EB-2005-0551

ONTARIO ENERGY BOARD

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.

Final Argument of The Board Hearing Team

August 28, 2006

Introduction

The Board Hearing Team ("BHT") will be making submissions on Issue II (Storage) only.

In preparing this Argument, the BHT was guided by the following core objectives:

- To facilitate an open and competitive market;
- To create an environment that is conducive to investment in natural gas storage in Ontario; and
- To ensure that the public interest was met.

The central issue which has emerged from the extensive evidence given concerning the state of the gas storage market in Ontario is whether the primary and secondary markets provide product alternatives to natural gas storage services offered by Union Gas Limited ("Union") and Enbridge Gas Distribution Inc. ("Enbridge") within the geographic market, such that the Board can find there is competition sufficient to protect the public interest and should forbear in whole or in part from regulating the gas storage market in Ontario.

When considering the evidence provided and evaluating the public interest issues raised by that evidence, the BHT was mindful of section 2 of the *Ontario Energy Board Act, 1998* which enumerates various objectives which guides the Board. Of particular relevance are sections 2.2, 2.4 and 2.5.1:

The Board, in carrying out its responsibilities under this or any other Act in relation to gas, shall be guided by the following objectives:

1. To facilitate competition in the sale of gas to users.
2. To protect the interests of consumers with respect to prices and the reliability and quality of gas service.
3. To facilitate rational expansion of transmission and distribution systems.
4. To facilitate rational development and safe operation of gas storage.
5. To promote energy conservation and energy efficiency in a manner consistent with the policies of the Government of Ontario.

5.1 To facilitate the maintenance of a financially viable gas industry for the transmission, distribution and storage of gas.

In coming to its recommendations, the BHT assessed the evidence as it evolved during the course of the hearing, the objectives enunciated by the Legislature in section 2, and the steps that might be taken to foster competition in both the in- and ex-franchise markets. The position ultimately taken by the BHT reflects the evidence as a whole.

Summary of BHT's recommendations

A summary of the BHT's recommendations on key issues related to storage are as follows:

- To ensure consistent treatment of customers across all gas utility franchises in Ontario, 'in-franchise' and 'ex-franchise' should be replaced by a 'core' and 'non-core' re-classification, and a process of election should replace location within a franchise area as the means of determining the pricing regime for storage services;
- Core customers would receive services from the gas utility at regulated rates. These customers would include all end-use customers in the

province of Ontario that take bundled or unbundled regulated services from the gas utilities, including customers within the City of Kingston and Enbridge's franchise area. Non-core customers would include customers that have opted out of the regulated rate protection and take the total risk of their total portfolio management, including storage. Non-core customers would include marketers and out-of-province Local Distribution Companies ("LDCs").

- Storage services provided to non-core/ex-franchise customers should be provided at market prices, subject to certain conditions, as there is sufficient evidence for the Panel to find that a competitive market exists sufficient to protect the public interest, and to forbear regulating the sale of storage to non-core/ex-franchise customers in Ontario;
- As a result of complete forbearance of the non-core/ex-franchise market, the BHT believes that rates should be adjusted, subject to certain conditions, to exclude all storage costs and revenues associated with non-core/ex-franchise storage sales from the determination of the 2007 rates; and that storage related deferral accounts should be eliminated;
- To encourage third-party storage developers to enter the Ontario market, the BHT agrees that the storage allocation for core/in-franchise customers for both Union and Enbridge should be frozen as of January 1, 2007;
- Storage services provided to core/in-franchise customers should remain at regulated rates, as there is not sufficient evidence for the Panel to find that a competitive market exists sufficient to protect the public interest;
- To ensure a competitive storage market in Ontario, the BHT is recommending that the Board implement a number of conditions to create a level playing field for market participants, protect the public interest and promote market transparency. Prior to full implementation of these conditions, the BHT recommends that Union continues to charge market-based rates for storage services to non-core/ex-franchise customers; and

- Some of the recommendations made by the BHT may require significant changes, and implementation will likely occur over a period of time.

