Ontario Energy Board

Commission de l'Énergie de l'Ontario

EB-2005-0211
EB-2006-0081

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.

AND IN THE MATTER OF an Application under section 36 of the Act by Enbridge Gas Distribution Inc. for approval of an accounting order to establish a deferral account to capture the proceeds from the sale of land;

AND IN THE MATTER OF an Application under section 36 of the Act by Enbridge Gas Distribution Inc. for an Order or Orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas commencing January 1, 2006.

BEFORE: Howard Wetston
Presiding Member and Chair

Pamela Nowina
Member and Vice Chair

Paul Sommerville
Member

DECISION AND ORDER

Procedural background

In February 2005 Union Gas Limited ("Union"), one of the principal gas distribution companies in Ontario, made an application pursuant to Section 36 of the *Ontario Energy Board Act* (the "Act") for, amongst other things, the disposition of certain deferral accounts.

One of the components of that rates application concerned the treatment of the proceeds of certain sales of cushion gas, which had occurred in 2004. The Board's RP-2003-0063/EB-2004-0480 Decision, dated November 19, 2004, directed that this issue was to be addressed at the time 2003 earnings sharing and 2004 deferral accounts were disposed of.

Cushion gas, which is also sometimes described as base pressure gas, is a feature of the operation of gas storage pools. Cushion gas exists so as to maintain an appropriate and necessary operating pressure within a gas pool so that the injection and withdrawal of gas can be accomplished efficiently. It is not working gas, and is not intended for sale. As a structural feature of the operation of the gas pool, and insofar as it is not gas in trade, it is an undepreciated capital asset.

Union came to sell portions of the cushion gas in 2001, 2002 and 2004 because it had determined that its requirement for base pressure gas was lower than had been previously thought. These sales were staged so as to allow Union to be satisfied that the removal of a portion of the cushion gas would not effect system operation. In Union's estimation there is still more surplus cushion gas which may be safely disposed of.

Union takes the view that the entire proceeds of the sale of cushion gas in 2004 should be credited to itself, and that ratepayers have no legitimate claim to any portion of the money realized on the sale.

Union contends that the proceeds of sale of capital property are not subject to any sharing with ratepayers unless it can be demonstrated that the sale has in some way harmed or prejudiced its customers in relation to the services they receive from the utility. In Union's view, the Board lacks jurisdiction to allocate any portion of the proceeds so as to reduce the rates it charges to its customers.

Ratepayer groups disagree and argue that they are entitled to some or all of the proceeds from such sales. They believe that the Board does have jurisdiction to apportion proceeds from the sale of capital property to reduce rates.

As it happened, when this issue originally came before the Board panel considering the rates application, the Supreme Court of Canada was considering a case that concerned the apportionment of proceeds of a sale of land by an Alberta-based utility. Because it was recognized that the case before the Supreme Court could have implications for the Board's treatment of the proceeds from the sale of cushion gas, the Board decided to defer its consideration of the issue until the Supreme Court had rendered its decision.

The Supreme Court issued its decision on May 15, 2006 (the "ATCO" decision)[1].

The Board panel considering the original application then invited parties to the Union proceeding to make submissions on the effect of the Supreme Court decision on the distribution of proceeds from the sale of cushion gas.

After considering the submissions made by the parties, the Board rendered its Decision and Order on June 28, 2006. A copy of that decision is attached to this decision as Appendix "A".

A number of parties were concerned that the Board's decision on the issue was ambiguous. Union filed a motion with the Board for clarification of the decision

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

on the grounds that the decision lacked clarity. Union also filed an application for judicial review on the same grounds.

The panel considering the rates case issued a letter of clarification in response to the concerns of Union and some of the other parties. This clarification letter itself became the subject of some complaint by parties who felt that the Board's clarification was not consistent with its original decision. A copy of this letter is attached as Appendix “B”.

Under the circumstances the Board decided, on its own motion, to review the panel's decision with a view to removing any doubt as to whether or not the Board has jurisdiction to order the sharing of the cushion gas proceeds between the shareholder and ratepayers. The Board also considered it advisable to consider a decision in which a similar apportionment of assets was approved in an Enbridge Gas Distribution case (file no. EB-2006-0081). Through a combined Procedural Order, the Board offered the parties an opportunity to state, or restate, their respective positions on these issues.

The Board's authority to proceed in this fashion is governed by the *Statutory Powers Procedure Act* and Rules 42-45 of its Rules of Practice and Procedure, and it is considering the issue *de novo*.

The ATCO decision

After a brief discussion of the regulatory environment, Mr. Justice Bastarache expressed the question before the Court as follows:

> “Against this backdrop, the court is being asked to determine whether the board has jurisdiction pursuant to its enabling statutes to allocate a portion of the net gain on the sale of a now discarded utility asset to the rate paying customers of

> the utility when approving the sale. Subsequently, if this first question is answered affirmatively, the Court must consider whether the Board's exercise of its jurisdiction was reasonable and within the limits of its jurisdiction: was it allowed, in the circumstances of this case, to allocate a portion of the net gain on the sale of the utility to the rate paying customers? "(Paragraph 5)

In answering this question the Supreme Court considered the actions of the Alberta Energy and Utilities Board (the "AEUB") in its treatment of the proceeds of the sale of land by an Alberta utility. The AEUB had ordered that the proceeds from the sale of the land were to be shared between the utility's shareholder and the ratepayers. The utility objected to this allocation, contending that the AEUB lacked jurisdiction. The utility argued that insofar as ratepayers acquired no property right in the capital property used by the utility in providing services, and insofar as the AEUB had made a determination that there was no harm to the interests of ratepayers occasioned by the divestiture, they, the ratepayers, had no right to any distribution of the proceeds of the sale of such property

In order to understand the actions of the AEUB it is important to understand the steps which preceded the decision by the AEUB to grant ratepayers a share of the proceeds.

