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August 28, 2006

VIA Fax-E-mail and Courier

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th floor
2300 Yonge Street
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: EB-2005-0551 – NGEIR Issues and Storage Regulation
Final Argument of Vulnerable Energy Consumers Coalition (VECC)

As per Procedural Order No. 9 we have enclosed the Argument of the Vulnerable Energy Consumers Coalition (VECC) with respect to the above-noted proceeding.

As requested we have also enclosed 14 hard copies and filed with the Board Secretary and all parties by email.

Thank you.

Yours truly,

Original signed

Michael Janigan
Counsel for VECC

Cc: All Registered Parties

EB-2005-0551

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.

NGEIR ISSUES AND STORAGE REGULATION

FINAL ARGUMENT OF THE

VULNERABLE ENERGY CONSUMERS COALITION (VECC)

August 28, 2006

1. Introduction

The Vulnerable Energy Consumers Coalition (VECC) represents the Ontario Coalition of Senior Citizens (OCSCO), and the Federation of Metro Tenants Association. OCSCO is a coalition of over 120 senior groups, as well as individual members, across Ontario. OCSCO represents the concerns of over 500,000 senior citizens through its group and individual memberships. OCSCO's objective is to improve the quality of life for Ontario Seniors. The Federation of the Metro Tenants Association is a non-profit corporation composed of over ninety-two affiliated tenants associations, individual tenants, housing organizations, and members of non-profit housing co-ops. These organizations have longstanding concerns associated with the provision of important public services and utilities.

On October 24, 2003, the Ontario Energy Board ("the Board" or "the OEB") informed stakeholders that it was about to undertake a comprehensive review of the natural gas sector with the objective of further improving the regulation of Ontario's gas markets. This review, known as the Natural Gas Forum ("the NGF"), began with a stakeholder meeting on November 12, 2003, hosted by Board staff. This process involved consultations with and submissions by interested parties with respect to system gas, storage, and rate regulation.

In its NGF submission on storage regulation, Enbridge Gas Distribution ("EGD") supported a "hybrid" solution of some storage services regulated and some deregulated[1] as "the best policy route on the way toward a fully competitive marketplace for storage services." (EGD Submission, p. 9) EGD continued that "if

[1] EGD did not endorse the status quo option of regulated in-franchise rates with Transactional Services ("TS") being sold on the market with the margins split between the shareholder and ratepayers. Rather, EGD invited the Board to consider the threshold issues of (i) whether it the TS market was competitive and the Board should deregulate it and (ii) whether the market for new storage development is competitive and the Board should forbear.

the Board is satisfied that TS services and new storage capacity development operate in a competitive marketplace, then the Board has the policy option of forbearing altogether on their economic (rate) regulation." (Ibid) EGD then stated that the hybrid option it supported "allows one to "learn as you go" and either lengthen or shorten the time frame for the full movement to a market-based storage end state, depending on the state of the marketplace." (EGD Submission, p. 10)

Union, in its NGF presentation on storage regulation, stated that the storage market was competitive in the market area of at least the Great Lakes basin (Union Presentation, p. 6). However, Union stated that in the end state model cost-based storage rates should be applied for in-franchise base requirements "especially for small-volume customers who need to be assured of a reliable and efficient service" (Union Presentation, p. 16) although "[i]n-franchise customers may also pay market-based rates for base service requirements if corresponding changes to the regulatory framework are made." (Ibid)[2] (emphasis added).

In its report entitled "Natural Gas Regulation in Ontario: A Renewed Policy Framework," (the "Report") issued by Board on March 30, 2005, the Board identified growth in gas-fired power generation, higher gas prices and increased price volatility, and change in the structure for natural gas demand as being key developments that led the Board to begin a reconsideration of the regulatory treatment of storage services with the unique requirements of gas-fired generators in mind. The Board stated that "[t]aken together, these factors point to an increasing demand for Ontario's existing storage capacity, and a probable need for investment in storage capacity, deliverability and transportation." (Report, p. 40)

[2] These representations led VECC to believe that the utilities both believed that competition in storage services was adequate to protect the public interest and that the regulation of storage services provided to in-franchise customers at cost-based rates was not their preferred end-state.

The Board went on to observe that "[i]n part to encourage further storage development, the Board has gradually widened the scope for the owners of storage to charge market-based rates since the RP-1999-0017 Decision … ." (Report, p. 46) In this respect, guided by the objectives of the Board set out in the *Ontario Energy Board Act* and by the requirements of section 29 of the Act, the Board concluded that it would "determine, through a generic hearing, whether it should refrain, in whole or in part, from regulating the rates charged for natural gas storage in Ontario." (Report, p. 49)

Subsequently, the Board initiated a generic hearing on its own motion, the Natural Gas Electricity Interface Review ("NGEIR"), with the objectives being "to determine (i) whether it should order new rates for the provision of natural gas transmission, distribution and storage services to gas-fired generators (and other eligible customers); and (ii) whether to refrain, in whole or part, from exercising its power to regulate the rates charged for the storage of gas in Ontario by considering whether, as a question of fact, the storage of gas in Ontario is subject to competition sufficient to protect the public interest." (Board Procedural Order No. 1, EB-2005-0551, p. 1) The Board identified four issues in this proceeding: Issue I (rates for gas-fired generators and other qualified customers), Issue II (storage regulation), Issue III (transportation capacity bidding process and allocation), and Issue IV (EGD's Rate 300 series rates).[3]

By way of process for NGEIR, the Board convened seven days of Technical Conferences (beginning April 05, 2006, ending May 19, 2006) and fourteen days

[3] The bulk of VECC's submissions are in respect of Issue II. While Procedural Order 9 specified that "arguments with respect to Issue II of all other parties shall be heard at 9:30 a.m. on August 28, 2006," it is VECC's understanding that there are unresolved issues with respect to non-storage related proposals before the Board. VECC will make a brief submission in respect of these issues.

of oral hearing (beginning June 19, 2006, ending July 20, 2006) for discovery and testing of the NGEIR evidence. The Board also convened a Settlement Conference in respect of Issues I, III, and IV but declined to do so for Issue II, opting instead for a full oral hearing on this issue.

Settlement Proposals were presented to the Board on June 13, 2006 in respect of Issues I, III, and IV. Arguments on behalf of the utilities (Union and EGD) and their affiliates (Market Hub Partners or "MHP" and Enbridge Energy Distribution Inc. or "EI") in respect of Issue II were provided on August 11, 2006. The City of Kitchener ("CCK") also provided argument in respect of sub-issue 4 of Issue II, "Appropriate Storage Allocation Method."

The following constitute VECC's submissions in respect of Issue II.

