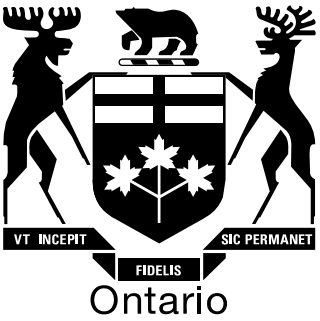
Ontario Energy Board

Commission de l'énergie de l'Ontario



EB-2006-0322
EB-2006-0340

A REVIEW OF CERTAIN PARTS OF THE NATURAL GAS ELECTRICITY INTERFACE REVIEW (EB-2005-0551) DECISION OF NOVEMBER 7, 2006 AND CONDUCTED PURSUANT TO THE BOARD'S REVIEW DECISION OF MAY 22, 2007

DECISION WITH REASONS

July 30, 2007

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EB-2006-0322
EB-2006-0340

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

AND IN THE MATTER OF a proceeding initiated by the Ontario Energy Board to determine whether it should order new rates for the provision of natural gas, transmission, distribution and storage services to gas-fired generators (and other qualified customers) and whether the Board should refrain from regulating the rates for storage of gas;

AND IN THE MATTER OF a review of certain parts of the Natural Gas Electricity Interface Review (EB-2005-0551) Decision of November 7, 2006 and conducted pursuant to the Board's review decision of May 22, 2007.

BEFORE: Gordon Kaiser
Presiding Member

Cynthia Chaplin
Member

Bill Rupert
Member

DECISION WITH REASONS

July 30, 2007

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1. BACKGROUND

On November 7, 2006 the Board issued its Decision with Reasons on the Natural Gas Electricity Interface Review proceeding (the "NGEIR Decision").[1] In December 2006, the Board received three Notices of Motion made pursuant to Rule 42 of the Board's Rules of Practice and Procedure requesting the Board to review and vary the NGEIR Decision. The three Notices were filed by the City of Kitchener, the Association of Power Producers of Ontario, and jointly by the Industrial Gas Users Association, the Vulnerable Energy Consumers Coalition and the Consumers Council of Canada.

The Board then issued a Notice of Hearing and Procedural Order indicating that it would conduct a review to address two initial issues: (i) the test that the Board should apply in determining whether it should review the NGEIR Decision; and (ii) whether the moving parties met the test.

In its decision of May 22, 2007 (the "Motions Decision"),[2] the Board determined that three of the matters raised by the moving parties had met the test for review:

a. The decision to cap the amount of storage available at cost-based rates for in-franchise customers of Union Gas Limited ("Union") at 100 petajoules (PJ),

b. The decision regarding additional storage requirements for Union's in-franchise gas-fired generator customers, and

c. The decision regarding Enbridge Gas Distribution's ("Enbridge") Rate 316.

The Board also determined that the original NGEIR panel should hear submissions on the merits and make a final determination as to whether the NGEIR Decision should be varied.

[1] Decision with Reasons, Natural Gas Electricity Interface Review, EB-2005-0551, November 7, 2006.

[2] Decision with Reasons, Motions to Review the Natural Gas Electricity Review Decision, EB-2006-0332/0338/0340, May 22, 2007.

By Procedural Order dated May 29, 2007, the Board requested that the parties make submissions on the three matters in writing. The Board received submissions from the following parties: the Consumers Council of Canada, jointly with the Vulnerable Energy Consumers Coalition ("CCC/VECC"); The City of Kitchener ("Kitchener"); the Industrial Gas Users Association ("IGUA"); the Association of Power Producers of Ontario ("APPrO"); Enbridge Gas Distribution Inc. ("Enbridge"); and Union Gas Limited ("Union").

The Board has now considered these submissions and for reasons expressed below finds that it will not vary the original NGEIR Decision with respect to any of the three issues.

