Ontario Energy Board

Commission de l'Énergie de l'Ontario

Ontario

EB-2005-0211

IN THE MATTER OF the *Ontario Energy Board Act 1998*, S.O.1998, c.15, (Schedule B);

AND IN THE MATTER OF an Application by Union Gas Limited for an Order or Orders amending or varying the rate or rates charged to customers as of January 1, 2005. **(Phase 3)**

BEFORE: Gordon Kaiser
Vice Chair and Presiding Member

Paul Vlahos
Member

Cynthia Chaplin
Member

DECISION WITH REASONS

June 27, 2007

In 2004, Union Gas Limited ("Union") sold 1.6 petajoules ("PJ") of surplus cushion gas for $13.493 million resulting in a pre-tax gain on the sale of $12.829 million. In two previous decisions[1], this Board determined that it has the jurisdiction under its governing statute to allocate all or part of this gain to utility customers. The question before this panel is whether there is any basis on the evidence for allocating all or part of the gain to customers.

For the reasons set out below, the Board finds there is no economic, legal or policy principle that justifies allocating any of the gain of the 2004 sale of cushion gas to utility customers in this case.

Procedural Background

This proceeding relates to a Union application for approval of the company's 2003 earnings sharing disposition, its 2004 deferral account disposition, and its 2005 demand side management program. A settlement conference resolved all but two issues: the company's demand side management program and the sale of cushion gas. The Board ordered that the hearing on the cushion gas issue would be deferred pending a ruling of the Supreme Court of Canada on the ATCO Decision by the Alberta Court of Appeal[2]. That case concerned the jurisdiction of the Alberta regulator to allocate revenues from the sale of utility assets to utility customers. This Board wanted the benefit of the Supreme Court's analysis before making the decision on Union's 2004 cushion gas sales.

On February 9, 2006, the Supreme Court released its decision.[3] The Board then heard argument on its jurisdiction to allocate revenues from asset sales and ruled on June 28, 2006[4] that it had jurisdiction in a rates case. Union requested a clarification of that

[1] *Re Union Gas Limited*, Decision with Reasons, EB-2005-0211, (June 28, 2006); *Re Union Gas Limited*, Decision with Reasons, EB-2005-0211, (January 30, 2007)

[2] *ATCO Gas & Pipelines Ltd.* v. *Alberta (Energy & Utilities Board)* (2004), 24 Alta. L.R. (4th) 205)

[3] *ATCO Gas & Pipelines Ltd.* v. *Alberta (Energy & Utilities Board)*, [2006] S.C.J. 4

[4] *Re Union Gas Limited*, EB-2005-0211, (June 28, 2006)

decision and a clarification letter was issued on July 26, 2006. Some parties claimed that the Board's clarification was not consistent with its original decision. The Board decided, on its own motion, to review the June decision, and offered the parties an opportunity to state, or restate, their positions on these issues.

On January 30, 2007, the Board ruled[5] that it had jurisdiction to order the sharing of proceeds between the shareholder and utility customers. The Board also ordered the original panel to consider the extent to which the proceeds from the sale of cushion gas should be allocated between the shareholder and customers. This Decision is limited to that issue.

Factual Background

Union owns significant storage assets in Southwestern Ontario which are used to balance the annual seasonal and daily differences between supply and demand. The storage reservoirs are filled during the summer when the demand is low and emptied during the winter period when the demand is high. Once developed, the capacity of the storage gas reservoir is divided into two primary components, working gas in storage and cushion gas. The latter is also referred to as base pressure gas.

Working gas in storage is gas purchased for and consumed by Union's franchise and ex-franchise customers. This is the volume of gas that is available for injection and withdrawal. Cushion gas, on the other hand, is the volume of gas required to maintain the minimum base pressure for the operation of the storage reservoir. Because cushion gas is always necessary to maintain the pressure, it is treated as a capital asset and capitalized as a cost of the storage reservoir assets. In the ordinary course, cushion gas would never be available for consumption. Cushion gas is valued at cost for accounting purposes and not revalued to reflect the current cost of gas. Cushion gas is paid for and owned by Union and makes up part of Union's assets and rate base.

[5] *Re Union Gas Limited*, EB-2005-0211, (January 30, 2007)

In early 2001, Union determined that its existing storage reservoir could be operated at a lower minimum operating pressure. This determination resulted in potential surplus cushion gas that could be sold. Prior to 2001, Union had been operating its storage pools at varying minimum pressures ranging from 500 pounds per square inch ("psi") to 300 psi. Union determined that it could lower the minimum pressure in all storage pools to 300 psi which resulted in approximately 6.4 PJ of potential surplus cushion gas.

