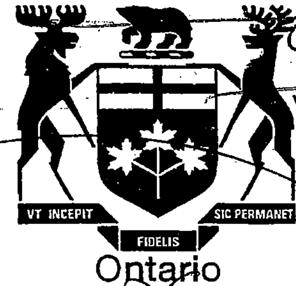
Ontario Energy Board

Commission de l'Energie de l'Ontario



RP-1999-0017

IN THE MATTER OF AN APPLICATION BY

UNION GAS LIMITED

FOR RATES FOR FISCAL 2000 - 2004, PERFORMANCE BASED REGULATION, UNBUNDLING OF STORAGE AND UPSTREAM TRANSPORTATION SERVICES

DECISION WITH REASONS Volume 1

2001 July 21

will an opportunity to ensure that there are not unreasonable relationships or undue discrimination or cross-subsidization

2.7.3 Treatment of Market Priced Storage

2.472 Union proposed to continue to provide storage to in-franchise customers at rates based on a fully-distributed cost basis, subject to escalation under the PBR price cap. Union proposed to renew existing ex-franchise (M12) storage contracts at market prices, citing the Board's Decision in EBRO 494-03 in which the Board-approved market pricing for incremental storage provided to ex-franchise customers. Union commented that it has no obligation to serve ex-franchise customers and that these customers have access to alternative storage services.

2.473 Union proposed to close the deferral account (179-72) in which the market premium is recorded and, going forward, any premium above the cost of the service would be immediately recorded as revenue and used to manage risks to which Company operations would be exposed under the new PBR plan. Union also proposed the same treatment for any revenue streams associated with new storage pools.

2.474 Further, Union indicated that market-priced storage revenue from ex-franchise customers was required in order to "manage the risks of the further unbundling of storage in the in-franchise market, including the further allocation of storage at cost-based rates for incremental in-franchise customers." Union noted that the incremental cost of new storage exceeded the rates based on current embedded costs.

2.475 Union also referred to the evidence of its witness, Ms. Elliott, who indicated that if transactional revenues (storage and transportation) or long-term (storage) premiums were not available to Union, then it would have sought a premium or a growth factor under the cap.

2.476 Union proposed for the year 2000 and subsequent years to book to the account of the shareholder balances which would otherwise accumulate in transactional services and storage premium deferral accounts, arguing that under unbundling Union's ability to generate these revenues becomes more uncertain, given the loss of Company control over the unbundled assets. Union submitted that under PBR it would require these revenues in order to manage system growth, investment, and its commitment to provide in-franchise customers with storage at cost. Finally, Union noted that the approximately $5 million embedded in rates would remain to the benefit of the ratepayer under its proposal.

Positions of the Intervenors - Treatment of Market Priced Storage

2.477 CAC accepted M12 storage renewals at market-based rates but it opposed the elimination of the market premium deferral account. CAC argued that: Union has not provided adequate support for Union's proposal ; the development of the assets that provide ex-franchise storage services has been funded by the ratepayers; and Union and the Board have, in the past, both supported the existing treatment of the long-term storage premiums.

2.478 Energy Probe asserted that full unbundling of storage requires unbundling storage rates from distribution rates, the permanent release of storage capacity, the ability to rebundle storage services, and market pricing of storage services. Energy Probe recommended that the Board direct Union to present a study of options for storage deregulation at its next rates or unbundling case.

2.479 IGUA accepted Union's proposal to renew M12 storage contracts at market rates, but took issue with the proposed disposition of the margin. IGUA argued that since Company assets have been used to generate the revenues from both transactional services and long-term storage, and because they have not otherwise been accounted for in rate design, it is appropriate to record the premiums relating to these services and credit them to ratepayers. IGUA noted that this treatment had been agreed to in the EBRO 499 Settlement Agreement and respected the principle that ratepayers should be credited for margins above cost being realized from Company assets.

2.480 In the case of margins from transactional services, IGUA noted that in EBRO 499 parties agreed that these amounts be shared 75:25 between ratepayers and shareholders. IGUA submitted that this agreement was reached to provide an incentive for Union to make full use of the Company's assets. IGUA's position was that there is no evidence of any new circumstance that would justify any change.

2.481 IGUA estimated that the net effect of Union's proposal would be to disadvantage ratepayers by approximately $7 million in 2000 and $9.5 million in 2001.

2.482 IGUA submitted that: revenue sharing is a PBR-type feature of the existing cost-of-service regime that should be retained in transition; a PBR plan should start from a point which is representative of the Company's current situation; there is no evidence, expert or otherwise, that suggests that the elimination of the deferral account is integral to the PBR plan; and unbundling is not likely to reduce these premiums and, in any case, the risk is borne for the most part by ratepayers.

2.483 IGUA indicated that it would accept maintaining the existing arrangements for the long-term storage and transactional services accounts for the year 2000 and then, beginning in 2001, sharing the funds in the long-term storage premium account in the same ratio as the transactional service revenues are currently shared.