2. THE 100 PJ "CAP"

Background

In the NGEIR Decision, the Board found that Union should be required to reserve 100 PJ (approximately 95 Bcf) of its storage space at cost-based rates for so-called in-franchise customers (gas distribution customers). That reserved amount is 8 PJ higher than the amount of storage space currently required for in-franchise needs. Union's in-franchise storage needs have grown at 0.5% per annum in recent years. At that rate, in-franchise demand for storage space would not reach 100 PJ until 2024. At a highly accelerated growth rate of 2% per year, the level of 100 PJ would be reached in 2012.

Given that only about 60% of the capacity of Union's Dawn storage facilities has been required for in-franchise needs, there is space that Union has sold for many years to a variety of ex-franchise customers (marketers, gas distribution companies, and other entities that are not gas distribution customers of Union).

Before the NGEIR Decision, the Board had not fixed the amount of storage available at cost-based rates for Union's in-franchise customers. A major finding of the Board's NGEIR Decision was that the natural gas storage market in Ontario is competitive and that, pursuant to section 29 of the *Ontario Energy Board Act*,[3] the Board will refrain (or forbear) from regulating the prices charged to ex-franchise customers and from approving new storage contracts with those customers. Under the NGEIR Decision, that ex-franchise storage activity is no longer a utility business. The NGEIR Decision explained that:

[3] Subsection 29 (1) of the *OEB Act* states: "On an application or in a proceeding, the Board shall make a determination to refrain, in whole or part, from exercising any power or performing any duty under this Act if it finds as a question of fact that a licensee, person, product, class of products, service or class of services is or will be subject to sufficient competition to protect the public interest."

> The Board concludes that its determination that the storage market is competitive requires it to clearly delineate the portion of Union's storage business that will be exempt from rate regulation. Retaining a perpetual call on all of Union's current capacity for future in-franchise needs is not consistent with forbearance.[4]

Fixing the amount of storage space available at cost-based rates for in-franchise customers at 100 PJ was the method chosen by the Board to effect this delineation. In the NGEIR proceeding, Union had argued for a cap of 92 PJ, which the Board rejected as too low.

The Motions Decision

In its decision, the Motions panel stated:

> The NGEIR panel is silent on the outcome if in-franchise customers require more than the 100 PJ of storage per year. Although the NGEIR panel is clear that it does not expect this circumstance to occur for many years, the decision nevertheless appears to raise the possibility that in-franchise customers may, at some point, be subject to unregulated prices.[5]

The Motions panel found that the following questions should have been addressed by the NGEIR panel:

a. If the cap of 100 PJ of storage for in-franchise Union customers remain[s] in place in perpetuity, what is the basis for forbearance (under section 29) of required storage above 100 PJ for in-franchise customers?
b. If the cap of 100 PJ of storage for in-franchise Union customers does not remain in place in perpetuity, what mechanism should the Board use to monitor the likelihood of the cap being exceeded?
c. If the cap of 100 PJ of storage for in-franchise Union customers is likely to be exceeded, what, if any, remedy is available to in-franchise customers?[6]

[4] NGEIR Decision, page 82.

[5] Motions Decision, page 48.

[6] Motions Decision, page 49.

Responses to the Motions Decision and Board Findings

CCC/VECC, IGUA, and Kitchener submitted that the 100 PJ cap should be set aside and rescinded. Their position is that all of Union's storage capacity should be available at cost-based rates for in-franchise consumers regardless of how many years it will take before the in-franchise consumers actually need the storage space.

They argued that the Board's finding in the NGEIR Decision regarding the 100 PJ cap is inconsistent with its finding that in-franchise customers do not have effective access to competitive alternatives. They noted that in the future when the 100 PJ limit is exceeded, Union will flow through to its in-franchise customers unregulated market prices for the incremental storage requirement, prices they assert will be materially higher than cost-based storage rates.

The Board does not agree that there is any inconsistency or contradiction in the NGEIR decision in respect of the 100 PJ reserved for in-franchise customers at cost-based rates.