2. Storage Available to Develop

Evidence in the hearing concerning available storage

VECC submits that based on the evidence provided in this hearing, the amount of additional storage in the province that could be economically developed is likely much less than 50 Bcf. Further, the amount of this space that would lend itself to providing high deliverability is even less. <u>In any case, VECC submits that it is not at all necessary to transfer wealth to holders of existing storage in order to incent the development of new storage.</u> In making these assertions, VECC notes the response of Union's panel when asked if he concurs with a consultant's opinion in 2001 that "there is potentially 150 Bcf of additional storage in Ontario" and if not, "what is Union's current best estimate?" (TC, May 19, p. 168)

The response from Union's witness was[4]:

MR. POREDOS: Union certainly doesn't have all of the information for all of Ontario for all of the possible areas that have been explored or seismic has been done on it. I think it is public knowledge that MHP is suggesting that there's somewhere in the area of 6 Bcf that they're looking to develop. There is also public information I think Tribute had on the record of about I think it was 12 Bcf that they would develop. There's probably more than that, but I don't think that Union, today, has a good answer that there's 50 or 100 or whatever. <u>Generally speaking, there could be somewhere between 30 and 50, as someone from Enbridge yesterday said.</u> (emphasis added, TC, May 19, pp 168-9).

VECC notes that the Union/Enbridge estimate was not restricted to storage developments that had characteristics amenable to providing high deliverability service: in VECC's view, such a restriction would have invariably lowered their estimates.

VECC submits that a large impetus driving the review of storage regulation in this proceeding is to address the expected growth in needs on behalf of the gas-fired generators. The representatives of these generators have indicated that higher deliverability (up to 10% versus the current standard of 1.2%) is a key service they require for intraday balancing of loads for plants dispatchable on short notice.

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[4] VECC acknowledges that subsequent responses by other panel members ultimately resulted in an estimate, given their most likely price forecast of 40-50 Bcf developed by 2025. Further, the panel member providing that figure stressed that this range referred to expected, not potential development. However, VECC notes that Mr. Poredos' response of 30-50 Bcf was not qualified in a like way and yet yielded a similar range to Mr. Henning's estimate.

VECC further submits that the evidence on record indicates that there is no reliable evidence before the Board that there will be significant additions in the near future to the approximately 250 Bcf of storage space already developed in Ontario regardless of incentives, largely due to:

- the lack of significant, undeveloped geological formations having characteristics favourable for use as storage pools either in close proximity to existing pipelines or markets or located such that they would be economical to develop in conjunction along with a pipeline project that would connect them to market (the "elephants" have been pretty well discovered by now);

- the expected capital costs of the base cushion gas required for a large working pool is a major capital cost that is a much greater factor today than it was in the past (when commodity prices were lower) and therefore possesses an impediment to development not seen in the past; and

- the evidence before the Board is that no party has plans to develop more than modest additions to existing storage space and that the developments that are planned are not conducive to providing the high deliverability service sought by the gas-fired generators at this proceeding. Rather, both Union and EGD have proposed "builds" to enhance deliverability from existing pools.

In this regard, VECC notes that the evidence of MHP is that:

- MHP currently provides no storage service but that it owns two assets, the St. Clair Pool and the Sarnia Airport Pool (50% stake) with capacities of 1.1 Bcf and 5.23 Bcf respectively when these reservoirs are converted to storage. (TC, May 17, pp 248-9). When fully developed, these facilities will increase Ontario storage space by 2.47%.

- "MHP Canada and its predecessor companies have invested over $15 million in exploration and project development activities in Ontario for the past ten years in pursuit of viable storage development opportunities." (TC, May 17, p. 250)

- "The company plans to provide 1.1 Bcf of working storage capacity to the market in 2007 and increase that capacity to 10 Bcf by 2010." (TC, May 17, pp 254). However, Mr. Redford on behalf of MHP states that "I couldn't tell you how much of that 10 Bcf would be 10 percent deliverability service. Based on the data we have, we would assume that the St. Clair Pool would not be able to provide that service." (Ibid) Mr. Redford subsequently was unable to provide any assurance that his corporation would be able to offer any deliverability in excess of 1.2%. (TC, May 17, pp 254-5)

- Further, in respect of the ST. Clair Pool project, under questioning by Mr. Thompson, MHP admitted that in the initial 2002 application to develop this pool the intention was to provide storage services to Union at market based rates. Further, MHP admitted that it is possible that once developed it could

be marketed to Union if the project goes forward now.[5] (TC, May 18, pp 32-4).

Further in this regard, VECC notes the direct evidence filed by Enbridge Inc. on May 1, 2006, in this proceeding. Specifically of interest to VECC are the first four points in the submission which are reproduced below:

1. Essentially all of the known, large, good and favorably located pinnacle reef pools in Ontario have been previously developed for gas storage by Union Gas Limited or Enbridge Gas Distribution (or its predecessor Tecumseh Gas Storage Limited.)

2. More recent storage capacity additions have come from developing smaller pools or from pressure enhancements to previously developed pools.

3. In an effort to locate more gas storage, Enbridge Inc. under an unregulated company, Enbridge Energy Distribution Inc. (EEDI), has undertaken some exploration, evaluation and pool development activity in Ontario over the last several years.

4. While to this point this activity has not lead to the development of any new gas storage, at this point, this effort continues with the hope of a successful outcome in the future. (EI, Issue II Evidence, p. 1)

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[5] Notwithstanding the fact that **Union currently owns about 70 Bcf in excess of its in-franchise requirements** that it sells on the ex-franchise market. The mere possibility of Union acquiring storage at market rates from an affiliate to serve in-franchise customers given the surplus storage it has developed under the current regulatory regime raises concerns, in VECC's view.

With respect to the utilities' plans, other than the 2 Bcf that EGD proposes under its storage build program, (TC, April 06, p. 56 and p.226), neither Union nor EGD have indicated any interest in developing new pools under the prevailing utility regime.

VECC submits that given the evidence before this Board, it is reasonable to conclude that (i) there is not a substantial amount of new storage pools that can be developed in Ontario and (ii) additional storage space does not address the concerns of gas-fired generators (and other qualified customers).

VECC submits that the record is clear that the existing storage space that has been developed in the province under the current regulatory regime has been beneficial to both ratepayers and to the utility and that the existing space is more than sufficient to meet all in-franchise demands for the foreseeable future.

Further, given the current plans of Union and EGD and the existence of unregulated third-parties willing to undertake new storage development, there is no apparent reason why the utilities should be involved in the development of new storage pools.[6] Furthermore, transferring rents to incumbent owners of storage developed in the past will not provide any incentive to future storage developers: the Board can provide such an incentive by forbearing from regulating or by regulating at market rates in the case of new third-party storage developers.

[6] By this, VECC is not suggesting that the utilities should not enhance existing storage assets. VECC is referring to the exploration and development of new pools only here.

3. Nexus of forbearance to Storage Development

Forbearance is not a necessary precursor to new storage development

VECC submits that it is completely unnecessary for the Board to forbear from regulating all storage rates – including rates for in-franchise storage services currently provided on a cost-based basis – in order to foster new storage development in the current circumstances. The evidence states broadly that storage is valuable and that services from assets surplus to in-franchise requirements (for both Union and EGD) are marketed to the highest bidder at Dawn, irrespective of the development costs or operational costs of the assets. As such the prices received reflect or are at least a proxy for[7] the marginal values[8] to the successful bidders, and independent of the assets' development and operational costs.

