Ontario Energy Board
Commission de l'Énergie de l'Ontario

Ontario

RP-2003-0203

IN THE MATTER OF AN APPLICATION BY

ENBRIDGE GAS DISTRIBUTION INC.

FOR RATES FOR FISCAL 2005

DECISION WITH REASONS

November 1, 2004

3. GAS, TRANSPORTATION AND STORAGE COSTS (ISSUE 5.1)

3.1 BACKGROUND

3.1.1 Issue 5.1 deals with the Enbridge proposal to reflect in 2005 rates the cost consequences of a new storage contract negotiated with Union.

3.1.2 An agreement for Union to provide storage at cost-based (M12) rates to the Company was filed with the Board under docket number EBO 90 (June 16, 1978) and amended under docket number EBO 150 (September 9, 1988). The Company's view was that this contract would not expire until March 31, 2006.

3.1.3 However, the Company stated that Union's position was that the existing contract would expire March 31, 2004. The Company indicated that it began negotiating with Union for a new contract in 2003, in an effort to avoid the possibility of litigation.

3.1.4 The Company and Union reached agreement on a contract for 19.9 bcf of storage covering the period April 1, 2004 to March 31, 2014. The market-based rates in the new contract exceed the cost-based rates in the existing contract during the overlapping period, April 1, 2004 – March 31, 2006.

3.1.5 Union submitted the new contract to the Board for approval on February 25, 2004. On April 1, 2004, under docket number RP-2004-0137, the Board approved the parties to, the period of, and the space that was the subject of the new contract.

3.1.6 The Company has requested that the Board now approve the cost consequences of the new contract for ratemaking purposes. For the 2005 Test Year, the Company has included the costs of the new contract, which are estimated to exceed cost-based storage services by $2.7 million. For the period April 1, 2004 to September 30, 2005, Union's charges to EGDI for storage services under the new market-based rates are estimated to exceed the charges at cost-based rates by approximately $5.1 million.

3.1.7 The alternative to the Company receiving storage service under the new contract is for the Company to continue paying cost-based rates under the same terms as the existing contract until March 31, 2006, and proceeding thereafter under market rates to be negotiated. This contingency is specifically contemplated in the new contract. It provides that if the Board decides to not accept the cost consequences of the new contract for the purposes of rate making, that the parties, Union and EGDI would revert to the cost-based rates for the period up to March 31, 2006. The Company estimated that were the cost consequences of the new contract accepted by the Board, ratepayers would pay $11.4 million more in the first two years of the new contract, but would save an estimated $31 million over the following eight years. The Company estimated that the new contract would provide a ratepayer benefit of $11.855 million over the life of the contract in terms of net present value ("NPV").

3.2 POSITIONS OF PARTIES

3.2.1 The Board heard arguments opposing the Company's proposal from CAC, IGUA, Energy Probe, VECC, Direct Energy, SEC, and CME. These included:

- The upcoming Natural Gas Forum ("the Forum") will consider regulation of storage and transportation and will include a review of the merits of cost-based storage versus market-based storage. Board approval of the Company's proposal could predetermine the outcome of storage issues at the Forum;

- The Company's fear of potentially expensive litigation was not credible given the lack of any written communications attesting to the dispute over when the existing contract would expire;

- If the Company were to charge market rates rather than cost-based rates for all the storage it holds and contracts for, about 110 bcf, the additional cost would be approximately $76 million. For Union's and the Company's ratepayers combined, the additional cost could total up to $152 million;

- Storage is a provincial asset that should benefit Ontario ratepayers by being provided at cost-based rates. Until the Board concludes its upcoming review of storage in the Forum, the Board should not approve long-term contractual obligations. Otherwise the Board could be frustrated if its review concluded that Ontario gas utility customers should have access to storage at cost-based rates;

- The estimated future market prices for storage used to compare the new arrangements with the old are dubious as they were benchmarked against two bids that were untested. Further, the lack of disclosure of the details of these bids did not permit them to be tested in the hearing;

- The 10-year term of the agreement is inappropriate because it does not provide the Company with the requisite flexibility for a changing marketplace.