2.484 IGUA stated that "the Company's contention that its expropriation of the full amount of the customer share of transactional services and long-term market premium margins in the revenue deferral accounts is an integral feature of its price cap plan is ... a contention that is entirely discredited by the Company's prefiled evidence and the evidence of the Company's expert witnesses who acknowledged that they were never asked to provide an opinion on the expropriation of amounts in the revenue deferral accounts issue."

2.485 LPMA, MECAP, and WGSPG accepted Union's proposal to renew M12 storage contracts at market rates but rejected Union's proposal with respect to the disposition of the margin. LPMA calculated for the entire term of Union's PBR plan, that if the ratepayer share in the storage and transactional services deferral accounts was only 50% of the 2000 year forecasted amount, then the Company would benefit by $7 million, which is more than double the proposed stretch factor amount of $3.1 million (0.4% of base delivery revenues).

2.486 LPMA challenged Union's contention that if transactional services revenues were not credited to the Company's account then Union would have proposed a growth factor in the price cap formula, submitting that a growth factor while appropriate for a revenue cap plan is inappropriate for a price cap plan.

2.487 NOVA stated that there was no evidence that the approved existing methodology was unfair.

2.488 Schools argued that the current treatment of the long-term storage premium and transactional services deferral accounts was appropriate, since Company assets are used to generate the revenue flows and the 75:25 sharing provided an incentive for the Company to more fully utilize these assets. Schools also noted that under Union's proposal, net revenues from any new storage pools would flow to the shareholders.

2.489 VECC opposed the renewal of M12 contracts at market-based rates, arguing that it would set a precedent for moving all customers to market-based storage rates. Further, some of the M12 customers who renew at market rates (such as Enbridge and GMI) are also distributors who will then be charging their own in-franchise customers market-based storage rates, strengthening the possibility of Union, in the future, charging its in-franchise customers market-based rates for storage.

2.490 VECC urged that the Board deny the application to eliminate the storage deferral accounts. The rationale was that ratepayers, having funded the supporting Company assets should be the beneficiaries of the incremental net revenues. VECC submitted that the risk of storage prices being less than costs was very low, citing the evidence of Union's witness, Mr. Birmingham, that the market price of storage has not been lower than the cost for any extended period of time and that development of new storage is limited by the existence of feasible geological formations.

2.491 Alliance, AMO, CEED, Comsatec, Enbridge, Enron, Fullerton, GEC, HVAC, Kitchener, OAPPA, Pollution Probe, and TCPL submitted no arguments on this issue.

2.492 CENGAS supported Union's proposal.

Union's Reply - Treatment of Market Priced Storage

2.493 Union challenged VECC's argument that accepting its proposal would set a precedent for charging market-based prices to its in-franchise customers. Union argued that the Board has already approved market rates for the ex-franchise customers of its Bentpath-Rosedale and Century Pools developments, customers who have competitive alternatives and for whom Union has no obligation to serve. Union submitted that pricing for ex-franchise customers accessing the same services should be consistent and noted that GMI has agreed to renewal of its contract at market rates. Union submitted that implementing market rates for in-franchise customers would require Board approval.

2.494 Union reiterated that unbundling would transfer control of the assets presently used to generate the revenues in question to unbundled customers and, as such, the Company required the margins presently credited to ratepayers to manage the risk of decreased transactional services revenues. Union's position was that the change in regulatory framework, from cost-of-service to PBR, is a material change that justifies a change in treatment of the revenues in question: revenues are not constrained, rather, prices are capped. Union submitted that under a PBR framework rates would

not be cost-based, therefore net revenues from these services should be treated the same way as other services under the price cap.

2.495 Regarding the claim that margins generated by Company assets ought to be to the credit of the ratepayer, Union's position was that ratepayers have paid for the services from the assets, not for the assets themselves. Further, Union asserted that "a level of sharing of these margins in EBRO 499 was an agreement in light of the entire ADR package and in no way bound any signatory to the agreement from proposing alternatives at future proceedings."

2.496 Union also argued that the initial rationale for establishing the storage and transmission account was that forecasting these revenues was difficult, in part depending on the weather. Union submitted that under its PBR proposal there is no reason to forecast these revenues.

2.497 Union further disputed the contention that its proposal on deferral accounts is unrelated to its PBR plan, stating that its application is an integrated proposal. With respect to the claim that its retained experts did not provide an opinion on the treatment of deferral accounts, Union submitted that its external experts advised on the basic framework and the productivity parameters, but it was the Company's responsibility to evaluate the effect of the overall proposal. Union testified that the PBR plan would have to be changed if the deferral account proposal was denied.

2.498 As to the position of some parties that the elimination of the deferral accounts should be denied on the basis that ratepayers would be worse off under Union's integrated proposal as compared to the current regime, Union's position was that this conclusion was reached based on a selective analysis of individual components. An appropriate evaluation would require an assessment of the complete integrated PBR plan, which, in Union's view, would lead to the conclusion that ratepayers would not be worse off under its proposal.