Under the enabling statute in Alberta the utility was required to seek the permission of the AEUB prior to the divestiture of any capital property which had been used in the provision of distribution services, but which had now become surplus to the utility's requirement. When it had determined that the subject land was no longer needed within its distribution system, the utility brought the matter to the AEUB for approval of the sale, as it was required to do. The AEUB was obliged by the statute to determine whether the removal of the capital property, in

this case, the land, would have any detrimental effect on the services enjoyed by the customers of the utility.

The AEUB concluded that the sale of the property would have no detrimental effect on the services enjoyed by ratepayers, and added that any issues respecting the distribution of proceeds from the sale would be considered at a later date. At that point the AEUB had done all that its statute explicitly allowed it to do with respect to the request for approval of the sale of the land. There were no provisions in that or any other section of the enabling legislation which addressed the question of the distribution of proceeds from sale.

The AEUB subsequently ruled that the ratepayers were entitled to a portion of the proceeds from the sale. In doing so, the AEUB relied upon Section 15 of its enabling legislation which provides as follows:

> Section 15(3)(d): with respect to any order made by the Board, the ERCB or the PUB in respect of matters referred to in clauses (a) to (c), [may] make any further order and impose any additional conditions that the Board considers necessary in the public interest.

The Supreme Court rejected the AEUB's distribution of the net proceeds of the sale. First, the Court noted that the section of the enabling statute which addressed the approval of the sale of the capital property did not contain any provisions which explicitly authorized the Board to order a distribution of the proceeds of sales of such property by a utility (Paragraph 45). That section limited the AEUB's jurisdiction to a consideration of whether the sale caused any harm to the interests of ratepayers. Further, in the Court's view, the general power bestowed by Section 15 could not be relied upon by the AEUB to give it the jurisdiction to graft a condition "in the public interest" onto its earlier finding

that no harm had been visited upon the ratepayers as a result of the sale to create just such a distribution of proceeds. [Paragraph 46 *et al*]

The Court also held that the doctrine of implied jurisdiction could not be applied so as to fill the gap between the AEUB's finding of "no harm" with respect to the sale, on the one hand, and its order to distribute a portion of the proceeds of the sale to ratepayers on the other. In the Court's view, if the AEUB wanted to impose conditions on the sale it should have done so attendant with its initial finding on the reference. Given the initial finding of "no harm", no public interest could be found to support an order for the allocation of some of the proceeds to ratepayers.

The Supreme Court also commented that, in its view, utility customers do not through the payment of rates acquire a divisible interest in the capital property used by the utility in the delivery of distribution services. The City of Calgary had argued that ratepayers acquire an interest in the assets used by the Utility in the provision of services, and that it was this property interest that gave rise to an interest in the proceeds of sale of such property. In addressing this assertion the Court considered in great detail the structure of the rate regime (see Paragraphs 54 through 67 inclusive), and concluded that the payment of rates entitled ratepayers to service, but not to any property interest in the assets themselves. This extensive review of the AEUB's ratemaking power was directed to the consideration of the City's claim that customers acquired a property right in utility assets through the payment of rates. This review culminated in Paragraphs 68 and 71 with the determination by the Court that no such rights existed. In Paragraph 68 the Court concluded:

> "Thus can it be said, as alleged by the City, that the customers have a property interest in the utility? Absolutely not: that cannot be so, as it would mean that fundamental principles of corporate law would be distorted…."

And in Paragraph 71:

> "From my discussion above regarding the property interest, the Board was in no position to proceed with an implicit refund by allocating to ratepayers the profits from the asset sale because it considered ratepayers had paid excessive rates for services in the past."

Accordingly, in the Court's view, a division of the proceeds of the sale of such property between the utility and the ratepayers was confiscatory.

This finding, together with the AEUB's own initial determination that the sale of the asset caused no harm to the ratepayer interest, is key to the Supreme Court's decision.

These two factors, together with the specific statutory provisions governing the AEUB, formed the basic architecture of the Court's consideration of the issue before it.

The Ontario Context

Union argues that the Supreme Court decision in ATCO disposes of the issue in Union's rates application.

It contends that the absence of a property right residing in utility customers means that they have no interest in the proceeds of the sale of capital property, such as cushion gas, and that this Board has no jurisdiction to order any distribution of the net proceeds of the sale of such property. Union's argument in this case is also heavily dependent on a characterization of the sale as causing

no harm to its Ontario distribution customers. This approach seeks to align its argument to the specific findings of the Supreme Court in ATCO.

The Board's analysis of this submission begins with our observation that the statutory authority governing the OEB is markedly different than that governing the AEUB.

Ontario gas distribution utilities are not obliged to seek Board approval for the sale of capital property which has been, but is no longer used in the provision of distribution services. The Ontario Board is not authorized to approve or disapprove of divestitures of capital property by Ontario utilities that are no longer necessary in serving the public (section 43 of the Act). Union did not seek, nor could it have sought, any form of approval from this Board with respect to its decision to sell the cushion gas. This Board has not made, nor could it have made, any finding with respect to the effect of the divestiture of cushion gas on Union’s distribution customers.

What Union has done is apply for distribution rates to govern its gas distribution business. As an integral part of that application it seeks direction from this Board as to how the proceeds of the sale of the cushion gas should be accounted for in its revenue requirement, which is a key component of the rates it is authorized to charge its customers.

Unlike the Alberta case, the case before this Board is a rates proceeding, pursuant to section 36 of the Act, and the Board's jurisdiction to address the question of an allocation of net proceeds from the sale of capital property is dependent on a consideration of the application of that section in the Ontario statute.

It is the Board's view that there is a material distinction between the case giving rise to the Supreme Court's decision in ATCO and the case that is before us.