Brief Overview of the Analytical Framework

The Panel will recall that there was extensive evidence given concerning the analytical framework to be applied when evaluating whether the natural gas storage market in Ontario is competitive. The BHT filed a brief[1] which contained the Canadian and American framework—tab 1 of that brief contains the Merger Enforcement Guidelines issued by the Competition Bureau Canada ("the Bureau"), referred to throughout this hearing as the MEGs, and tab 2 holds the FERC equivalent, which was referred to as the 1996 Policy Statement. It was common ground between the parties that the anti-trust principles and framework reflected in those documents were similar, and to a large degree, interchangeable. The application of the framework in the Canadian context is reflected in the CRTC series of cases referred to in the report of View Communications Inc.[2] ; the application of the framework in the American context is reflected in a number of FERC cases which were filed, notably the Red Lake and Northwest Natural Gas Company cases found at tabs 3, 4 and 5 of the BHT's Brief of Documents.

The steps to be taken in the analysis are:

- The definition of the product, and of specific importance in this case, the identification of product alternatives which provide customers of the product being sold (in this case, physical gas storage) with a choice of other products comparable in price, quality and availability;
- The definition of the geographic market, the boundaries of which are set by the existence of product alternatives and their sellers;
- A calculation of market share and market concentration of the seller of the product and all those who sell alternatives (note that in Canada the

[1] Ex. J.1.2
[2] EGDI, Ex. 3, Tab 2, Sch.1

emphasis is upon market share, which is the four-firm concentration while in the US, the emphasis is upon market concentration which is the HHI);

- The market share and market concentration is not definitive—other factors are to be considered before a finding of market power is made; and
- Other factors to be examined include: the extent to which foreign products or competitors provide or are likely to provide effective competition; whether acceptable substitutes are likely to be available; the existence of any barriers to entry into the market and any other factor relevant to competition such as vertical market power issues.

As stated at the outset, the focus of this hearing was upon whether the primary and secondary markets provide product alternatives to the gas storage products offered by Union and Enbridge within the geographic market sufficient that the Board should forbear in whole or in part from regulating the gas storage market in Ontario.

When evaluating the evidence concerning the product alternatives in the market, it is the position of the BHT that a key element of the analytical framework to be kept in mind is buyer behaviour.[3] On this issue the MEGs provide clear direction that buyers' behaviour should be considered when defining the product market, whether or not reliable statistical evidence on demand elasticity's[4] are available. Indirect evidence of substitutability, including evidence from market participants, and the views, strategies and behaviour of buyers in the past should also be considered. [5]

[3] 5 TR. 153   "An alternative is not an alternative unless perceived to be one by a buyer."
[4] Elasticity is a measure of responsiveness. For example, the elasticity of demand tells us how much the quantity demanded changes when the price changes. The elasticity of demand measures the responsiveness of quantity demanded to changes in the price charged.
[5] MEGs, paras. 3.12, 3.14, 3.20, 3.21

Market Power Issues: Non-Core/Ex-Franchise Customers

In considering product alternatives, the Bureau believes that products can be viewed as product alternatives when buyers purchase these products in the marketplace. In this hearing, the evidence regarding buyer behaviour was a central concern. In an exchange with counsel for the Board Support Team, the expert for the BHT stated that to alleviate her concerns with regard to the secondary market, there needed to be sufficient evidence that Ontario storage users used the secondary market to find alternatives to Ontario storage.[6] The BHT believes such evidence is also necessary when looking at the primary market.

In the opinion of the BHT, there was sufficient evidence in the non-core/ex-franchise market to demonstrate that these buyers considered product alternatives to be available to them in and outside Ontario, and in both the primary and secondary markets.

The gas utilities and Market Hub Partners Canada ("MHP Canada"), in their respective arguments, provided an extensive review of the evidence filed on this point, and it is not the intention of the BHT to do the same. What the BHT will do is focus upon the evidence concerning buyers' behaviour that has caused the BHT to accept that product alternatives exist and are purchased in the primary and secondary markets, and conclude that the Board should forbear from regulating all aspects of the sale of natural gas storage in the non-core/ex-franchise market.