VECC submits that the Board need only forbear from regulating rates (or regulating and allowing market rates) for new storage developments undertaken by third-parties in order to encourage new storage development by these parties. In fact VECC claims that any forbearance regarding in-franchise storage services would only result in a wealth transfer from ratepayers to the shareholder in respect of assets that had been previously developed under a regulatory compact, i.e., where the regulated firms were afforded the opportunity of a reasonable return, provided by a captive in-franchise customer base, in exchange for an obligation to serve where viable. Other than this distributional effect – which VECC submits is

[7] Under a sealed bid, first-price auction the bid price would not exceed the marginal value to the buyer usually.
[8] This is not to say that VECC regards a single supplier of an asset that sells a service by auction is a price-taker in the conventional, economic sense any more than a single-price monopolist who likewise faces the constraint of facing the market demand curve is a price-taker. In both cases, an unregulated monopolist can exercise market power by restricting the quantity available for sale. In the case of an "open season," an unregulated monopolist could restrict the quantity either directly, or indirectly by setting a minimum reservation bid above marginal cost.

inequitable – there would be neither any effect on the allocation of storage to in-franchise customers[9] nor on the development of new storage.

In short, a potential third-party storage developer will look at the economics of an individual project based on its costs and expected revenues and can be expected to be unconcerned with whether the utilities have to share margins with ratepayers (or whether ratepayers have to share margins with utilities).

4. Forbearance from Storage Regulation

a) The Legislation

Enbridge and Union seek relief in these proceedings pursuant to the provisions of sec. 29(1) of the *Ontario Energy Board Act 1998.* The *Act* provides as follows:

Refrain from exercising power

29. (1) 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 competition sufficient to protect the public interest. 1998, c. 15, Sched. B, s. 29 (1).

Scope

(2) Subsection (1) applies to the exercise of any power or the performance of any duty of the Board in relation to,

[9] The utilities allocate storage to bundled, in-franchise customers on an aggregate-excess methodology that does not include a price variable. But, even if the effect of storage price were a factor or the allocator of the service, VECC submits that the effect of higher prices on usage would be minimal absent egregious increases. VECC will argue in a later section that the evidence supports the view that the in-franchise demand for storage is highly inelastic at current price levels and quite inelastic at price levels significantly in excess of current prices. In that case, the main impact of increasing prices is a wealth transfer, not an allocation change. In the polar case of perfectly inelastic demand the only effect of a price increase is to transfer wealth.

(a) any matter before the Board;

(b) any licensee;

(c) any person who is subject to this Act;

(d) any person selling, transmitting, distributing or storing gas; or

(e) any product or class of products supplied or service or class of services rendered within the province by a licensee or a person who is subject to this Act. 1998, c. 15, Sched. B, s. 29 (2).

Where determination made

(3) For greater certainty, where the Board makes a determination to refrain in whole or in part from the exercise of any power or the performance of any duty under this Act, and does so refrain, nothing in this Act limits the application of the *Competition Act* (Canada) to those matters with respect to which the Board refrains. 1998, c. 15, Sched. B, s. 29 (3).

Notice

(4) Where the Board makes a determination under this section, it shall promptly give notice of that fact to the Minister. 1998, c. 15, Sched. B, s. 29 (4).

The application of the individual components of the test for forbearance set out in the above provisions will be subsequently discussed in our Argument.

b) The Proposals

VECC understands the relief sought by Union in respect of storage-related matters as follows:

- Union requests a finding that the storage market is workably competitive and therefore the Board should forbear from regulating storage rates;

- Union will provide cost-based storage service to in-franchise customers for an amount of space equal to the January 1, 2007 calculated in-franchise requirement on the basis that in-franchise customers are today and have been in the past been served under bundled rates;

- Any subsequent, incremental (to January 1, 2007) in-franchise storage requirements would be procured by Union at market rates on behalf of these customers with the full cost being recovered by rolling in the market costs with the cost-based costs. To the extent that these incremental demands are experienced, storage rates for in-franchise customers will rise above their current cost-based level and towards the "market" rate;

- Union requests that the Board forbear from regulatory approval of the party, term, and subject space in respect of storage contracts; and

- Union asks the Board to forbear from regulating the ex-franchise market, a relief which if granted would impact the ratepayers detrimentally by the amount of $44.5 million while benefiting the shareholder by the same amount due to the elimination of revenue sharing with ratepayers of premiums associated storage-related assets marketed to ex-franchise customers. Union proposes that this be given effect by removing all associated costs, revenues, and rate base from the utility through a cost allocation exercise.[10]

[10] Union also has some proposals with respect to gas-fired generators and some associated storage and transportation deferral account proposals that are also dealt with later.

VECC understands the relief sought by EGD in respect of storage-related matters as follows:

- EGD asks the Board to forbear from regulating all transactional services;

- EGD asks the Board to forbear from regulating storage services provided to ex-franchise customer(s) (Gazifere);

- EGD asks the Board to forbear from regulating new storage development;[11]

- EGD would however continue to provide cost-based rates to its existing in-franchise customers.[12]

VECC submits the following comments on the utilities' requests:

- The evidence does not support the claim that the storage market is workably competitive. VECC provides its rationale for this conclusion in the next section;

- Therefore, it is not appropriate at this time for the Board to forbear, in whole or in part, from regulating existing utility storage services;

- Given that the storage space currently owned and operated by Union (approximately 150 Bcf) is almost double their current in-franchise requirement, VECC opposes Union's proposal to freeze the in-franchise

[11] This request has also been made by the affiliates, MHP and EI.
[12] VECC understands that similar to Union, high deliverability services provided to gas-fired generators would be at market rates.

requirement at the January 1, 2007 level. In VECC's view, Union's proposal raises equity concerns in conjunction with its proposals in respect of the ex-franchise market and it is also directly opposed to Union's standard practice of first determining in-franchise requirements first and allocating the remainder to the ex-franchise market.

- Bundled in-franchise customers receive service from an integrated system that includes transmission and storage assets, both of which were developed under a regulatory regime that provided the utilities with a fair return. It does not make sense to now claim that the storage is competitive while transportation is not. Further, it is opportunistic, and in VECC's view a violation of the regulatory compact, for Union and EGD to now attempt to scoop the entire premium in the ex-franchise market associated with these assets.

- In Union's case, the assets underpinning the short-term storage and balancing services sold in the ex-franchise market are presently included in rate base. In the case of EGD, <u>all</u> of the assets underpinning their transactional services sold in the ex-franchise market are included in rate base. As stated earlier, VECC views it as highly inappropriate for the utilities to seek the entire margin associated with these assets given that they have been "substantiated" by captive ratepayers who have paid in rates for the full opportunity cost of the associated capital investment (including a fair return on equity) along with overhead costs and direct operational costs associated with providing service. In VECC's view, the utilities should be required to provide a rationale for receiving any of the associated margins given their earlier mentioned obligation to optimize the use of utility assets.;

- With respect to Union's proposals for margins earned by marketing long-term ex-franchise, VECC submits that the status quo regarding margin sharing and embedding forecasts in rates is acceptable. Again, VECC notes that these services are underpinned by assets already developed under the regulatory regime in place, not future assets yet to be developed.