Where the Alberta case involved the grafting of a condition onto a permission to divest capital property, the case before us involves the establishment of just and reasonable rates pursuant to a distinct and comprehensive statutory framework. In this context it is not surprising that the Supreme Court spent considerable time in its decision dealing with the effect of rate making on the creation of a property interest in ratepayers. In the Alberta case, the statutes governing the specific regulatory engagement of the AEUB dictated that that is exactly what was at issue. The distribution of proceeds from the sale was entirely dependent on a finding that ratepayers acquired a property interest in the divested asset which demanded recognition-even in the absence of a finding of harm. Finding no property interest lead inexorably to a finding that the AEUB lacked jurisdiction to do what it did.

This Board is not dependent on implicit powers in its consideration of rate applications, nor is it dependent on a finding that ratepayers acquire a property interest in utility assets through the payment of rates. Where the AEUB was limited to a consideration of the harm occasioned by the divestiture of the subject land, this Board has explicit powers to make its rate orders subject to conditions. The OEB is also explicitly entitled to use whatever technique it considers appropriate in the establishment of gas distribution rates. A plain reading of section 36 indicates that this Board has been very broadly authorized by the Legislature to make just and reasonable rate orders.

Section 36 provides as follows:

36. (1) No gas transmitter, gas distributor or storage company shall sell gas or charge for the transmission, distribution or storage of gas except in accordance with an order of the Board, which is not bound by the terms of any contract. 1998, c. 15, Sched. B, s. 36 (1).

Order of Board re Smart Metering Entity

(1.1) Neither the Smart Metering Entity nor any other person licensed to do so shall conduct activities relating to the metering of gas except in accordance

with an order of the Board, which is not bound by the terms of any contract. 2006, c. 3, Sched. C, s. 3.

Order re: rates

(2) The Board may make orders approving or fixing just and reasonable rates for the sale of gas by gas transmitters, gas distributors and storage companies, and for the transmission, distribution and storage of gas. 1998, c. 15, Sched. B, s. 36 (2).

Power of Board

(3) In approving or fixing just and reasonable rates, the Board may adopt any method or technique that it considers appropriate. 1998, c. 15, Sched. B, s. 36 (3).

Contents of order

(4) An order under this section may include conditions, classifications or practices applicable to the sale, transmission, distribution or storage of gas, including rules respecting the calculation of rates. 1998, c. 15, Sched. B, s. 36 (4).

In this connection the Courts have long recognized the broad nature of the Board's power to set just and reasonable rates. In *Garland v. Consumers' Gas Company*, the Ontario Superior Court of Justice stated: "It is clear that the Ontario legislature intended that the Energy Board would have exclusive jurisdiction over all aspects of the gas distribution industry. In particular, the statute provides that part of the Board's role is to approve and set rates for the sale of gas-related products."[2]

The Court went on to remark:

> The purpose behind the Ontario Energy Board Act, both in its current and past form, is clear. The Act provides a detailed and comprehensive scheme upon which the Energy

[2] *Garland v. Consumers' Gas Company*, [2000] O.J. No. 1354 (Sup. Ct. Jus.). Note that this case was overturned on different grounds.

> Board relies in order for it to carry out its very specific objectives. Rate setting is at the core of the Energy Board's jurisdiction. […]
>
> In addition to providing the Energy Board with guidelines, the OEBA provides the Board with specific and broad ranging powers. Pursuant to section 36(2) of the current Act, the OEB may make orders approving or fixing just and reasonable rates for the sale, distribution and storage of gas. Subsection 36(7) authorizes the Board to fix or approve such rates of its own motion or upon the request of the Minister. In addition to the provisions outlining the Board's expansive rate making power, section 23 of the current Act is an expression of the provincial legislature's intention to bestow upon the OEB broad powers, which allow the Board to attach conditions to its orders as a means of fashioning effective and far reaching decisions.

In ATCO, the Supreme Court considered the absence of explicit language authorizing the Board to distribute the proceeds of the sale of capital property to be a key factor in limiting the Board's jurisdiction. Indeed, in Paragraph 81 of the Supreme Court Decision, the learned Justice noted that both the City of Calgary and the AEUB itself could have caused a review of ATCO's rates to be conducted, with the explicit purpose of taking into account the "new economic data" arising from the sale. This suggests that had the Alberta proceeding been a rates case, and not a case dealing with the approval of the sale, the AEUB would have been fully authorized to consider the treatment or effect of the proceeds from the sale. There is a significant difference between the applicable statutory provisions in the ATCO case and those in the present case before the Board. In approving the sale of the land in the ATCO case the AEUB had exhausted its authority under its statute. From that point on it had to rely on the

general public interest conditions clause to make its order distributing proceeds from the sale of the land.

In the case before us, no such limitation exists. As a rates case, this Board is entitled to use the full range of tools contained in Section 36.

It is true that section 36 does not contain any specific authorization related to the distribution of proceeds of the sale of capital property, but neither is it explicit with respect to any other element of ratemaking

In some instances the Board has employed very different methodologies in the establishment of rates. Both of the major gas utilities have been subject to some form of incentive based regulation in recent years. The Board intends to implement such a regime for the establishment of rates for both the gas and electricity sectors. This method of rate setting is highly formulaic and represents a sharp departure from traditional cost of service/rate base practice.

The Board also has the authority to incent (or disincent) utility behaviour at its discretion. The Board is not limited to a traditional cost of service approach to rate regulation; as noted above, it considers a variety of rate setting methodologies. Inherent in that flexibility is the power to incent or disincent particular utility behaviour. The Board acts well within its powers when it encourages or discourages certain utility activities through its ratemaking powers.