With regard to product alternatives available outside of Ontario, there was evidence that the gas utilities and the marketers purchased storage in New York and Michigan[7], and that at least one of the marketers had firm transportation on

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[6] 9 Tr. 107

[7] McConihe Report, May 1, 2006, p. 22. Ex. X.2.1. See also Union Reply, Ex. D. Tab 2, pp. 2-10. GD and Coral Energy have contracted for storage at Stagecoach, N.Y.; Nexen, Union and BP Canada have

Vector to move gas from Michigan to Dawn[8]. This point was expanded in Union's Argument[9] by stating that the natural gas marketers hold significant amounts of natural gas pipeline and storage capacity in the geographic market.

Therefore, it is clear that Michigan storage, and to a lesser extent that in New York, is viewed by non-core/ex-franchise customers as an attractive, available and accessible alternative to Ontario storage by market participants.

Moving to the evidence regarding the intersection between the primary and secondary markets, there were two key fact witnesses. Gaz Métro Limited Partnership ("GMI"), the largest non-core/ex-franchise customer of Union[10], provided a buyer's perspective while BP Canada ("BP"), provided both a buyer and a seller's perspective.

There was direct evidence from GMI concerning its on-going use of the primary and secondary markets to secure competitive prices with its preferred supplier, Union. A vocal and vehement supporter of market rates specifically, and competition generally, GMI gave the following evidence:

- GMI tests the primary and secondary markets each and every time it negotiates with Union by looking at alternatives in the markets and what Union provides is competitive with those alternatives.[11]
- While there are not "a whole group of alternatives", there are alternatives and it takes more than one phone call to canvas those alternatives.[12]

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contracted for firm storage at Washington 10, Michigan; and Nexen, Coral, and BP Canada have contracted for firm storage at ANR, Michigan.
8 Union Reply, Ex. D, Tab 2, Table 1, p. 5
9 Ex. Y2, p. 11
10 Union Undertaking 47, GMI, July 13, 2006, vol. 10, p. 63, ls. 14-23. GMI is 28.27% and EGDI is 26.54% of Union's ex-franchise load.
11 10 Tr. 78-79
12 10 Tr. 104, 111

- The secondary market alternatives are provided by marketers such as BP Canada, Nexen and Coral. The price they provide is fairly reliable, and during negotiations, GMI has asked marketers to commit to a price for several weeks, which they have done.[13]
- If GMI couldn't purchase Union storage in the primary market it would, in Ms. Brochu's words, "fall back on a whole melting pot of solutions"which would include exchanges at Dawn, transportation, and probably some Michigan based options through a third party that would have transportation on Vector.[14]
- It is GMI's experience that the secondary market can supply what a buyer wants. Citing Ms. Brochu again in response to a question by Mr. Kaiser: "here are many people who have capacities on Vector right now who are interested in marketing a product… if you ask for a certain type of delivery service over a certain period of time, you will find people interested in doing that. And that's how we benchmark our friends at Union."[15]
- The secondary market is not necessarily more expensive than the primary market. Using a marketer who provides services out of a portfolio of assets, which may include delivery from Michigan for example, will not necessarily result in the passing along to the consumer all of the costs. And that is because the delivery service contracted for by one buyer may be a small part of a greater transaction, thus lowering the costs for that buyer.[16]
- The secondary market has grown and evolved. GMI gave evidence on the growth in the secondary market from the time they first used a marketer in 1994 to the present date. A summary of the evidence on that

[13] 10 Tr. 116
[14] 10 Tr. 77
[15] 10 Tr. 85-86
[16] 10 Tr. 86-87

point is that the market has more sellers, there are more products to buy and the products are more sophisticated.[17]

- The markets provide the discipline that keeps the ceiling on prices. GMI gave evidence that there was a price ceiling beyond which it would not go. In response to questions posed by Mr. Thompson, Ms. Brochu stated: “the ceiling that Union can charge to a long-term customer for storage is the transportation costs. The date the storage costs goes beyond transportation storage costs, we move the gas from the West, and we will sell…capacity in the summer. And that has a price, but that will be to me the ceiling of what Union can push the envelope to.”[18]

From this evidence it is clear that GMI looks at a number of alternatives in both the primary and secondary markets as a key part of its business strategy when dealing with Union, either when negotiating a price or when determining whether to accept a price. It is buyer behaviour that is predicated on the existence of viable alternatives that provide choice.