- With respect to which customers are entitled to long-term storage at cost-based rates, on the basis that the assets are nominally at least a provincial resource, VECC urges that consideration be given to providing all provincial end users with long-term storage at cost based rates. ;

- If however, the Board accepts Union's proposal to forbear from regulating the storage market, VECC submits that removing these assets from the regulated utility would significantly lower its risk and would therefore require the Board to make compensating changes, in the name of just and reasonable rates, to the utilities equity thickness and/or risk premium used in setting rates.

- Contrary to Union's submissions, VECC does not believe that the cost allocation exercise required to remove assets from rate base would be either quick or easy. VECC believes a major effort would be required to disentangle the assets, overheads, financial impacts, etc., associated with the ex-franchise storage market from what remains of a formerly integrated utility operation.

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c) Kitchener's Issues

VECC has reviewed Kitchener's argument and submits the following:

- It is not clear to VECC that the aggregate-excess storage allocation method is a least cost method, especially in view of the fact that the costs of allocating too little storage (in terms of the attendant winter peaking purchases) appear to exceed the costs of allocating slightly more storage than the aggregate excess method would indicate. In any event, VECC supports the use of minimum cost planning in the utility's supply asset use and notes that under the current regulatory regime, the utility has an incentive to trade off storage allocated to in-franchise for increased winter peaking supply purchases: Union would be able to market more assets in the ex-franchise market and earn increased margins while passing on the commodity costs of the peaking supply to system customers. VECC is not alleging that Union is presently operating to take advantage of this incentive, but rather suggesting that, given the magnitude of the dollars involved, the Board should assure itself that Union and EGD both adhere to least cost practices when specific concerns are raised.

d) The Product, Market, and State of Competition

This section deals with the market power evidence submitted in this proceeding, i.e., the evidence purporting to show that Union either does or does not have the ability to exercise market power in the relevant geographic area for the relevant product definition.

Although VECC initially assumed a lead role in retaining an expert, Mr. Stauft, on behalf of the "sponsoring parties," early on in this proceeding, VECC ceded the lead role to Mr. Thompson. VECC's understanding is that other sponsoring parties will deal with Mr. Stauft's evidence in detail. To avoid wasteful duplication, VECC will provide only few high level submissions on Mr. Stauft's evidence, while providing other submissions that VECC feels may not be made by other parties and yet still may be of value to the Board.

VECC has reviewed Mr. Stauft's evidence and submits that it supports a finding that both EGD and Union can exercise market power in the provision of storage services at the burner tip. Also, VECC notes that there was some discussion around Mr. Stauft's testimony as to whether FERC's 10% rule for an increase in prices indicating market power was with reference to the existing cost-based rate or with reference to some proxy for a market-based rate. VECC submits that using the cost-based rate is preferable for the following reasons:

- Had the storage market developed in a competitive environment, it is quite possible that, absent the comfort afforded by the existence of captive customers and the regulatory compact that characterized the regulatory regime in place, a lot of the storage that was developed would not have been in a competitive environment. Using 10% above what today's owners can get for underutilized assets in an open season may not, in fact, reflect what would have been the case had storage been competitively developed as there might be, in that case, plenty of low cost storage yet to be developed, especially if the complementary transmission and distribution services –

both exhibiting the characteristics of natural monopoly[13] – had been left to develop under a competitive regime. Further, it at the same time both ignores the benefits conferred by the regulatory regime of the past and conferred on the utility and its ratepayers, and at the same time, assigns them in large part to the utility which had been a party to and beneficiary of, the regulatory compact.

- Use of an alternative proxy would only serve the purpose of transferring windfall gains to a utility that had enjoyed a fair rate of return under the regulatory compact during the time that the assets were developed. Justifying a considerable transfer of wealth to such a utility due to past activities undertaken under the regulatory umbrella, appears to be both unfair and unwarranted in VECC's view.

- In any case, under cross-examination by Mr. Thompson, the MHP panel appeared to confirm that FERC's general practice is to award market-based pricing authority to new storage developments that pass FERC's screen while reserving cost-based rates for existing developments. This appears to be a sensible and fair approach in VECC's view.

VECC makes the following claims, not so closely related to Mr. Stauft's evidence, rather more in respect of the competing EEA/Schwindt study, in respect of the market power issue:

[13] VECC notes that in the economic literature, control of an essential resource or input is regarded as a source of monopoly.

- Every firm that argues it is unable to exert market power has an incentive to expand the relevant geographic area and the relevant product area when a measure such as the HHI or some other concentration measure is used as such extensions invariably decrease the measure of market power;

- While VECC agrees with Dr. Schwindt (tr. Vol. 01, p. 82) that in the real world, markets can be "workably competitive" even though they are not perfectly competitive, VECC submits that perfect competition is a useful benchmark against which to assess real markets as perfectly competitive markets assure efficiency in production (in choice of output mix and input factor usage) and in consumption.[14]

- VECC submits that price-taking behaviour – in the sense of any single buyer or seller being unable to affect price by their demand or supply decision – is the signature characteristic of perfectly competitive markets and it indicates the absolute lack of market power, which, not coincidentally, is related to the much admired efficiency properties of perfectly competitive markets.

- VECC notes that at the Technical Conference, it was acknowledged that the price elasticity of demand[15] facing the firm was the key theoretical determinant of the ability to exercise market power: firms facing a perfectly elastic demand have none, firms facing perfectly inelastic demands (i.e., elasticity of zero) have infinite market power at that price level.

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[14] In this regard VECC notes that nothing in the real world is 100% efficient. But whereas for example no gas-fired generator is 100% efficient in converting the energy in the gas to electrical energy, the efficiency of a generator (as measured by the heat rate) is of great interest to the owner and the higher it is the better.
[15] Defined as the percent change in quantity demanded induced by a 1% change in price.

Unfortunately, though demand elasticities have been estimated for other sectors at other times, no such evidence was available in this case.

- It was acknowledged at the Technical Conference that a key determinant of the elasticity of demand was the availability of close substitutes.[16]

- However, there is no evidence that any in-franchise end using customer of either Union or EGD has ever foregone the use of utility storage in favour of balancing by means of ex-franchise storage or any other storage substitute, regardless of the price changes arising from different rates proceedings. As it stands, VECC believes this is indicative of substantial, potential exercise of market power by the utilities should the Board forbear in whole.

- With respect to the correlation analysis that was relied upon to demonstrate the connectedness of the geographic market, VECC notes that the testimony indicated that correlation of prices may not be indicative of market connectedness but rather can be due to correlations in exogenous factors such as the weather or the change in price of an input required in two separated markets. (Tr. Vol. 09, pp 99-100). Further, in cross-examination Mr. Thompson elicited the fact that such price correlation studies have not been relied upon before as a test of market power or market connectedness in any regulatory jurisdiction in North America.