Having determined that 6.4 PJ of cushion gas was potentially surplus to its operational needs, Union decided to sell some of the surplus assets. The company disposed of 2.1 PJ of cushion gas in two transactions during the winter of 2001 and 2002. Those proceeds were recorded as capital gains in Union's financial statements filed with the Board. Union's 2004 assets and corresponding rate base calculations were reduced to reflect the sale of cushion gas in 2001 and 2002.

Union sold an additional 1.6 PJ of surplus cushion gas in 2004 for $13.493 million resulting in a pre-tax gain on the sale of $12.829 million. (The book value of the cushion gas was $0.664 million.) This transaction is the subject matter of this decision.

Position of the Parties

Union argued that none of the proceeds of the 2004 sale of cushion gas should accrue to the benefit of customers. All the other parties, with the exception of Board Staff counsel, argued that some or all of the proceeds should accrue to the benefit of Union's customers. These parties include the Industrial Gas Users Association ("IGUA") the Consumers Council of Canada ("CCC"), the School Energy Coalition ("SEC"), the Vulnerable Energy Consumers Coalition ("VECC"), the London Property Management Association ("LPMA") and the City of Kitchener ("Kitchener").

Board Staff counsel took no position on whether any part of the proceeds should be allocated to the customers but submitted an Affidavit previously filed by this Board with the Supreme Court of Canada in the ATCO case. That Affidavit referenced different

decisions in which this Board, for different reasons, had allocated proceeds from the sale of assets to customers.

The Evidence

Union's witnesses testified that the 2004 sale of surplus cushion gas had not in any way harmed customers but had instead resulted in substantial direct and indirect benefits.

The only opposing evidence was the Affidavit of Peter L. Fournier, the President of IGUA[6]. The majority of Mr. Fournier's evidence consisted of an examination of the Uniform System of Accounts and in particular Account #152 (Gas in Storage – Available for Sale) and Account #458 (Base Pressure Gas).

Mr. Fournier noted that Account #458 contained a note which states "gas deliveries to or withdrawals from underground storage for customer consumption shall be charged or credited to Account #152 Gas in Storage – Available for Sale". He argued, as did IGUA's counsel in final argument, that this means that if base pressure gas is to be sold, it must be reclassified to Account #152 (Gas in Storage – Available for Sale) . This in turn implies that any profit on the sale should accrue to the customers. Union elected not to cross-examine on the Fournier Affidavit.

The Rationale for Allocating Proceeds to Customers

The question of allocating all or part of the profit on a sale of assets by a utility is not a new issue. It has come before this Board several times. In its 1984 decision in *Northern and Central Gas*[7]*,* the Board distinguished between depreciable and non-depreciable assets and concluded that it was inappropriate to allocate any of the proceeds on the sale of land, which is non-depreciable, to customers. In subsequent

[6] Affidavit of Peter Fournier, President of IGUA, March 27, 2006.

[7] *Northern and Central Gas Corporation Limited Decision and Order,* EBRO 399 (December 28, 1984); See also C*onsumers Gas Company Ltd*., EBRO 465 (March 1, 1991); *Re Enbridge Gas Distribution Inc.*, RP 2002-0133, (November 7, 2003); *Re Natural Resource Gas Limited*, RP 2002-0147, (June 27, 2003); *Re Union Gas Limited,* RP-2002-0130, (January 20, 2003)

decisions regarding land sales, the Board has allocated the gains equally between utility customers and the utility. In its 1991 decision in *The Consumers' Gas Company Ltd.*[8], the Board referenced a concern regarding the potential to skew the timing of land sales and purchases and determined that the proceeds should be shared. In the case of Natural Resource Gas in 2003, the company proposed the same sharing. Other decisions, including the decision to share the proceeds of the cushion gas sales in 2001 and 2002, were the result of Settlement Agreements among the parties.

The matter before us is not whether the Board has jurisdiction to allocate the proceeds from the sale of assets to customers. That has been decided affirmatively by two different panels in this proceeding. The issue is whether the Board should exercise its jurisdiction and allocate all or part of the proceeds to utility customers.

Those arguing that the proceeds of the sale of assets by a utility should be allocated to utility customers generally rely on three different arguments.

The first is that the sale of assets has caused harm to the customers and customers should therefore be compensated. The second ground is that allocation to customers of some or all of the proceeds are necessary so as not to create incentives to the utility that are not in the public interest. The third ground is that the customers have in some sense acquired an ownership interest in the asset in that they have paid for or "substantiated" the asset. Each of these potential grounds is dealt with in turn.