The Board approved sharing of proceeds from transactional services is illustrative. The Board permits the gas utilities to collect revenues for transactional services, i.e. the sale of storage or transportation assets that are temporarily surplus to utility needs. The underlying assets (i.e. the actual pipelines and storage facilities) remain in ratebase; however, the utility is not only permitted, but in fact encouraged to “rent out” these assets to third parties when they are not needed to serve the utilities’ in-franchise customers. As such the

Board allows for a sharing of proceeds to incent the utilities to maximize the use of these assets. This benefits the ratepayer and the shareholder, who both share in the benefit of the transactional services revenues. The Board's authority to require a sharing of such proceeds is not explicit but is derived from its s. 36(3) jurisdiction to adopt any method or technique it deems appropriate in setting rates.

As noted earlier, unlike the AEUB, the Board has no authority to approve (or disapprove) the sale of an asset that is no longer required for serving the public. Nevertheless, its authority to take these transactional services revenues into account flows directly from its regulatory responsibility to incent or disincent certain types of behaviour by the utility as part of its broad ratemaking authority. Where incentives or disincentives are created, it is expected that the utilities to act in their own self-interest.

The Board's authority to encourage or discourage utility behaviour in the public interest is not limited to transactional services. In appropriate circumstances, it can be and has been exercised where the utility has sold an asset outright.

Instead of providing a detailed prescription for ratemaking, the Ontario legislature has provided the Board with the broad discretion outlined above.

The fact is that this Board, like many other jurisdictions in North America, has accounted for the proceeds of sales of capital property in a number of instances in establishing just and reasonable rates. In 1991, for example, the Board ordered that the proceeds from a sale of land by Consumers' Gas (now Enbridge Gas Distribution Inc.) be allocated equally between ratepayers and the shareholder (EBRO 465). In 2003, the Board accepted two settlement proposals in Enbridge cases where the proceeds from a sale of land and buildings were divided equally between ratepayers and the shareholder (RP-2002-0133 and RP-2003-0048). In 2004, the Board ordered that Natural Resources Gas (which is a

small rate regulated natural gas distributor) split the proceeds of a land sale equally between ratepayers and the shareholder (RP-2002-0147/EB-2002-0446). In fact, there is even precedent for the sharing of proceeds from a sale of cushion gas. In 2003, the Board approved a settlement in a Union case which allocated the proceeds from a cushion gas sale equally between ratepayers and the shareholder (RP-2002-0130) [3].

It should also be noted that we are not aware of any regulatory agency having responsibilities analogous to those of this Board that would countenance "confiscation" of utility property. Those agencies which take the proceeds from the sale of assets into account in ratemaking do so as part of their respective powers to set just and reasonable rates, not as exercizes in confiscation. In Ontario, it would be more appropriate to look for an explicit prohibition of this practice if the legislature didn't intend this result, given the very broad language of the Board's ratemaking powers, and our history of making such orders.

It is also true that the prospect of a Board consideration of the proceeds from sales of capital property, and the possibility of an allocation of some portion of such proceeds to ratepayers can curb any inclination a utility may have to sell assets which are needed for provision of the regulated service, but which have appreciated in value over the years. Unlike the AEUB, this Board has no role in approving the sale of capital property which the utility has identified as surplus to its needs. It cannot prohibit such sales on a finding that the interests of ratepayers have been harmed by them. However, as noted above, the OEB must be able to incent and disincent utilities through its ratemaking powers as contained in the statute.

[3] The Board's "Interpretive Guideline to the Affiliate Relationships Code for Gas Utilities" also addresses this issue, and states that gains and losses on sales of utility assets will generally be allocated equally between ratepayers and shareholders. For American examples, see *Re Boston Gas Company* (1982), 49 P.U.R. 4th 1 (Mass. D.P.U.), and *Re Arizona Public Service Co.* (1988), 91 P.U.R. 4th 337, 1988 WL 391394 (Ariz. C.C.), both of which were cited in the ATCO decision.

The rates panel will have to make the final determination regarding the extent, if any, to which the shareholder and ratepayers should share the proceeds from the sale of the cushion gas. It is our view that the legislature provided the OEB with the power to employ such techniques as it considers just and reasonable in establishing rates, including taking into account the proceeds from the sale of capital property in appropriate cases.

The Board therefore orders that the original panel consider the extent to which, if any, the proceeds from the sale of cushion gas shall be allocated as between the ratepayers and the utility in light of our findings herein.

Other Issues

Question Two

The Board's combined Procedural Orders Nos. 10 and 4, which initiated this review, set out two questions. The Board has answered the first question in the preceeding paragraphs. The second question is: "what is the impact of the settlement agreements and Board orders approving those settlement agreements in RP-2002-0133 and RP-2003-0048 on the Board's jurisdiction?" As the Board has already decided it has the power to apportion the proceeds of asset sales between the shareholder and the ratepayer, there are no outstanding issues related to the Board's jurisdiction to approve the settlements in question.

Bias and Retroactive Rates

In the original decision, the Board considered argument presented by Union on two additional matters: that the Board was prevented from making any order disposing of the assets of the cushion gas sale because to do so would amount to retroactive ratemaking; and that there was a reasonable apprehension of bias on the part of the Board, and it should therefore refrain from adjudicating on the cushion gas issue. The Board rejected both of these arguments.

These two issues are outside the scope of the review as framed by combined Procedural Orders Nos. 10 and 4, and the Board will therefore make no further comment on these issues. The decision in the original decision stands. It should be noted that neither of these findings have been challenged by any party to date.

In order to ensure that all parties are given a fair opportunity to provide comments on cost eligibility and the quantum of costs for these proceedings up to January 31, 2007, the Board has decided to implement the following process:

1. The eligible parties shall submit their cost claims by **February 13, 2007**. For parties that have not yet been found eligible for an award of costs, those parties must file a letter with reasons as to why they should be allowed to be eligible for costs in this proceeding in addition to filing their cost claims. A copy of the letter and/or cost claim must be filed with the Board and one copy is to be served on each of Union Gas Limited and Enbridge Gas Distribution Inc. (altogether, the "Applicants"). The cost claims must be done in accordance with section 10 of the Board's Practice Direction on Cost Awards. If a party has already been deemed eligible to receive an award of costs and has already filed its cost claim with the Board and served a copy of the cost claim on each of the Applicants, the party does not have to do so again. However, that party must provide a letter to the Board by **February 13, 2007** that states that the cost claim has already been filed with the Board and served on each of the Applicants.