The argument of CCC/VECC, IGUA and Kitchener seems to be based on the assumption that the competitive position of individual in-franchise customers is the same as that of the distribution system operator which purchases storage services on its customers' behalf. The NGEIR Decision quite clearly drew a distinction between the competitive position of distributors and their in-franchise customers.[7] Union operates in the competitive storage market; its in-franchise customers generally do not.[8]

[7] NGEIR Decision, page 61: "…Enbridge and Kingston, which are buying storage services on behalf of their customers because they do not have sufficient storage resources of their own, do have access to alternatives." At page 63, the Board found: "The issue is whether Enbridge and Kingston, as purchase of storage for bundled customers, should receive regulated cost-based storage service from Union. The Board concludes that they should not, because the storage services they acquire are subject to competition sufficient to protect the public interest…" The Motions Decision also recognized this distinction at page 43: "The NGEIR decision differentiates between the competitive position of a utility (e.g. Enbridge) and the competitive position of that utility's in-franchise customers."

[8] The Board did note at page 57 of the NGEIR Decision: "However, customers taking unbundled and semi-bundled services do have greater control over their acquisition and use of storage than do bundled customers. It is also the Board's expectation that these customers will have access to and use services from the secondary market. Therefore, the Board concludes it is particularly important to ensure that the allocation of cost-based regulated storage to these customers is appropriate."

CCC/VECC argued that this is a distinction without a difference. They maintained that when a utility purchases services on behalf of its monopoly customers in the competitive market, the customers are paying a price which is obtained in another market, and there is no competition for the in-franchise business. The Board disagrees. There may be no competition for the storage business of individual in-franchise customers; but there is certainly competition in the storage market for the utility's business – and it is the utility which is making the transaction on behalf of its customers.

The moving parties have in effect argued that Union's in-franchise customers should have a perpetual call on cost-based storage services from Union's storage assets because they are "utility" assets. The Board disagrees. In-franchise customers have no inherent entitlement to the entirety of the storage assets purchased, developed, and owned by Union. As the NGEIR Decision makes clear, Union's storage capacity was not developed exclusively for its in-franchise customer needs; a significant proportion was developed for the ex-franchise market. All of Union's storage assets were treated as "utility" assets when the ex-franchise services were regulated, but the assets were not used exclusively for in-franchise services.

In the NGEIR Decision, the Board determined that the storage market in Ontario is workably competitive. It found that it should refrain from regulating prices paid by ex-franchise customers (and prices paid by some larger in-franchise customers for extra storage or new services[9]). Although CCC, VECC, IGUA, and Kitchener objected to that finding, it was not found to be reviewable by the Motions panel. Having made the finding on competition, the Board had an obligation to clearly set out what part of Union's existing storage assets are to be considered non-utility assets (not subject to Board regulation) and what part are utility assets that are owned and operated to provide service to in-franchise customers at regulated prices. The 100 PJ limit does that. In the Board's view, refraining from price regulation only until in-franchise customers lay claim to the space would not be forbearance.

[9] See footnote 8.

Kitchener suggested that the only rationale given for the 100 PJ cap was the desire to support the development of the competitive storage market and to give certainty to the ex-franchise market. The Board agrees that these outcomes are expected to be a result of the allocation, but is not the driving rationale for the allocation. Again, the purpose of the 100 PJ cap is to establish a permanent allocation between utility and non-utility storage.

CCC/VECC further argued that the 100 PJ cap, as a transition mechanism, mitigates but does not address the central problem created by the alleged contradiction – that in-franchise customers will still not have access to competitive alternatives. The Board does not agree with this argument. First, the purpose of the 100 PJ cap was not as a transition to forbearance in the in-franchise market. The Board quite explicitly rejected proposals for such a transition.[10] Second, when in-franchise storage needs exceed the 100 PJ limit, in-franchise customers will have access to competitive prices. Union will buy incremental capacity in the market on their behalf and will be required by the Board to pass on those competitive prices. In short, in-franchise customers are adequately protected.