BP provided evidence concerning the products offered by marketers and its use of the primary and secondary markets to acquire assets and provide buyers with products. The key points are as follows:

- BP holds transportation and storage accounts, in its own name and under management for third parties, in both Michigan and Ontario. BP has successfully bought and sold those services. They buy and sell gas along Vector, Great Lakes, ANR, Union and TCPL systems to create opportunities.[19]
- BP has pipeline capacity in and out of Dawn, and buys and sells gas at Dawn to meet their obligations. [20]

[17] 10 Tr. 117
[18] 10 Tr. 90-94
[19] 13 Tr. 23, also 29
[20] 13 Tr. 29

- BP is a major player at Dawn in the origination or marketing business, where they sell to industrial end-users and LDCs. Top competitors are Coral, Nexen, ConocoPhilips and Seminole. [21]
- Marketers such as BP offer commodity sales of natural gas (baseload, spot or peaking); financial services; transportation services (such as swaps or exchanges between two points); park and loans (short-term lending or borrowing of gas to balance daily accounts); and delivery and re-delivery services.[22]
- BP offers a delivery/re-delivery contract that it believes displaces a firm physical storage contract with Union by using its own assets, pipeline capacity in and out of Dawn, and out of jurisdiction storage. BP states that to an end-user, the substitution of BP's product for storage makes no discernible difference.[23]
- All prices in the secondary market are negotiable, and a marketer may over, under or fully recover the full cost of the asset or service.[24]
- In Mr. Acker's opinion the secondary market is competitive and relatively liquid.[25] In support of that opinion, he told the Panel that BP had been beaten on numerous occasions by other buyers and sellers of services in the secondary market, and had at other times enjoyed considerable success.
- Mr. Acker also advised there were alternatives to Union's storage, at better prices. He told the Panel that BP bid unsuccessfully several times in the recent past in Union open seasons for storage service at Dawn. BP was able to acquire service that provided almost identical capability at a lower price.[26]

[21] 13 Tr. 39-40
[22] 13 Tr. 20-21
[23] 13 Tr.13, 21.22; also 49-50
[24] 13 Tr. 24
[25] 13 Tr. 16
[26] 13 Tr. 60-61

When the evidence of GMI and BP are considered in conjunction with the evidence filed by Union and Enbridge concerning the use of Michigan and New York storage, it is clear that sufficient evidence exists of buyers seeking and finding alternatives to Union's storage outside of Ontario in both the primary and secondary markets, and that a finding of competition sufficient to protect the public interest can be made with regard to the non-core/ex-franchise market.

Implications: Non-core/Ex-franchise Customers

The BHT has concluded that the non-core/ex-franchise market is competitive sufficient to protect the public interest and as a result, the Board should forbear[27] from the regulation of natural gas storage in this market. Since gas utilities' shareholders will be bearing the risk associated with storage transactions in the non-core/ex-franchise market, it is the BHT's position that any premiums or shortfalls in excess of or under costs should accrue to the shareholder. This will help to move the market towards a level playing field by eliminating the cross-subsidization between the core and non-core/in- and ex-franchise markets.

Accordingly, the BHT recommends that the Board should allow Union and Enbridge to: (i) adjust rates, effective January 1, 2007, to exclude all storage costs, revenues and rate base (when applicable) associated with non-core/ex-franchise storage sales from the determination of the 2007 rates; and (ii) eliminate any storage related deferral accounts.

In order to prospectively implement forbearance related to the ex-franchise market, Union proposes to fix the allocation of storage capacity allocated to in-franchise customers effective January 1, 2007. New storage capacity required

[27] OEB would still retain authority with respect to environmental, safety, licensing and permitting of natural gas storage in Ontario.

for the ex-franchise market will be developed or acquired outside of regulation.[28] Similarly, since Enbridge currently has one ex-franchise customer [29], its proposal also amounts to freezing the allocation of in-franchise customers effective January 1, 2007. Enbridge also proposed that the regulated rolled-in storage rate include the price of standard storage services developed or procured from third-party service providers to meet the needs of existing and new in-franchise customers.[30]

The BHT supports both Union and Enbridge's proposals since it would promote storage development, and provide third-party storage developers the opportunity to compete to serve the incremental needs of core and non-core/in- and ex-franchise customers. Further, a claw back of the capacity presently available to the non-core/ex-franchise market would be counter to the development of new product alternatives for core and non-core /in- and ex-franchise customers.