[16] This can be measured by estimating the cross-price elasticity of demand in the presence of sufficient data. This information was not available, not unexpectedly. Other determinants of the price elasticity frequently cited are "nature of the good" (necessity or other?) and "proportion of income spent on the good" with all three determinants, especially the last one used to explain why the demand for toothpicks, for example, is quite inelastic. The last determinant would also argue in favour of inelastic storage demand in VECC's view.

As stated before, VECC does not argue that a market need be perfectly competitive before it should be deregulated as, if that were the case, we would live in a much different (and poorer) economy if that were the guiding principle. VECC does assert however that, as a general guide, the further a market is from the perfectly competitive ideal, the less "workably competitive" the market is. VECC further submits that the factors it has raised tend to support the Stauft conclusion in a qualitative sense.

VECC notes that the testimony confirmed the theoretical relationship, for a profit-maximizing firm, between the markup of price over marginal cost and the (own price) elasticity of demand facing the firm, during the hearing as evidenced by the following exchange at Volume 09, pp. 98-99:

MR. JANIGAN: Thank you, Mr. Chair.
Ms. McConihe, I have three general areas of cross-examination to deal with. One deals with the issue of price elasticity and its affect on market power. Secondly, I want to deal with, briefly, the issue of price volatility that my friend Mr. Smith discussed. And thirdly, I want to deal with market failure and dangers of premature deregulation.

First, with respect to price elasticity. This proceeding has heard a fair amount of evidence from the proponents of forbearance about the product market and the description of the product market but very little about the behaviour of price and demand in the chosen markets.

I wanted to initially put to you the same proposition or the -- confirm with you the same fact that I confirmed with Professor Schwindt earlier in the proceeding that if a firm is acting to maximize profits, the mark-up of price above marginal

costs, expressed as a proportion of the price charged, is inversely proportional to the magnitude of the price elasticity of demand. (emphasis added)

MS. McCONIHE: Yes.

MR. JANIGAN: Okay. Effectively what that means is the more inelastic the demand, the greater the likelihood that a firm can enforce a price increase without losing market share.

MS. McCONIHE: That's correct.

VECC submits that this relationship implies that for a firm to be limited to be able to profitably increase price by exactly 10% above the perfectly competitive price level implies that the firm faces an elasticity of demand of 11, i.e., a 1% increase (decrease) in price would be associated with an 11% decrease (increase) in quantity.[17] VECC argues that such a highly elastic demand for Union's storage services marketed at Dawn is highly improbable as it implies that if Union were to market 11% less storage at Dawn, the bid price would only increase by 1%. While VECC agrees that whatever "workably competitive" means, it is not synonymous with perfectly competitive, VECC submits that workably competitive should be, in some sense, close to perfectly competitive, i.e., in a workably competitive market price will be expected to be above marginal cost but not by a large multiple.

VECC submits that forbearance on storage regulation is unjust and unwarranted given the evidence before the Board, i.e., that market rates are approximately three times cost-based rates. VECC supports the status quo of cost-based services for in-

[17] The derivation of the formula, (p-MC)/p = 1/e is standard and may be found for example at pp 88-91 of *Modern Industrial Organization, Third Edition*, D. Carlton and J. Perloff, Addison-Wesley, 2000. Rearranging this as (p-MC)/MC = (p/MCe) and using the fact that in a perfectly competitive market price (p) equals marginal cost (MC) yields the result above when p/MC is set to 1.1, i.e., 10% above marginal cost.

franchise customers with revenue (margin) sharing for utility assets marketed ex-franchise.

e) Competition Sufficient to Protect the Public Interest

While much of the evidence associated with the storage forbearance issue was directed to the issues of the relevant product market and market dominance, there was little in the Union and Enbridge proposals that addressed the final key element of the statutory test evolved in section 29 of the Act. Whatever the robustness of competition in the storage market, the Board must be satisfied that the public interest will be protected in the event that regulation is removed. In other words, the test for forbearance is not simply that a competitive market exists, but also that the deregulated market so created, will operate in a fashion that ensures that market discipline will be at least as effective as regulation in effecting fair and reasonable conditions in the customer relationship.

As the proceeding record has disclosed, the forbearance proposals of both Union and Enbridge are replete with the provision of essentially windfall monetary benefits for the shareholders both LDCs, to be paid for by the elimination of the share of market premium and transactional services revenues credited to ratepayers. The current value of these amounts $ 44.5 million in the case of Union and $4-5 million in the case of Enbridge, will now be credited to the shareholders: in Union's case this is equivalent to an increase in ROE 234 basis points on current utility assets (Exhibit U2.8). In addition, in franchise customers of both utilities will pay market rates for additional storage requirements, despite the presence, in Union's case, of additional storage to meet in franchise customers demand in the conceivable future.

The LDCs have approached the issue of forbearance as if the test was a kind of switch that is triggered simply by the presence of a competitive market featuring substitutes for the regulated product. Once the switch is triggered, forbearance must follow. In reality, the finding of competition or workable competition is simply one step in the analysis. The consequences of forbearance on the public interest must be considered.

There is general agreement that the regulated price for storage is currently roughly one third of the current market price for storage. Whatever the implications of that price differential on the consideration of the question of market dominance, the impacts of moving to forbearance pursuant to the Union and Enbridge proposals are centered around that price differential. Union and Enbridge, having developed storage assets through rates assessed over the years from in-franchise customers now wish to disconnect the transactional services revenues obtained from the storage that is surplus to infranchise customer needs from the ultimate cost of storage assessed to in- franchise customers. In effect, the LDCs want the Board to approve forbearance although it will lead to an increase in the rates assessed to customers who would otherwise has the benefit of 75% of those revenues.

This is why the governing legislation has a public interest component in the determination of the question of forbearance. Union witness, Professor Schwindt gave an apt example of the inadequacy of market forces to deal with a public interest issue when he noted the existence of competitive rental market for housing in New York, while large numbers of rental units are subject to rent control. The prices of the rent-controlled units are far below those in the open market. Any removal of regulation or rent control would likely provoke fairly massive rental

increases together with a housing crisis as tenants struggled to deal with the consequences of deregulation in what is nevertheless considered a competitive market by competition theorists. At the very least, one would have to be certain the public economic benefits of removing rent control outweighed the economic and social costs to the tenants, and that those benefits were equitably distributed among the relevant stakeholders before proceeding with deregulation.

In the case of regulated storage, Professor Schwindt's analysis would also compel deregulation notwithstanding the price and rate consequences associated with the move. While the relative equities associated with New York rent control are not always clear, in this case, the owners of the regulated assets have been fairly compensated by the rates paid by consumers which have allowed recovery of development costs plus a return on equity. It is to be noted that the setting of the ROE of the LDCs that involves the consideration of the business risks of the utilities including those concerned with the storage development.