IGUA argued that the Board is precluded from making a permanent allocation between utility and non-utility storage because the allocation can only be implemented through a rate order, and a rate order is of limited duration. The Board often approves methodologies or principles that endure beyond an individual rate order. This establishment of a permanent allocation is consistent with established regulatory practice in that it creates an enduring methodology or principle: namely, that the allocation of "utility" storage is to be fixed at 100 PJ. It is clear that we cannot preclude a future panel from re-examining this allocation if the assets continue to be held together. However, a re-allocation from "non-utility" to "utility" would require a finding

[10] NGEIR Decision with Reasons, p. 57: "MHP Canada has suggested that the Board adopt full forbearance in storage pricing as a policy direction. Similarly, Union has characterized its allocation proposal and Enbridge has characterized its "exemption" approach for in-franchise customers as being "transition" to full competition. The Board has found that the current level of competition is not sufficient to refrain from regulating all storage prices; nor do we see evidence that it would be appropriate to refrain from regulating all storage prices in the future."

that in-franchise customers had some entitlement to Union's assets; the Board fails to see how that could ever be the case.

The Board will now turn to the specifics of each of the questions raised in the Motions Decision.

a. If the cap of 100 PJ of storage for in-franchise Union customers remain[s] in place in perpetuity, what is the basis for forbearance (under section 29) of required storage above 100 PJ for in-franchise customers?

The Board will not forbear from regulating the rates of Union's in-franchise customers for storage requirements above the 100 PJ cap. As the NGEIR Decision states, rates for in-franchise storage services will continue to be regulated. The difference will be that the incremental storage needs will be met in the competitive market; in-franchise customers will not be entitled to cost-based rates from Union's "non-utility" storage. Union (as the operator of the distribution system) will acquire storage services (or potentially other competitive services which satisfy the same need) from the open market. The costs will be included in rates, if they are found to be prudent. This is the same treatment as any other service acquired by a utility in the open competitive market.

b. If the cap of 100 PJ of storage for in-franchise Union customers does not remain in place in perpetuity, what mechanism should the Board use to monitor the likelihood of the cap being exceeded?

This implies that there should be a re-examination of the allocation between "utility" and "non-utility" storage. The Board cannot foresee how such a re-examination would be justified. The re-allocation of "non-utility" storage to "utility" storage implies that the in-franchise customers have some sort of entitlement to the assets purchased, developed and owned by Union. As set out above, the Board finds that there is no basis for any such entitlement.

c. If the cap of 100 PJ of storage for in-franchise Union customers is likely to be exceeded, what, if any, remedy is available to in-franchise customers?

No "remedy" is required. Once the 100 PJ limit is exceeded, incremental in-franchise storage requirements will be met through purchases by Union in the open market, a market the Board has determined is competitive. The all-in cost for in-franchise consumers for storage services will be a blend of historical costs for 100 PJ and competitive market prices for the balance. As in markets for any good or service, those market prices will depend on market conditions at the time Union acquires the extra storage. The Board expects that parties will scrutinize how Union acquires services to meet the needs of its in-franchise customers, and the Board will determine just and reasonable rates. In short, competitive prices will be available to in-franchise customers and the regulatory oversight will remain in place to ensure that Union passes on those prices.

IGUA asserted that the 100 PJ limit will require "consumers of monopoly services to eventually pay materially higher and supposedly competitive prices for such services."[11] CCC/VECC and Kitchener made similar claims. The potential price impact of the Board's decision to limit the amount of cost-based storage for in-franchise customers will depend on (i) the level of market prices at the time the 100 PJ limit is exceeded (which could be 10 or more years from today), and (ii) how much extra storage Union will need to acquire in the market at that time.

Despite suggestions to the contrary, the Board does not know how it can predict what market prices for storage might be many years in the future. Indeed, the Board is not aware of any evidence on that issue. At the NGEIR hearing, there was evidence that market prices for storage in North America in 2006 were very high, largely due to record differentials in the forward prices for summer and winter deliveries of natural gas. But storage market prices fluctuate with supply and demand conditions, and it is inappropriate in the Board's view to assume that 2006 market prices will prevail over the long term. Indeed, as part of its ongoing study of the market, the Board observes that summer-winter forward price differentials have fallen substantially since 2006. In

[11] IGUA Argument, June 12, 2007, page 1.

addition, there was evidence at the NGEIR hearing about proposed liquefied natural gas facilities in Eastern Canada, New England, and other parts of North America. Those facilities, if constructed, have the potential to affect the flow of gas from producing regions to market areas, which could affect the market for underground gas storage.