3.2.2 The Board also heard submissions by SEC and VECC that there was potential merit in the Company's proposal.

3.2.3 VECC submitted that the new contract is likely in the ratepayers' long-run interest because it is deemed to be below market. Also, if a storage arrangement were renegotiated later, the price of storage would likely be higher. VECC proposed that 2005 ratepayers should pay only cost-based rates and the difference between cost-based rates and the rates in the new contract should be recorded in the transportation and storage deferral account.

3.2.4 SEC argued that the Board's decision on this issue should depend on the likelihood that the Board will allow Union to charge the Company market rates beginning in 2006. If the Board does allow Union to charge the Company market rates beginning in 2006, the new contract would result in a net saving to the Company's ratepayers of $23.4 million with an NPV of $11.9 million. In this case, the Company's proposal should be approved. However, if the Board were to require Union to charge the Company cost-based storage rates, rejection of the proposal would save the Company's ratepayers $59.3M.

3.2.5 The Board also heard the Company's responses to these objections:

- There was no reason to believe that at the Forum, the Board would consider issues previously decided. There was also no indication that the Forum would be used to review Board approved storage contracts or whether Ontario storage users should have access to cost-based storage rates;

- In its EBRO 494/03 Decision, the Board approved market rates for some ex-franchise storage contracts and warned M12 customers, all of which were Canadian distribution companies, that they might face market-based rates for storage used to serve their own in-franchise requirements. The Board noted that the distribution companies had based their rates on having access to Union's cost-based rates and stated that the distribution companies "... should be provided an opportunity to make necessary adjustments to supply arrangements ...";

- The Board has approved a storage contract arising from an open season bidding process between Union and Utilities Kingston that resulted in Kingston end-users paying market storage rates;

- The RP-1999-0017 Decision with Reasons approved the renewal of Union's ex-franchise storage contracts at market rates;

- The Board's regulation of storage rates should not be suspended pending the outcome of the Forum. The Forum's purpose is to explore alternative regulatory policies and not to debate fact-specific issues or contracts. As such, approving the cost consequences of the Company's storage contract with Union does not impede the Board's ability to explore policy options at the Forum;

- If the Board does allow Union to charge market based storage rates in 2006, the Company's proposal provides net savings to ratepayers. The Company added that all management decisions should be presumed to be prudent unless challenged on reasonable grounds;

- The RFP process undertaken by the Company to obtain the storage would comply with the Board's requirements even if an affiliate had won the contract to provide storage. Further, the two rejected bids were similar in price; and

- The Board has approved: the parties to, period of, and the storage space of the 10-year contract under file number RP-2004-0137 on April 1, 2004, following a public proceeding.

3.3 BOARD FINDINGS

3.3.1 The question before the Board is not whether existing M12 cost-based storage contracts may be renewed at market rates. The Board's RP-1999-0017 Decision with Reasons allows that. The issue is whether the Board should accept for ratemaking purposes the new market-based storage rates provided for in this new contract, or whether the Board should require the Company to continue with the existing cost-based storage rates until 2006.

3.3.2 The Board finds that the Company's estimate of ratepayer benefits under the new contract is speculative because the Company has filed no evidence with respect to a publicly available competitive price for storage services for 2006 and beyond. Instead, the evidence supporting the claimed net ratepayer benefit relies upon very uncertain estimates. The Board is concerned with the lack of detail and transparency in the RFP process that underpinned the negotiated Union price. Given the lack of supporting evidence, the Board is unable to accept the Company's claim of ratepayer benefits under its proposal.

3.3.3 The new contract indicates that rejecting the Company's proposal would trigger a reversion to terms existing in the prior contract for the period April 1, 2004 to March 31, 2006, and this reversion would result in storage costs reduced by $11.4 million for the Company's ratepayers over this period.

3.3.4 Therefore, the Board denies the Company's request for recovery of the cost consequences of the new contract because of the uncertainty of long-term net benefits of the new terms versus the certainty of the short-term benefits under the existing terms.