The retreat of regulation in favour of market forces that is associated with the plans of Union and Enbridge leaves customers with little protection against the imposition of higher rates made necessary by the decision to allocate the revenues associated with storage transactions with ex-franchise customers to the utility shareholder. It would appear that the principles associated with the use of storage assets paid for by ratepayers have changed significantly, particularly in the case of Union. The previous position of Union was explored in cross-examination by counsel for VECC, particularly in relation to the evidence offered by the Union witness, Ms. Elliott in the EBRO 486-02 proceeding. (Tr. Vol. 3, 139 Ex J3.5)

The “regulatory compact” is one factor to be considered in relation to any Board decision to forbear. Storage assets were developed under the standard prudency test that allowed the LDC to recover costs plus a reasonable return. In the event that the storage market was in surplus, and the rates for storage were more favourable with other providers in a competitive market rather than with the LDC, would an application for deregulation of storage be accompanied by a proposal that any losses associated with the storage operations be allocated solely to the shareholders. Regulation and ratepayers insulated the utility from the risks associated with storage development, and it is contrary to the public interest within the meaning of the forbearance test to put in place a new market based paradigm that doesn’t recognize these realities.

It is also unclear why ratepayers in the Union proposal are protected by a January 1 allocation of storage to cost based rates. Other than the achieving the objective of enriching the shareholder, there is little reason that surplus storage assets developed with regulated rates should be transformed into private profit centers offering a commodity at market rates. No realistic public policy would be constructed on a freeze of this kind, and VECC submits no forbearance can exist under these conditions.

Union put forward, in evidence and testimony, benefits to the forbearance plans that were scant in relation to the perceived decrements of their proposal. Union witness, Mr. Baker put forth four public interest benefits that Union claimed are achieved with its proposal (Tr.pp. 90-92) These include: protection of the in-franchise customer, encouragement to storage development, efficiency and consistency.

Taking each in the order that the so-called benefits were discussed by Union, it is readily apparent that the interests of the in- franchise customers are, to say the least, imperfectly protected by the Union proposal. The Union proposal results in a loss of utility transactional services revenue of $46.085 million dollars that will have to be absorbed in rates. It even freezes the level of protection of cost based rates for storage to January 2007 levels with market based rates to be paid for storage obtained to meet increased ratepayer needs.

The nexus between the facilitation of new storage development and the requirements to deregulate storage is somewhat obscure. Apparently, after many years of storage development through the regulatory system, where utilities are provided with cost recovery and a reasonable rate of return, we suddenly have a reluctance to embark upon new storage development unless the new facilities attract market base rates. This is ostensibly justified by the projected costs associated with scoping out new opportunities (TC, May 17, p.250 and EI Evidence, Issue II, p.1). VECC believes that the ability to charge market based rates in the ex-franchise market has skewed the LDC's approach to storage development in that the LDC's are unwilling to embark upon storage projects without being rewarded with the high rates commanded for storage. There is little reason to believe that either additional storage could not be developed in the normal regulatory fashion, or that LDC affiliates or other market entrants could not develop storage, unencumbered by regulated utility requirements without the necessity of obtaining forbearance from regulation of existing storage by the OEB. And if the connection between deregulation and new storage development is dubious in relationship with the need for higher returns within the utility, the link between the appropriation of transactional services revenues currently credited to ratepayers and new storage development is non-existent. There is no evidence of

any kind that the enrichment of shareholders in the fashion contemplated by the proposals of Union and Enbridge will provide incentives for new storage development.

The third and fourth types of benefits to be provided with the move to deregulation are associated with efficiency and consistency. From the answers given by Mr. Baker and Professor Schwindt these considerations seem to be interrelated. (Tr. Vol. 03, pp 153-6) Apparently, Union believes the unfettered ability to allow demand to set prices for storage far above existing costs will drive customers to contract only for what they need and storage services given to those who value them the most (Ex C,Tab 1, P 23). This result will of course obtain in circumstances of monopoly or market dominance as well as competition, and provides scant justification for abandonment of regulatory protection. Union, supported by Professor Schwindt, claim that allowing ratepayers to obtain the benefit of transactional revenues for the storage that they paid and assumed the risk for constitutes a kind of subsidy that interferes with the price economic signals that they should be receiving in the market.

Leaving aside the obvious efficiency perils associated with premature deregulation and/or market dominance in a deregulated situation, it seems rather fanciful to suggest that the utility shareholders should take it upon themselves to administer market discipline to their customers by drawing an artificial line across the storage assets developed through rates and regulation. The revenues from one side of that line now belong to the utility shareholders while assets on the other side of the line attract cost based rates. Efficiency and consistency requires that the storage assets developed in regulation be used for the benefit of ratepayers at least as long as those assets are used and useful. There is no efficiency in a system that makes

ratepayers pay or be denied revenues from rate base assets. Ratepayers have been paying fully allocated costs which have included a return to the utility. Enbridge witness, Mr. Smead confirmed in cross-examination that no subsidy of ratepayers exists (Tr. Vol 7,p. 132):

> *MR. JANIGAN: You're not making the submission that infranchise customers have been subsidized to any extent.*
> *MR. SMEAD: No, not really.*

There are, in reality, no tangible public interest benefits to be gleaned from the acceptance of the proposals of the LDCs. As we have noted the new storage development that is envisioned by the LDCs is relatively small and speculative, and it is far from clear that such development can take place only in the fashion demanded by Enbridge and Union. As the record of this proceeding currently stands, forbearance cannot be granted in the face of evidence of significant burdens to utility ratepayers with no protection or benefits to offset the same to be provided by the ostensibly competitive market. The transition from regulation to market forces envisioned by Union and Enbridge is virtually unprecedented in that their supposed competitors offer rates that are far above the regulated price. As Enbridge expert Mr. McKeown confirmed (Tr. Vol. 7 pp153-4):

> *MR. JANIGAN: Okay. Now, Mr. McKeown, you have advised telecommunications companies, I guess primarily competitors to the IELCs, over the last 10 years in terms of their applications before the Commission and their ability to seek regulatory relief from the Commission. Have you ever come across an example of a competitive market existing -- a*

telecommunications market, where the competitive price was greater than the regulated price?

MR. McKEOWN: Where the competitive price became greater than the pre-existing regulated price?

MR. JANIGAN: No, where, in essence, that there was a competitive market in existence, but the competitive market, the competitors were offering a price that was greater than the price that was offered by the regulated company?

MR. McKEOWN: I see. No, although I think the Commission confronted that problem when it determined that it would be in the public interests to have competition in the local telephone service market, but realized that unless those regulated rates were increased there would be no competition. There would be no entry or little entry by new facilities-based competitors.

MR. JANIGAN: You know, I'm speaking, more or less, of a workably competitive market in a -- and that may exist in some locale where you have on the one hand, you have a regulated company offering a regulated rate. Then you have a whole bunch of competitors offering a rate that was greater than the regulated rate of the competitor. Is that a workable scenario, as you were aware, from advising --

MR. McKEOWN: I can't think of a case that I've run across like that, no.

MR. JANIGAN: And as I understand it, under the tests under 94-19 that the Commission has used and adapted in their forbearance decision, effectively, the Commission looks for evidence of "rivalrous behaviour." And one of the key

elements of rivalrous behaviour is, as I understand it, a reduction in prices.