Even if market prices for storage were to remain high over the long run, the impact on Union's in-franchise consumers will be muted. For example, if in the future Union determines that it needs 105 PJ of space to meet in-franchise needs, it would acquire 5 PJ in the market. The storage price charged to in-franchise customers would be a blend of cost-based rates for 100 PJ and market prices for the 5 PJ acquired by Union at competitive market prices. Over time as in-franchise needs grow, the market-priced portion of an in-franchise customer's storage will increase. Given current growth rates in Union's in-franchise requirements, it will be decades before the market-priced portion becomes a significant component.

Thus, the Board can only conclude that the 100 PJ limit will not add significantly to the cost of Ontario consumers.

3. UNION HIGH DELIVERABILITY STORAGE SERVICE

Background

In the NGEIR Decision, the Board found that it would not regulate the rates of new storage services by Union or Enbridge, including high deliverability storage. The services in question included Enbridge's proposed Rate 316 and services related to the Tecumseh storage enhancement project (see section 4 below) and Union's proposed high deliverability storage services and three proposed ex-franchise services. These new storage services are of particular interest to gas-fired power generators as they seek to acquire services for intra-day balancing, which may be distinguished from the traditional usage of storage by in-franchise customers for daily and seasonal balancing.

The Motions Decision

In the Motions Decision, the Board stated:

> …it is unclear from the NGEIR Decision whether the NGEIR panel took the implications of the Union settlement agreement into consideration. The NGEIR Decision does not provide sufficient clarity regarding the issues raised by APPrO. It appears that there are some practical limitations faced by gas-fired generators in that presently they can only access certain services from the utility.
> …
> To the extent that APPrO's facts may be correct, there is a sufficient question whether the NGEIR decision erred by requiring monopoly services be priced at market. [12]

Responses to the Motions Decision and Board Findings

APPrO argued that the Board's findings in the NGEIR Decision do not address storage service for in-franchise customers. This is clearly incorrect: the NGEIR Decision, in describing new storage services, explicitly included Enbridge's Rate 316, new services from Tecumseh, Union's high deliverability storage services, and the three proposed ex-franchise services.

[12] Motions Decision, page 56.

The moving parties further argued that the decision to refrain from regulating new high deliverability storage services contradicts the NGEIR Decision that storage services for in-franchise customers will continue to be regulated. APPrO also asserted that in-franchise generation customers have no access to competitive alternatives for the high deliverability storage to be made available as a result of the Union Settlement Agreement and therefore this monopoly service should be regulated.

The Board disagrees with both arguments. First, the NGEIR Decision very clearly distinguished new storage services (for in-franchise and ex-franchise customers) from the whole of storage services taken by in-franchise customers:

> **Although there was general support for the continued regulation of storage rates for the bundled, unbundled and semi-unbundled customers, three aspects of its application were disputed**:
>
> - The amount of storage which should be allocated to these customers, both in aggregate and individually;
> - Whether Ontario utilities should receive access to cost-based storage from Union;
> - **Whether the rates for new storage services from utilities should be regulated.** [13] [emphasis added]

Second, the Board explicitly acknowledged that these services were not being offered currently, and that investments would be required in order to develop these services. However, the Board concluded that these services are substantially different from the bundled, unbundled and semi-unbundled distribution services: there is demand for them from marketers, and customers that hold these services (including generators) expect to be able to offer and trade them in the competitive market. Given the difference, the Board concluded that the best way to ensure the services are developed in a competitive framework is to refrain from regulating them. The NGEIR Decision finding is

[13] NGEIR Decision, page 58.

clear: "The Board finds that competition in these services ***will be*** sufficient to protect the public interest." [14] [emphasis added]

The moving parties have raised no new evidence to question that finding. Rather they assert that because there was a settlement on the allocation of standard deliverability storage space, there is no competitive alternative to the associated high deliverability storage from that space. The Board agrees that when a party contracts for a service from a supplier it may well be unable to acquire a *component* of that service from other suppliers; that is axiomatic. However, what is relevant is whether there are, or *will be*, competitive alternatives for the service as a whole. For gas-fired power generators, the service they require is intra-day balancing. The record in the NGEIR proceeding is clear that competitive alternatives will be developed for this service and that power generators and others will expect to access to these services. They will be able to compare the offerings available in the market to the combination of market-priced and cost-based services available from Union and decide which service(s) to take.