2. The Applicants will have until **February 27, 2007** to object to a request for cost eligibility and 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.

3. The party whose eligibility and/or cost claim was objected to will have until **March 6, 2007** to make a reply submission as to why they should be eligible for an award of costs or 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 each of the Applicants.

4. The Board will then issue its decision on the cost awards which will be followed by the Board's cost orders.

Dated at Toronto, January 30, 2007.

ONTARIO ENERGY BOARD

Original signed by

Peter O'Dell
Assistant Board Secretary

Appendix A
Decision and Order
EB-2005-0211/ EB-206-0081
The Board's Decision and Order of June 28, 2006

Ontario Energy Board

Commission de l'Énergie de l'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.

BEFORE: Gordon Kaiser
Presiding Member and Vice Chair

Paul Vlahos
Member

DECISION AND ORDER

Introduction

On October 4, 2005, Union Gas Limited ("Union") filed an Application with the Ontario Energy Board (the "Board") for Orders approving Union's proposals for 2003 Earnings Share Disposition, 2004 Deferral Account Disposition, and 2005 Demand Side Management Plans.

A settlement conference was convened on March 29, 2005. On April 7, 2005, the parties achieved a complete settlement on all issues except two—the DSM Framework and the Disposition of Revenue from Sale of Excess Cushion Gas. With respect to the cushion gas matter, the Board ordered that the matter would be deferred until the Supreme Court of Canada ruled on the ATCO case[1] and

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

that Union would establish a deferral account to track the interest on the capital gain that arose from the sale of cushion gas.

On February 9, 2006, the Supreme Court of Canada released its Decision in the ATCO case.[2] In response, the Board issued a Procedural Order on March 17, 2006 reconvening the proceeding with respect to cushion gas. The Board indicated that it would hear Oral Submissions on two questions:

1. Does the Board have jurisdiction to take revenues from cushion gas into account in setting rates?

2. If the answer to question 1 is in the affirmative, how should the Board do so in this case?

Subsequently on April 10, 2006, the Board issued a further Procedural Order indicating that it would consider only the first question, the issue of the Board's jurisdiction to take revenues from the sale of cushion gas into account when setting rates. The Board further stated, "if the Board finds that it does have the required jurisdiction, it will set a date for the filing of future submissions and evidence, if any, and will issue a Procedural Order in that regard." Accordingly, this Decision deals only with the question of the Board's jurisdiction as described above and the submissions made to the panel on April 21, 2006.

Background—the ATCO Case

ATCO, a public utility in Alberta, applied to the Alberta Energy and Utilities Board (the "AEUB") as required by the *Gas Utilities Act*[3] for approval of the sale of buildings and land located in the city of Calgary. The utility argued that the property was no longer useful and the sale caused no harm to the rate payers. The AEUB agreed that the customers would not be harmed and approved the sale.

In a second Decision, the AEUB determined that it would allocate the net proceeds of the sale between the utility and the customers. The AEUB held that

[2] *ATCO Gas & Pipelines Ltd.* v. *Alberta (Energy & Utilities Board)*, [2006] S.C.J. No. 4, 2006 SCC 4.
[3] R.S.A. 2000, c. G-5, s. 26.

it had jurisdiction to order this allocation because it had authority to attach conditions to its Orders in order to protect the public interest.

The Alberta Court of Appeal set aside the AEUB's Decision, referring the matter back to the AEUB to allocate the entire proceeds to ATCO. The City of Calgary, representing the customers' interests, appealed to the Supreme Court of Canada which upheld the Court of Appeal, finding that the AEUB did not have the requisite jurisdiction.

The fundamental rationale for the Supreme Court of Canada's finding is that ratepayers have no property interest in the assets of the utility. They are entitled to receive from the monopoly utility service at just and reasonable rates but payment for that service does not entitle them to any ownership interest. As to the AEUB's ability to attach conditions, the Court ruled that this ability did not extend the AEUB's substantive jurisdiction. Of importance to the Court's finding was the AEUB's own finding, that the sale would not cause any harm to the ratepayers. Having found that, the AEUB had no jurisdiction to allocate part of the proceeds to the ratepayers.

The Current Case

Does the Board have the jurisdiction to take revenues from the sale of cushion gas into account when setting rates? Union argues that the ATCO case prevents that and by taking into account revenues from the sale of any capital assets in setting rates, the Board is, they claim, reallocating those revenues from the company to ratepayers.

Union argues that the Board does not have jurisdiction to allocate to customers gains earned by Union as a result of the sale of capital assets not needed to serve the public:

> Such gains are the property of the company and shareholders. Neither the Board nor ratepayers have any valid claim in that property. Nor did cushion gas at any time become anything other than a capital asset; in the nature of property plant and equipment. The cushion gas was not purchased for resale to customers. It was, therefore, never injected into or withdrawn from underground storage for customer consumption and never

> became working gas held for use in meeting gas consumption requirements for customers. (Union Argument, paragraph 4)

Union further states:

> On the facts, the ATCO case involved land and this case involves cushion gas. Both are capital assets. Cushion gas, according to the undisputed evidence, is part of the capital structure of each storage pool and is never owned or consumed by customers. (Union Argument, paragraph 94)

> The only material factual difference is that, in ATCO, the Alberta Energy and Utilities Board had already decided that the assets were not used or useful and the sale would result in no adverse consequence to the customers. Here, Union acknowledges that the Board has jurisdiction to inquire into and to determine whether the cushion gas sold was "necessary in serving the public", and to explore whether there were any adverse consequences to customers resulting from the sale. That is why Union agreed to that issue being placed in the 2007 rate case issues list. (Union Argument, paragraph 95)

Union also raised two preliminary matters which attack the Board's jurisdiction in this case. The first was that any allocation of the proceeds of the sale from cushion gas would cause retroactive ratemaking. The second was that the Board's participation in the Appeal before the Supreme Court of Canada constitutes a reasonable apprehension of bias. Union argues that the Board should, as a result, recuse itself from the determination of this issue.