MR. McKEOWN: Yes. That's one element, yes. But that's one that the Commission does look for.

f) Minimum Consumer Safeguards

While VECC is of the belief that a competitive market in storage does not exist in Ontario, and that the LDCs are in a position of market dominance with respect to this market, we also believe that the Board may be assisted by an analysis that attempts to deal with a any Board finding that the ex-franchise market for storage is sufficiently competitive to protect the public interest. Specifically, given the obvious damage that implementation of the LDCs proposals will cause to the economic interests of in franchise customers, it would be necessary to fashion a framework for this type of forbearance that protects the public interest by at least ensuring that ratepayers are in no worse position following implementation.

The key elements of such a framework would include the following:

1. **In franchise customers of the LDCs pay cost-based rates for storage**.

   For Union's customers, all storage needs, now and in the future, would be met by existing storage provided at cost based rates. In the case of Enbridge customers, these rates may include a premium paid to Union for the storage negotiated with Enbridge subject to Board approval.

2. **Revenues from transactions involving utility storage surplus to in franchise customers will continue to be distributed in accordance with the historical formula**. A less desirable leveling mechanism might involve

locking in place an attributed revenue contribution to the revenue requirement subject to an escalator based on storage rates.

It should also be clear that through the exercise of its powers to determine just and reasonable rates, the Board would continue to scrutinize the utilities decisions with respect to the use, acquisition and development of storage for ratepayers. These utility management decisions will not be automatically immune from oversight simply because a particular service, namely ex-franchise storage transactions, is not subject to regulation.

The idea that forborne markets still require regulatory adjustment is a concept that is well known in the restructuring of the telecommunications industry and a subject explored by VECC counsel with Enbridge witness, Mr. McKeown. (Tr.Vol 7. p.141-155) In particular, the decisions of the Canadian Radio-Television, Telecommunications Commission (CRTC) are instructive with respect to forbearance determinations that provide safeguards to address potential market failure or consumer protection that the market is not likely to deliver. Enbridge, in its Argument in Chief, particularly commended the CRTC Decisions as a useful model for the Board. However, it is important to note that the CRTC did not embark upon forbearance decisions with the same cavalier approach to the economic interests of ratepayers urged by the LDCs.

In CRTC Telecom Decision 97-19 (referenced at Ex. E Tab 2 Sch. 1 p. 12), the Commission decided to refrain from regulating incumbent telephone companies' long distance telephone services. Despite the fact that the Commission concluded that the incumbents (the Stentor companies) no longer had market power, it was

also concluded that the basic toll (long distance) segment of the market was not subject to the same rivalrous behavior exhibited elsewhere in the toll market:

> "The relatively static level of basic toll rates compared with the price reductions in Stentor companies' discount plans, as well as the fact that some discount plans are generally marketed such that customers must enroll to qualify for savings off the basic toll rates, suggests, in the Commission's view, that the basic toll sector of the toll market is not subject to as intense a level of price competition as are the toll market as a whole and the toll free market".[18]

As a consequence, the Commission implemented price protection for the basic toll market:

> "The Commission considers that the retention of a ceiling on basic toll rates would be appropriate. A ceiling would preclude the Stentor companies from generating increased revenues from the basic toll sector of the toll market which could be used to finance below cost pricing in areas of the market which are highly competitive. The retention of a ceiling would also provide consumers in the less competitive non-equal access areas with an additional safeguard against unjust or unreasonable rate increases in a de-tariffed environment"[19]

In a similar vein, the Commission, this year had to consider whether a forborne local services market could deliver a result for consumers that would be sufficient to dispense with regulation for those services. While the Commission set minimum conditions for forbearance of the regulation of local services including requisite market share loss, the relevant geographic and product market and necessary incumbent compliance with access rules, it was far from satisfied that these conditions would be sufficient to produce a strictly market based result that protect consumers.

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[18] CRTC Telecom Decision 97-19, para 61
[19] ibid at para 75

> "The Commission recognizes that for some customers, particularly residential customers, the operation of market forces after forbearance may result in either a loss of services on which they are reliant or potential increases in prices for services which are essential to their daily lives. The Commission also considers that there may be pockets of uncontested residential and business consumers in forborne markets. The Commission is also cognizant of the arguments raised by ARCH and the Consumer Groups regarding the position of vulnerable customers, including persons with disabilities, and their unique needs with respect to telecommunications services. The Commission considers that market forces alone may not be sufficient to protect the interests of these customers".[20]

The Commission proceeded to address the interests of consumers making rules associated with incumbent local telephone companies (ILECs) in markets where regulation of local services had been forborne. Of particular significance, for the purpose of this proceeding, was the treatment of stand- alone primary exchange service (PES) for the residential customer.

> The Commission considers it important to ensure that the affordability of essential basic residential PES not be compromised in a forborne market. The Commission is concerned that vulnerable and uncontested residential consumers may not have access to stand-alone PES at affordable rates in a forborne environment without a pricing safeguard.
>
> In light of these concerns, the Commission considers that a ceiling on residential stand-alone PES would be appropriate. The Commission considers that such a ceiling would provide vulnerable and uncontested customers with a safeguard against unreasonable rate increases in a forborne

[20] CRTC Telecom Decision 2006-15, para 355

> environment while only minimally limiting the ILECs' pricing flexibility in forborne markets.[21]

The price ceiling was the last regulated price before the imposition of forbearance. In this way, the Commission sought to ensure that competitive markets would not worsen the position of the ordinary consumer as market forces replace regulation in the local services market. Other protections were implemented touching on other matters such as customer privacy rights, disconnection policies and obligations such as access to emergency and disabled services common to all LECs.

In the event that the Board chooses to forbear in all or any part of the storage market, the provision of a similar package of protections, as outlined above would be particularly important. As Mr. McKeown has confirmed, before forbearance can be granted, the CRTC requires confirmation of rivalrous behavior, frequently through price reductions of the subject service. (Tr. Vol 7, p.155) In the case of regulated storage, no such pattern of price reductions has been observed, in fact, there is evidence that the current market would set a much higher price. There is thus increased justification for imposition of a framework on any storage regulatory forbearance that protects consumers in a similar fashion from economic detriment.

5. Implications of the ATCO Decision

In the course of the oral hearing, the issue of the relevance of the Supreme Court of Canada decision in the *ATCO Gas and Pipelines Ltd. v. Alberta (Energy &*

[21] Ibid at paras 451 and 452

Utilities Board) [22]to the regulatory treatment of the storage assets of Union was raised by Chairman Kaiser. (Tr. Vol. 3 p.174). Union counsel responded (Tr. Vol. 4. pp 1-7) by reviewing selected passages from the case and stating:

> "I expect we will argue this in a more fulsome way and probably a more subtle way at the end of this hearing, but my submission is that those are the basic principles. The utility owns the assets, not the ratepayers.
>
> There were comments in the earlier cases that Mr. Janigan referred to yesterday by Union witnesses that are inconsistent with these conclusions. I think to some extent you have to put the issue in context. At that time, the issue was whether or not the premium would go to infranchise or ex-franchise customers, and the argument was in favour of infranchise; but, rightly or wrongly, those statements were made at a time prior to ATCO and ATCO now has, in my submission, pretty much settled the law in this area."