Board Findings - Treatment of Market-Priced Storage

2.499 The Board notes that in EBRO 494-03, issued in 1997, the Board gave approval to the application of market-based rates to certain ex-franchise storage contracts, under certain terms and conditions. The Board also notes that in that proceeding Union provided, among other things, an updated 10-year peak storage availability and utilization forecast that the Board found was "reasonable under a business-as-usual scenario".

2.500 The Board notes that with the exception of VECC no parties argued against the renewal of M12 contracts at market-based rates. VECC's opposition was based on the concern that this action would open the door to the use of market-based rates for in-franchise customers. The Board notes Union's acknowledgment that this would only be possible were the Board to approve such rates for in-franchise customers. The Board has also heard concerns about the ability of parties who have "rights" to storage at cost-based rates to take advantage of the arbitrage opportunity that may exist in the market directly or indirectly. In the Board's view one potential approach might be to apply market-based rates for all storage with a mechanism to fairly distribute any premium over cost-based rates. The Board would require more complete information on the storage market before adopting such an approach.

2.501 At issue in this proceeding was the treatment of any premium that exists due to the differential between market price and the embedded cost of storage. The Board notes that in a previous hearing, EBRO 486-02, Union argued that the premiums resulting from market-based rates for storage services rightfully belonged to ratepayers because the ratepayers had "substantiated" the asset; i.e., that since the ratepayers had taken on the risk and paid rates designed to cover the costs, they should receive any reward. The Board also notes that the market price referred to in discussing this issue is not necessarily a surrogate for a market price in a competitive market.

2.502 The Board notes that it has in the recent past provided an incentive to Union, through a sharing of the premium on transactional services, to encourage the Company to pursue opportunities to increase the efficient use of the assets. The Board has not to date applied any sharing with regard to the premium on storage. The Board recognizes that there should also be an incentive to efficiently manage the existing storage capacity in Ontario. With respect to the development of new storage during a PBR plan period, incentives will be dealt with within the related applications.

2.503 The Board notes that on the one hand, if it had a reliable current forecast of service volumes for the PBR plan period and a reasonable forecast of market prices for storage during the plan period, there would be no need for any deferral account to capture the variance arising from the difference between market-based rates and fully distributed cost-based rates. On the other hand, given the service volume uncertainty and the lack of a reasonable forecast for market-based prices for storage the approach of deferring the variance (premium) seems prudent.

2.504 The Board grants Union's proposal to renew existing ex-franchise cost-based storage contracts (M12) at market prices. However, with respect to Union's proposal to eliminate the deferral account for recording the market premiums from these arrangements, the Board finds it appropriate, given the volume and price uncertainties expected during the term of the Board-approved PBR plan maintain a deferral account for recording market premiums. The Board notes that in Chapter 4 the Board denies Union's request to close the transactional services deferral accounts.

2.505 The Board recognizes that the assets necessary to provide both transactional services and long-term storage services have been paid for by Union's customers. Providing the Company with a financial incentive to maximize revenues for these services should increase benefits to both the customer and the shareholder. Consequently the Board authorizes a sharing of net revenues for transactional services and market premium for long term storage services in the ratio of 75:25 between ratepayers and shareholder as an incentive to maximize the revenue associated with both these services. The balance in the Long-Term Storage Premium Deferral Account (179-72)

shall be allocated 100% to the ratepayer for 1999 and 2000, with the incentive sharing for the long term storage premium account to be effective January 1, 2001.

2.506 Based on the evidence in this proceeding the Board is unable to determine whether storage service can evolve to become workably competitive. The Board believes that it is wise to exercise care with respect to long-term contracting of storage and to keep options open for the design and development of the storage market in Ontario.

2.7.4 Treatment of New Services

2.507 New services may be developed by Union to enhance the storage, transportation, and delivery services now offered. If the new services are regulated, they will be placed into the appropriate service basket and priced subject to the price cap parameters; if unregulated, Union would price them competitively. In either case, Union will disclose all new services, introduced or proposed, so that they may be addressed in the customer review process and then brought before the Board for disposition.

Positions of the Intervenors - Treatment of New Services

2.508 CAC stated that "as a matter of policy only when the assets and costs of a particular service are removed from the utility it is appropriate to exclude revenues from flowing to the ratepayers " CAC submitted that since the assets have been paid for by ratepayers the revenue from those assets should accrue to those ratepayers. CAC also submitted that any new services developed by Union should be brought before the Board for determination of the appropriate revenue allocation.

2.509 CEED proposed that prior to providing new storage, transmission, or distribution services, Union should be required to obtain "either a rate order from the Board pursuant to section 36 of the *Ontario Energy Board Act, 1998* or an order from the Board to refrain from exercising its power to regulate rates for these services". Where new services other than storage, transmission, or distribution are contemplated by Union, CEED urged that these new services only be provided after Union has received prior approval of the Board as required by the Undertakings.