For reasons which are set out later, these two arguments are rejected by the Panel.

On the issue of jurisdiction, Union is supported by Enbridge Gas Distribution Inc. and opposed by the City of Kitchener, the Industrial Gas Association, London Properties Association, Consumers' Council of Canada, the Low Income Energy Network, the Canadian Manufacturers' and Exporters' Association, and Board Staff.

The parties opposing Union and Enbridge base their submissions on three grounds. First, the assets are of a different nature. Second, the legislative authority granted to the Board is different than that granted to the AEUB. Third, the issue before the Board arose in the context of a rate case as opposed to an application for approval of sale of assets.

The Sale of Excess Cushion Gas

Given that many of the arguments turn on the nature of this transaction in question, it is useful to review the exact nature of the transaction.

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 generally 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 which 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 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 usually valued at cost for accounting purposes and not revalued to reflect the weighted average cost of gas like working gas. Cushion gas is paid for and owned by Union and makes up part of Union assets and rate base.

There is little dispute on the facts to this point. The dispute arises where, as happened in this case, the cushion gas is declared to be excess and is sold at a profit.

In early 2001, Union determined that its existing storage reservoir could be operated at a lower minimum operating pressure. This determination resulted in

surplus cushion gas that could be sold. Prior to 2001, Union had been operating its storage pools at varying minimum pressures ranging from 500 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.

The Board is not at this juncture concerned with assessing the cost and benefits of the decision to sell the surplus gas. Union notes that the reduction in the cushion gas led to an increase in working gas storage capacity. This capacity could be sold and under existing arrangements the customers would receive a percentage of those proceeds.

Having determined that 6.4 PJ of cushion gas was surplus to its operational needs, Union decided to sell the surplus asset. The company disposed of 2.1 PJ of cushion gas in two transactions during the winter of 2001 and 2002. Those proceeds were capital gains in Union's financial statements and records filed with the Board. [4] Union's 2004 assets and corresponding rate base calculations were reduced to reflect the sale of cushion gas in 2001/2002.

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.

All parties to this proceeding agreed that whether the ATCO Decision applies to the cushion gas transaction before this Board turns on three different issues: the nature of the assets; differences in the legislation; and the nature of the proceeding in the Alberta case as opposed to the Ontario case.

Nature of the Asset

The ATCO case involved land while this case involves cushion gas or base pressure gas. Union argues that they are both capital assets, and nothing turns on the distinction.

[4] No objection was taken to this original sale by the intervenors; Union was under a performance based regulatory regime at the time and the benefits fell within the allowable range.

A number of intervenors, however, argue that the case before the Board is more complex. They argue that the cushion gas once withdrawn ceases to be an asset. In short, it became working gas and its sale, and profit, is captured under section 36 of the OEB Act.

Some intervenors argued that the cushion gas sale is not a gain related to a non depreciated asset but rather is a storage and transportational service. Regardless of the accounting treatment, the argument is that the gas became a different type of asset once it was declared surplus to the base pressure requirements. That argument invariably requires a finding, as argued by London Property Management Association that cushion gas was included in the rate base in the 2004 revenue requirement and the ratepayers “paid for these assets”. That, of course, was the fundamental issue before the Supreme Court of Canada. There, the Court held that the mere fact that the assets are in a rate base does not entitle the ratepayers to any property interest.

IGUA and the City of Kitchener do not rely upon the rate base argument but claim the sale did not comply with the Board rules respecting accounting procedures. They argued that the surplus cushion gas should have been reclassified as gas in storage available for sale. Even if the Panel were to accept that the Board’s accounting procedures bear the interpretation suggested by IGUA and the City of Kitchener, the Panel would still face the question of whether the Supreme Court of Canada's decision in ATCO permitted that type of reclassification. The question remains whether the Board can create a ratepayer property interest in this asset whether by Board Decision or Board accounting treatment.

It is also argued by some that the ATCO case can be distinguished from the Ontario case because in ATCO, the property sold was no longer useful in the gas distribution business. Union agrees that at this point, the Board has made no determination as to whether the sale will be harmful to customers.

If jurisdiction is found, that determination will be made by the Board in a subsequent proceeding. It is not clear to the Board that this distinction is fundamental to the question before us at this time, namely the jurisdiction of the Board.

The Board's Jurisdiction

The Alberta statute required that ATCO apply to the AEUB for approval to sell *any* assets. The AEUB approved the sale, finding that there was no harm to the public caused by the sale. What the Supreme Court of Canada objected to was a condition attached to the Order which required the utility to pay part of the proceeds to the ratepayers.

Unlike Alberta, Ontario gas utilities are not required to seek Board approval for sale of assets that are *not* necessary in serving the public (sections 43 and 86 of the OEB Act).

There is no section in the OEB Act that is directly comparable to section 26 of the *Gas Utilities Act* in Alberta. Union neither sought nor was required to seek permission to sell cushion gas. Section 43 does require Board approval for the sale of an asset that continues to be necessary in serving the public. Union argues that surplus cushion gas was not necessary to serve the public.

The issue of how to dispose of the proceeds from the sale of cushion gas did not arrive at this Board through an application to dispose of its asset; it came to the Board as part of a proceeding under section 36 of the Ontario legislation – a rates application.