In Union's argument, it is noted that:

> "The ATCO case confirmed that ratepayers have no claim to utility assets or to the revenues associated with those assets, once the assets are no longer required for regulated service."

Implicit in the Enbridge request for forbearance from regulatory oversight concerning transactional storage services, is the contention that the presence of transactional storage services competition can trigger a Board decision that insulates the utility from accounting for these rate base assets. Enbridge wishes to use the assets acquired through customer rates not to the fullest and best use for the benefit of the utility but rather to the benefit of the shareholder.

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[22] [2006] S.C.J. No. 4

The *ATCO* decision concerned the proceeds of sale of property that was specified to be no longer used or useful for the provision of utility services and whose sale would not cause harm to the ratepayers. The plain facts concerning the state of the storage assets in play for which forbearance is sought in this proceeding, negates a finding that the LDCs are in the same position as ATCO was in dealing with the proceeds of the property sale. More importantly, there is clear financial harm to the interests of the ratepayers through the loss of some 45 million dollars associated with the Union storage market premium, and the loss of 4-5 million dollars of Enbridge TS revenues (Undertaking K6.1).

The LDCs position glosses over the importance of the discretion of the Board to set just and reasonable rates. This exercise involves a balancing of the interests of the interests of the customers with the necessity to ensure that the regulated entity is allowed to make sufficient revenues to finance the costs of its services. [23] It is a broad power that requires a weighing of a large number of interlocking and interacting considerations[24] including the objectives of the *Ontario Energy Board Act*[25] (the *"Act"*). In particular the statutory Board objective contained in sec. 2. of the Act is instructive in relation to the balancing of concerns associated with the setting of rates:

> "2. To protect the interests of consumers with respect to prices and the reliability and quality of gas service"

For the Board to proceed to set rates for in franchise customers by acceding to the forbearance proposals put forward by the LDCs in this case would essentially comprehend an appropriation of rate base assets and associated revenues to the

[23] *Bell Canada v. Canada (C.R.T.C.)* [1989] 1 S.C.R. 1722
[24] Allstream Corp. v. Bell Canada [2005] F.C.J. No. 1237 paras 26-34 (C..A.)
[25] *The Ontario Energy Board Act 1998*,S.O. 1998 as amended

credit of the shareholder with the assurance of additional financial burdens being borne by customers who paid for the acquisition of the assets with their rates. It is difficult to advance a reasonable scenario where the Board acting pursuant to its statutory authority to set just and reasonable rates and in compliance with the objective of protection of consumer interests could set rates while being indifferent to the unfairness of the LDCs proposal ostensibly triggered by competition.

The *Duquesne Light* case, a decision of the Supreme Court of the United States is also insightful as to the breadth of the powers of utility regulatory tribunals to set just and reasonable rates.[26] The utility was seeking to overturn a utility commission ruling that denied recovery of expenditures for cancelled plants that had been previously ruled prudent. The majority judgment noted that it was the fairness of the result that was important in setting rates not simply the application of an economic theory:

> Similarly, an otherwise reasonable rate is not subject to constitutional attack by questioning the theoretical consistency of the method that produced it. "It is not theory, but the impact of the rate order which counts." Hope, 320 U.S., at 602 . The economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result. The Constitution is not designed to arbitrate these economic niceties. Errors to the detriment of one party may well be canceled out by countervailing errors or allowances in another part of the rate proceeding. The Constitution protects the utility from the net effect of the rate order on its property. Inconsistencies in one aspect of the methodology have no constitutional effect on the utility's

[26] *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989)

property if they are compensated by countervailing factors in some other aspect. [27]

The application of the principles set out in the cases cited above requires that the Board not be ambivalent to the net effect of the LDC forbearance proposals. Competition is not the equivalent of pixie dust transforming rate base assets into potential plunder for the utility shareholder. The granting of any forbearance would require conditions to enable the setting of just and reasonable rates that avoid the imposition of financial burdens on consumers for the enrichment of the shareholders. The recent *ATCO* case put no gloss on the requirement of the Board to ensure just and reasonable rates. The appropriation of revenues in the manner set out in the proposals of the LDCs must not succeed not because of a property right of ratepayers in the storage assets but because of the principle of regulatory fairness.

6. S&T Deferral Account Proposals and Other Issues

a) Union's S&T Proposals

Union proposes to eliminate two storage-related S&T deferral accounts, the Long Term Peak Storage and the Short Term Storage and Balancing Services accounts, and to cease sharing any of the forecasted revenues from the assets underpinning these accounts with ratepayers: the evidence is that this proposal will impact ratepayers adversely by $44.5 million. As such, VECC opposes the proposal to cease sharing as, in VECC's view:

[27] It is to be noted that the Court also gave short shrift to the principle that fairness in rate setting required a market value approach to compensating the utility for the value of the services provided.

- in the aggregate, a $44.5 million ratepayer hit is highly material;
- the assets underpinning both accounts have been developed under the mutually beneficial regulatory compact;
- the assets underpinning the latter account are included in rate base; as such, they have been and continue to be substantiated by ratepayers in terms of supporting the costs and providing an ROE on the assets. Any "extracurricular" benefits generated by such assets should not be appropriated entirely for the benefit of the utility.

VECC would find it acceptable to eliminate the Long Term Storage account, on the proviso that the forecast revenues generated be used to offset the revenue requirement, since the revenues should be easy to forecast accurately, based as they are on long-term contractual relationships.
Regarding the second storage-related account, VECC is not convinced that Union can accurately forecast the margins and therefore VECC's view is that it should be maintained.

Union also proposes to eliminate three transportation-related S&T deferral accounts, the Transportation Exchange Services, Other S&T Services, and Other Direct Purchase Services accounts. Union would however include the forecasted revenues as a credit against the revenue requirement. Although VECC agrees that the revenues should be credited against the revenue requirement, VECC notes that (i) there have been concerns regarding Union's ability to forecast these amounts accurately, and (ii) even if Union is able to forecast these amounts accurately, the utility has a financial incentive to underforecast these amounts. As such, VECC urges that these accounts be maintained.

b) EGD's TS Proposals

VECC understands that EGD proposes to eliminate all of its ex-franchise accounts and simply appropriate the entire amount for its own benefit. Unlike Union, the assets supporting EGD's services are all included in rate base. For the reasons given immediately above and earlier, VECC opposes EGD's proposal and urges the Board to maintain the status quo with respect to EGD's TS activities.

c) Other Issues

Both Union and EGD have made proposals to offer new services for gas-fired generators (and other similar customers) e.g., high deliverability services, at "market rates." VECC submits that, to the extent possible, these in-franchise customers, similar to other in-franchise customers, should be served at regulated rates that are cost-based, subject to the rates covering incremental costs caused by the new demands along with a reasonable contribution to the system.

7. Costs

VECC requests a cost award to reimburse 100% of its costs of participation in the within hearing. VECC submits that it has been responsible in its intervention and has worked with other intervenors and Board staff to attempt to reduce duplication of effort and reduce its own costs and those associated with the proceeding.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 28th day of August 2006.

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