue with respect to direct sales to eastern Canada.

While the province of Alberta undoubtedly has the authority to allocate and price gas within its boundaries, it should be noted that, at present, there is a certain inconsistency between the pricing of gas to the Ontario and Québec core market versus the pricing of Alberta gas destined for core market customers in the United States. Alberta currently imposes no restrictions upon such sales to the United States nor has it required ten to fifteen year contracts. Indeed, Alberta has permitted sales of gas which has ended up being burned by hospitals, school boards, hotels and other similar users in the United States under contracts shorter than the typical two year direct sale contract.

The province of Alberta has also encouraged new applications for export of Alberta sourced gas to new markets in the United States and for extensions of existing export licenses to commit gas to various U.S. markets well into the next century. Certain observers have suggested that there is again some inconsistency between that policy and a suggestion that access to lower priced gas for non industrial users in the provinces of Ontario and Québec should be restricted on the basis of security of supply. It may also be noted that the ten to fifteen year firm contract requirement, if it is in fact imposed for sales to Ontario and Québec users in the direct purchase market, would exceed the time remaining on some of the existing long term contracts under which most of the Ontario and Qubec core market is now supplied and where the price is fixed for only a period of six more months.

The province of Alberta has suffered a very significant erosion of its royalty revenues from the sale of its gas by reason of the recent decline in gas prices. The price is expected to continue its current end-user discrimination as long as such a policy is perceived to keep up provincial revenues and protect the higher priced sales of the WGML producers.

TransCanada Pipelines1988-89 Tolls Hearing

The National Energy Board's May, 1987, decision in RH-3-86 was issued following the Board's decision of May, 1986, "In The Matter of TransCanada PipeLines Limited - Availability of Services." End-users of natural gas are able to contract directly for the supply of gas (assuming they are not caught by Alberta's market restrictions). However, local distribution companies, party to existing long term contracts with TransCanada, were not similarly permitted to displace volumes by buying gas which would otherwise have been purchased under the long term contracts.

This ruling has been referred to as the rule against self displacement and represents the largest single remaining barrier to a more fully competitive domestic market for natural gas.

In the Hearing Order (RH-1-88) issued by the National Energy Board with respect to the TCPL 1988-89 Tolls Application due to start in May, 1988, the Board has included the possible reconsideration of the self displacement question as an issue to be addressed along with a number of other tariff and toll design issues which impact upon the deregulated portion of gas flowing through the TCPL system.

Summary

In summary, 30 months into deregulation, the market is continuing to develop notwithstanding the barriers raised by the province of Alberta and the continuing efforts of WGML to re-establish its former market share. The phase out in Ontario of price discounts (CMPs) targeted to potential direct purchasers and the possibility of further tariff changes which enhance open access to the TCPL transportation system as a result of the upcoming N.E.B. decision bode well for general positive development in the deregulated gas market.