Section 43 of the OEB Act may not apply to the transaction in question because the asset was not necessary to serve the public. The fact remains that Union cannot sell gas except in accordance with an Order of the Board. Section 36 of the OEB Act provides:

> No gas transmitter, gas distributor or storage company shall sell gas or charge for the transmission, distribution or storage of gas except in accordance with an order of the Board, which is not bound by the terms of any contract.

That section gives the Board clear jurisdiction over Union's gas sales.

The Supreme Court of Canada's decision in ATCO ruled that given the specific circumstances of that transaction and the specific section of the *Gas Utilities Act*, the AEUB had exceeded its jurisdiction:

> In my view, allowing the Board to confiscate the net gain of the sale under the pretence of protecting rate-paying customers and acting in the "public interest" would be a serious misconception of the powers of the Board to approve a sale…Such an attempt by the Board to appropriate a utility's excess net revenues for ratepayers would be highly sophisticated opportunism and would, in the end, simply increase the utility's capital costs. (paragraph 78)
>
> It is well established that potentially confiscatory legislative provision ought to be construed cautiously so as not to strip interested parties of their rights without the clear intention of the legislation. (paragraph 79)
>
> If the Alberta legislature wishes to confer on ratepayers the economic benefits resulting from the sale of utility assets, it can expressly provide for this in the legislation, as was done by some states in the United States. (paragraph 80)
>
> I am not certain how one could conclude that the Board's allocation was reasonable when it wrongly assumed that ratepayers had acquired a proprietary interest in the utility's assets because assets were a factor in the rate-setting process, and, moreover, when it explicitly concluded that no harm would ensue to customers from the sale of the asset. (paragraph 83)
>
> The power of the Board to allocate proceeds does not even arise in this case. Even by the Board's own reasoning, it should only exercise its discretion to act in the public interest when customers would be harmed or would face some risk of harm. But the Board was clear: there was no harm or risk of harm in the present situation. (paragraph 84)

> There was no legitimate customer interest which could or needed to be protected by denying approval of the sale, or by making approval conditional on a particular allocation of the proceeds. (paragraph 84)

All the above findings are specific to the particular section and the particular factual circumstances, such as the ability to use the condition power to allocate proceeds.

Here, the Panel is also dealing with a much broader question. That is, in a rate case, can the consequences of the sale be taken into account in setting rates? This is not a question of allocating proceeds to ratepayers. It is a question of considering the consequences (positive or negative) of the sale in the process of setting rates.

This, the Supreme Court of Canada said in ATCO, was allowable:

> Under the regulatory compact, customers are protected through the rate setting making process, under which the Board is required to make a well-balanced determination. The record shows that the City did not submit to the Board a general rate review application in response to ATCO's application requesting approval for sale of the property at issue in this case. Nonetheless, if it chose to do so, this would not have stopped the Board, on its own initiative, from convening a hearing of the interested parties in order to modify and fix just and reasonable rates to give due consideration to any new economic data anticipated as a result of the sale. (paragraph 81)

In summary, section 36 of the OEB Act gives this Board very broad jurisdiction in a rate setting case, to approve a sale or not approve a sale of gas and to consider the consequence of a sale. That ability is clearly contemplated by the Supreme Court of Canada decision in ATCO which may be a direct response to the intervention by the Ontario Energy Board in the proceeding.

Whether there are any consequences or how they would be dealt with in setting rates is a matter that has to be addressed another day on the basis of evidence submitted. As to the jurisdictional question, the Board finds that it has

jurisdiction, as indicated, to consider the consequences of the sale in setting rates.

This leads to the other preliminary matters. First, is the Board prevented from dealing with this issue at this time because it constitutes retroactive rate making? Second, should the Board recuse itself and refer the matter to Divisional Court because the Board's intervention before the Supreme Court of Canada constitutes a reasonable apprehension of bias?

Retroactive Rate Making

Union argues that the Board has no jurisdiction to allocate the capital gains from the 2004 cushion gas sales because to do so would involve setting rates retroactively which the Board has no power to do.

It is accepted as a fundamental principle that retroactive rate making is to be avoided. As the Supreme Court of Canada stated in the *Northwestern Utilities Ltd.* case.

> It is clear from many provisions of The *Gas Utilities Act* that the Board must act prospectively and may not award rates which will recover expenses incurred in the past and not recovered under rates established for past periods.[5]

However, the same Court concluded,

> It is conceded of course that the Act does not prevent the Board from taking into account past experience in order to forecast more accurately future revenues and expenses of a utility.

That is an important principle. It is also recognized that there are situations where the Board does not have all the facts at hand to render a Decision. In many of those cases, the Board will declare the rates interim. This practice has been approved by the Supreme Court of Canada in the *Bell Canada* case[6]. It is

[5] *Northwestern Utilities Ltd.* v. *Edmonton (City)*, (1979) 1 S.C.R. 684 at 699.
[6] *Bell Canada* v. *Canada (Canadian Radio-Television and Telecommunications Commission)*, [1989] 1 S.C.R. 1722.

also clear that with the consent of all parties, this matter was being deferred. It was being deferred for good reason. It was in the interest of all parties to obtain guidance from the Supreme Court of Canada in what appeared to be a parallel case. No one objected.

Here, a final Rate Order became effective January 1, 2004.

The principle behind the prohibition on retroactive rate making is that rates are presumed to be final, and just and reasonable until altered. Parties are entitled to assume they are final unless there is a clear exception.

There are exceptions such as the case of interim rates. This case fits that exception. It was clear to all parties that one aspect of this case had not been settled and was being deferred pending further proceedings. All parties were aware that this aspect of the case was not final.

Accordingly, it is fair and reasonable to take into account in setting future rates any consequences of this sale. Of course, there may be no consequences and the matter may be academic. That will have to be decided in a future proceeding.