The starting point for any analysis, however, must be the Supreme Court of Canada decision in ATCO. Much of the analysis in the ATCO decision turned on whether the Alberta Board had jurisdiction to allocate all or part of the gains to customers. On that point, the Court was divided. But the ATCO case also reaffirmed an important property interest principle. With respect to this principle, the Court was not divided. The Court clearly stated that utility customers have no property interest in the assets of a utility. Rather, customers are entitled to receive service from the utility at just and reasonable

[8] *The Consumers' Gas Company Ltd*., EBRO 465, March 1, 1991.

rates. The payment for that service however, does not entitle them to any ownership interest.[9]

The mandate of this Board as set out in the objects in the Act[10] is to protect the interests of consumers with respect to price and quality of service while ensuring a financially viable gas industry. It has long been recognized that the regulatory compact requires a balance of these interests. It is important that utilities can expect a fair rate of return on their investments and a clear definition of property rights is fundamental to these investment decisions. Any reading of the ATCO decision requires that, at a minimum, any departure from the property rights principle enumerated by the Court requires clearly articulated public interest grounds.

Harm to Customers

There may be cases where the sale of an asset by a utility can harm customers. That situation could arise in this case if there were any adverse consequences – operational or financial – for customers. The evidence was clear that there were no adverse operational or material cost consequences for customers. (In fact, ratebase will be reduced slightly, thereby lowering costs to customers.) The one potential for harm would be if it turned out that Union had made an error, and additional cushion gas was required. In this case, the cost of replacement cushion gas would be significantly higher than the book value of the original cushion gas.

Union argued that there is little likelihood that this will happen. Union did acknowledge that because the weather has been warmer than usual in recent years, it has not been able to fully test the extent to which this amount of base pressure gas can be removed. Union explained that this is the reason that it has yet to dispose of the remaining one-third of the potentially excess cushion gas. However, Union's evidence is that should it have to purchase additional cushion gas in the market to replace what it has sold, the entire cost would be for the account of the company and the shareholder, and Union

[9] *ATCO Gas Pipelines Ltd. v. Alberta (Energy & Utilities Board)* 2006 S.C.C. 4 at 44-45

[10] *Ontario Energy Board Act, 1998*, section 2.

would depart from traditional ratemaking practice and would not seek to include the cost of the purchased cushion gas in rate base.

Union argued that rather than causing harm, the converse is true in that substantial benefits to customers result from the sale of cushion gas. This is because the sale created incremental storage capacity at no incremental capital cost, and that incremental capacity was sold to generate additional revenue that customers share. Union's franchise customers currently receive 75% of the margin from additional unforecast storage service sales to ex-franchise customers. The customers' share to date exceeds $5.4 million as of the end of the 2006-2007 storage season. This Board's recent decision in NGEIR[11] will reduce the customers' share of this income stream, but the stream will continue nonetheless.

In summary, there is no evidence before us that the customer will in any fashion be harmed by the transaction in question. Rather, the public interest will be served by the addition of new storage capacity at little cost. The revenue sharing mechanism also ensures that benefits will flow to customers in the future.

Utility Incentives

This Board's January 30th 2007 decision notes that one of the reasons why the Board may wish to allocate the proceeds from asset sales to customers is to ensure that proper incentives exist for utilities to operate in the public interest. This argument most often arises in the case of land, which is another type of non-depreciable asset held by a utility. Past decisions allocating proceeds from the sale of land by utilities to customers by the Ontario and Alberta Boards have been justified on the ground that the utilities should not be encouraged to speculate in land. In the matter before us, there is no evidence that Union is speculating in the purchase or sale of cushion gas. The requirement for cushion gas is established by the technical requirements of the storage pool. There is no evidence that Union has or could purchase or sell cushion gas for speculative purposes.

[11] *Natural Gas Electricity Interface Review*, EB-2008-0551, (November 7, 2006)

Unlike the sale of land, this sale of cushion gas created an enduring benefit, in the form of additional storage capacity, from which customers also benefit. Union pointed out that the Board in its NGEIR decision stated that increasing storage capacity in Ontario is an important public policy objective. Union argued that allowing the utility to retain the proceeds from cushion gas sales promotes this policy objective.

In summary, there is no evidence before us in this proceeding to indicate that allocating part of the proceeds to customers is necessary to incent utilities to operate in the public interest. The converse is true: in this case, allowing utilities to retain the proceeds of cushion gas sales will encourage them to maximize the availability of storage. The Board clearly stated in its NGEIR decision that creating additional storage is an important public policy objective:

> "The Board also agrees that further development of storage in Ontario would be of benefit to Ontario consumers in terms of reduced price volatility, enhanced security supply and overall enhance competitive market at Dawn." [12]

Allocating part of the proceeds to customers would reduce this incentive, which in the Board's view would be inappropriate.