[14] NGEIR Decision, page 70.This echoes the Board's comment at page 26 of the NGEIR Decision: "It is also important to remember that competition is a dynamic concept. Accordingly, in section 29 the test is whether a class of products "is or will be" subject to sufficient competition. In this respect parties often rely on qualitative evidence to estimate the direction in which the market is moving."

4. ENBRIDGE'S RATE 316

Motions Decision

With respect to Enbridge's Rate 316, the Motions panel found that there was some ambiguity in the NGEIR Decision:

> The NGEIR decision seems to indicate that the Board will refrain from regulating Rate 316. Even so, the Enbridge NGEIR Rate Order has a tariff sheet for Rate 316 with storage rates for maximum deliverability of 1.2% of contracted storage space. This seems to indicate that Rate 316 is regulated for 1.2% deliverability storage and the Board has refrained from regulating rates for deliverability higher than 1.2%. It is difficult to recognize this distinction from the NGEIR Decision.[15]

Responses to the Motions Decision and Board Findings

The Board can confirm that Rate 316 is regulated for 1.2% deliverability, in recognition that this is not a new service and consistent with the finding in the NGEIR Decision that existing in-franchise services would continue to be regulated. The Board can also confirm that the Board has refrained from regulating rates for high deliverability service under Rate 316, in recognition that this is one of the contemplated new storage services and the Board's finding in NGEIR that the competition for these services ***will be*** sufficient to protect the public interest. The moving parties did not question this interpretation.

APPrO argued that the Board should order:

> Enbridge to amend its [Rate 316] tariff setting out the service in appropriate detail and reflecting that the incremental deliverability for the purposes of the storage service to be provided to in-franchise generators will be provided at Enbridge's incremental cost to develop its own assets or on a cost pass-through basis, whichever is more economic.[16]

[15] Motions Decision, page 57.

[16] APPrO Argument, paragraph 42 (b).

A similar request was made at the original motions hearing. In its Motions Decision, the Board stated:

> Enbridge has already committed to offering this service in the Settlement Proposal and the Board has already noted this commitment in this decision. The panel does not see any further value to issuing an order stating the same.[17]

This Review decision will therefore not address that matter any further.

[17] Motions Decision, page 57.

5. DECISION

For the reasons outlined above, the Board denies the motions to vary the NGEIR Decision by the City of Kitchener, Association of Power Producers of Ontario, Industrial Gas Users Association, Vulnerable Energy Consumers Coalition and Consumers Council of Canada.

6. COST AWARDS

The eligible parties shall submit their cost claims by August 15, 2007. Two copies of the cost claim must be filed with the Board and one copy is to be served on both Union and Enbridge. The cost claims must be done in accordance with section 10 of the Board's Practice Direction on Cost Awards.

Union and Enbridge will have until August 30, 2007 to object to any aspect of the costs claimed. Two copies 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.

If there is an objection to a party's cost claim, the party will have until September 6, 2007 to make a reply submission as to why their claim should be allowed. Again, two copies of the submission must be filed with the Board and one copy is to be served on both Union and Enbridge.

All filings with the Board must be in the form of two hard copies and received by the Board by 4:45 p.m. on the stated date. The Board requires all correspondence to be in electronic form as well as paper. Therefore, all parties must also e-mail an electronic copy of their filings preferably in searchable PDF format to the Board Secretary at Boardsec@oeb.gov.on.ca.

DATED at Toronto, July 30, 2007

Original signed by

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Gordon Kaiser
Presiding Member and Vice Chair

Original signed by

_____
Cynthia Chaplin
Member

Original signed by

_____
Bill Rupert
Member