Apprehension of Bias

Union argues that there is a reasonable apprehension of bias on the part of the Ontario Energy Board in this matter. The utility take this position because the Board intervened in the ATCO case before the Supreme Court of Canada.

Union says the Board placed itself in the position of direct adversity to Union and claims the Board has “chosen one side of the dispute, thereby, calling to question its impartiality on the issue”. If, as Union claims, the Board has chosen one side of the dispute, there clearly would be a problem. However, that is not the case. The Board, in intervening before the Supreme Court of Canada in the ATCO case, was not supporting the position of either the AUEB, City of Calgary or ATCO. Rather, as disclosed in paragraph 3 of the Board's factum, the intervention clearly limits the Board concern to jurisdiction:

> The OEB will confine its argument to addressing the concern that the Alberta Court of Appeal's Decision, if broadly interpreted, and upheld by this Honourable Court to prevent public utility regulators, such as the OEB, from taking the proceeds of sale into account when setting rates for utility services. The OEB's submission is that this Honourable Court should confine its Decision to this specific issue whether the Alberta Energy and Utilities Board ("AEUB") had the authority to make the impugned order under s. 25.1 (now 26(2) of the *Gas Utilities Act* ("GU Act)) and not whether public utility regulators, such as the OEB, have the authority to consider the proceeds of sale of setting just and reasonable rates.

In short, there is nothing wrong with the Board defending its jurisdiction as long as the Board does not side with one of the parties in the actual dispute. This principle is established in E.A. *Manning Ltd.* v. *Ontario Securities Commission* where the Divisional Court states:

> In the context of the litigation brought by the securities dealers, including the motion for judgment in the Ainsley case and pending appeal, the OSC went beyond merely defending itself and its jurisdiction and adopted the role of advocate against them and strenuously sought to demonstrate that Manning Limited and others are guilty of the very conduct which is now the subject of the current notices of hearing.[7]

That is not the situation here. The role of the Ontario Energy Board in its intervention before the Supreme Court of Canada was limited to the matter of jurisdiction and was, in fact, even more remote. The Board argued that the Court should exercise caution in extending the principle beyond the specific legislative provisions that were faced by the Alberta Board and the Alberta Courts. To put it simply, while the Alberta Court may have been correct in finding that the AEUB had no jurisdiction to allocate the proceeds of the sale in approving the sale of assets it did not follow that the AEUB in a rate case could not take into account in setting rates the consequences of the sale. This is entirely a different matter and

[7] *E.A. Manning Ltd*. v. *Ontario Securities Commission* (1994), 18 O.R. (3d) 97 (Div. Ct.); aff'd (1995), 23 O.R. (3d) 257.

the Supreme Court of Canada recognized the distinction and has specifically pointed out in its Decision that the Alberta proceeding was not a rate case.

The Panel finds that there was no reasonable apprehension of bias by this Board by the participation in the Supreme Court of Canada appeal on the limited basis adopted by the Board. The nature of the participation was clearly defined. No oral arguments were submitted by the Board. The Factum and submissions have been made part of the record in this proceeding. None of those submissions disclose any reasonable apprehension of bias with respect to the matter here.

Future Proceeding

For the reasons expressed above, the Board finds it has jurisdiction to consider the consequences of the sale of cushion gas by Union in a rate case. The Board also finds that such an action on its part would not constitute retroactive rate making. The Board further finds that participation by this Board in the appeal before the Supreme Court of Canada in the ATCO case did not disclose a reasonable apprehension of bias.

The Board will hold a further hearing to determine whether there are any consequences of the sale and if so, how those should be taken into account in setting rates. Any party who wishes to file evidence regarding consequences shall do so within 30 days of the date of this decision. Any reply evidence should be filed 15 days thereafter. The Board will convene a technical conference 15 days after the filing of reply evidence at which time any parties filing evidence will be required to produce a witness to be questioned with respect to the evidence.

The Board will convene in a hearing 15 days after the technical conference at which time the evidence will be presented. Following the examination of the witness panel, interested parties will be asked to make oral submissions.

A Procedural Order will issue shortly giving effect to these directions.

The decision on cost awards will be deferred to the future hearing.

Dated at Toronto, June 28, 2006.

ONTARIO ENERGY BOARD

Peter O'Dell
Assistant Board Secretary

Appendix B
Decision and Order
EB-2005-0211/ EB-206-0081
Letter of clarification

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Ontario

BY E-MAIL

July 26, 2006

Michael A. Penny
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M5K 1N2 Canada

Subject: EB-2005-0211- Union Gas' clarification request

Dear Mr. Penny:

By correspondence dated July 14, 2006, Union Gas requested clarification of the Board's June 28, 2008 Decision (EB-2005-0211) dealing with the 2004 sale of cushion gas.

Union Gas states that the decision is ambiguous in two respects: (1) the intended scope of the Board's jurisdiction to consider the consequences of the 2004 sale of cushion gas when setting rates and (2) which rate year any such consequences would apply.

Union Gas indicates that the ambiguity around the meaning of "consequences" arises because there are two conflicting interpretations. Specifically, Union Gas states:

(a) "One interpretation is that the OEB restricted the scope of its consideration to prospective operational impacts of the 2004 cushion gas sale on rates in subsequent years, i.e., whether rates increased as a result of increased operating or capital costs resulting from the sale and /or whether there were revenue impacts apart from the gain itself."

(b) “Another interpretation is the Decision is that the “consequences” includes the regulatory treatment of the gain from the 2004 cushion gas sale itself, and, for example, whether some or all of the gain should be attributed to utility revenue (i.e., credited to customers) for the purposes of determining Union’s revenue requirement in 2004 or some other year.”

The Board clarifies that the first interpretation is correct.

The Board is issuing concurrently Procedural Order No.9 amending the dates set out in Procedural Order No.8.

Yours truly,

Original Signed By

Kirsten Walli
Board Secretary

cc. All Intervenors