Ownership Interests

The other rationale advanced by intervenors for allocating proceeds from the sale to customers is that the customer has in some sense paid for the asset and therefore is entitled to the gain on its sale.

The Supreme Court of Canada in the ATCO case clearly stated that customers do not have an ownership interest in the assets of the utility. They have a right to receive services that involve the operation of the assets and must pay the costs associated with the services.

[12] *Natural Gas Electricity Interface Review*, EB-2008-0551, (November 7, 2006) at pg. 50

The interveners took the position, however, that once the cushion gas was no longer needed, Union should not have disposed of it and retained the gain for its shareholders. The interveners argued that because cushion gas is physically no different than working gas, it should have been declared surplus and converted to working gas. In their view, customers are entitled to this “cheap gas”. They claimed this cheap gas should have been used to provide service to the customers, as opposed to using more expensive gas purchased on the open market to provide the same services.

Some intervenors took the position that this reclassification is mandatory. They base this argument on a note to Account #458 (Cushion Gas) in the Uniform System of Accounts. Account #458 contains a note stating that “gas deliveries to or withdrawals from underground storage for customer consumption shall be charged or credited to Account #152 (Working Gas).” The intervenors suggested that this note reflects direction by the Board that any amount withdrawn from underground storage should be transferred to Working Gas.

Union disagreed and pointed out that the Uniform System of Accounts is quite explicit about the treatment of non-depreciable assets that are no longer required for utility service, namely that the proceeds from the disposition of these assets should be accounted for in Other Income. In Union’s view, if the Board intended surplus cushion gas to be reclassified, the Board would have made an explicit provision. The Board agrees and finds that the note for Account 458 cannot reasonably be interpreted to mean that surplus cushion gas is to be reclassified; rather its purpose is to distinguish between “base pressure gas” and “gas in storage available for sale” so that they are accounted for properly. The Board concludes that there is no accounting requirement for cushion gas to be treated differently from other non-depreciable assets or that surplus cushion gas is automatically to be considered available for sale to customers. In the treatment of non-depreciable assets, it is clear that any profits or losses be accounted for through an income account or as an extraordinary item, depending upon whether the profit/loss is material.

The intervenors also argued that even if the Board found that there was not an accounting requirement to reclassify the cushion gas, then the Board should still find that Union had an obligation to reclassify the cushion gas because of its duty to act in the best interests of its customers. The Board does not agree. Union does have an obligation to act in the interests of its customers, but it does not have an obligation to give its assets to its customers. This could only be justified if the customers had some property interest in the cushion gas, and under the ATCO decision, customers very clearly have no such property interest.

Decision

Union's sale of cushion gas results in substantial benefits to the customers at no cost to customers. There is, in the Board's judgment, no economic, legal or policy principle that would justify allocating part of the gains of the cushion gas sale to customers in this case. In the present case, the Board cannot identify any public interest which requires protection and there is therefore nothing to trigger the exercise of the discretion to allocate all or part of the proceeds of the sale to utility customers.

As part of the earlier proceeding, Union was directed to establish a deferral account to track the interest earned on the capital gain. Because the Board has determined that the proceeds of the sale will not be shared with ratepayers, the interest earned on the proceeds will also not be shared. Union is authorized to close the deferral account and retain the balance.

Cost Awards

The eligible parties shall submit their cost claims by July 12, 2007. As indicated in Procedural Order No. 11, the Board will address only those costs that are related to the phase of the proceeding after the January 30, 2007 Board decision on jurisdiction.

A copy of the cost claim must be filed with the Board and one copy is to be served on Union. The cost claims must be done in accordance with section 10 of the Board's Practice Direction on Cost Awards.

Union will have until July 26, 2007 to object to any aspect of the costs claimed. A copy of the objection must be filed with the Board and one copy must be served on the party against whose claim the objection is being made.

The party whose cost claim was objected to, will have until August 2, 2007 to make a reply submission as to why their cost claim should be allowed. Again, a copy of the submission must be filed with the Board and one copy is to be served on Union.

DATED at Toronto, June 27, 2007

ONTARIO ENERGY BOARD

Original signed by

Gordon Kaiser
Vice-Chair and Presiding Member

Original signed by

Paul Vlahos
Member

Original signed by

Cynthia Chaplin
Member