On the aspect of cost allocation, Union argues that there is no need for another proceeding to determine the allocation of costs and revenues associated with ex-franchise storage sales on the ground that Union has been allocating storage costs between in- and ex-franchise customers for some time.[31] Enbridge proposes that the costs and revenue forecast be dealt with in its next rate case.[32]

The BHT believes that under a forbearance scenario, it is paramount that the allocation of revenue and costs relating to non-core/ex-franchise storage sales be examined to ensure that there is no cross-subsidization between regulated and non-regulated storage services. If the Board orders forbearance in the non-core/ex-franchise market there will be no further opportunity to review the cost

[28] Ex. C, Tab 1, p. 3
[29] 6 Tr. 29
[30] 6 Tr. 26
[31] 4 Tr. 110
[32] Ex. Y, Tab 1, p. 20

allocation methodologies. It is the BHT's position and recommendation that such an examination should occur in a generic review.

Transactional Storage Services

The objective of transactional services is to make additional use in off-peak periods of the physical and contractual storage and transportation assets acquired primarily to serve in-franchise customers. While transactional services net revenues were originally fully credited to the ratepayers, the proceeds are presently shared between ratepayers and shareholders.[33]

Enbridge and Union are seeking approval from the Board to forbear from regulating Transactional Storage Services. The rationale advanced by the utilities is that these services are provided to ex-franchise customers in a competitive marketplace, and that the current sharing mechanism "effectively charges in-franchise customers less than cost-based rates for storage services", thereby hindering the development of new storage in Ontario.[34] It is the position of Enbridge and Union that the current sharing mechanism should end, and "all revenues, relevant costs, net income, and risks associated with this activity should be excluded from the Board's rate making process."[35] This proposal would eliminate the forecast of the Transactional Storage Services margin currently embedded in delivery rates, and discontinue the sharing of any deferred Storage Transactional Services margin captured in the utilities' respective variance accounts.

As previously indicated, the BHT has concluded that the market for non-core/ex-franchise storage sales is workably competitive. That would include both short-

[33] J6.1, para. 3.3.2
[34] Ex. C, Tab 1, p. 14
[35] Ex. C, Tab 1, Sch. 1, para. 28

and long-term storage services provided to non-core/ex-franchise customers. Consequently, the forecast margin associated with the additional use of the physical and contractual assets "reserved" for core/in-franchise customers should no longer accrue to ratepayers, and storage transactional services deferral accounts should be eliminated.

While the BHT agrees that the physical and contractual storage assets were acquired to meet the needs of bundled core/in-franchise customers, the BHT is of the position that bundled core/in-franchise customers are not entitled to these assets per se. Rather, these customers receive storage services from the utilities' contracting or developing and operating storage facilities to meet their storage requirements (based on the excess over average storage allocation methodology). In addition, the recovery of fixed storage costs for most bundled service customers is currently done through variable storage or delivery charges. In other words, most core/in-franchise bundled service customers pay for storage services rendered based on their usage.

<u>Elimination of Transportation Service Deferral Accounts</u>

Union is proposing the elimination of its transactional transportation deferral accounts (179-69, 179-73, and 179-74) effective January 1, 2007. The rationale advanced by Union is that:

- There is no reason to treat these revenues (margins) any differently than any other revenues;
- The revenue derived from these services can be forecast as accurately as any other revenue; and

- The elimination of these deferral accounts is consistent with the Board's policy direction as outlined in the Board's Natural Gas Forum ("NGF") Report dated March 30, 2005. [36]

The BHT agrees with Union's proposal. Since Transactional Transportation Services are part of the gas utility's monopoly service, the BHT concludes that Transactional Transportation Services revenue should not be treated any differently, from a ratemaking perspective, than any other regulated revenue. Under the current regulatory regime, forecast revenue act as an offset to the revenue requirement, and there are no variance accounts to capture variances relative to forecast. The utilities thus bear the risk of any under earnings, and can reap the benefits of over earnings. This treatment would also be consistent with the Board's view that "an appropriate balance of risk and reward in an IR framework will result in reduced reliance on deferral or variances accounts".[37]

Market Power Issues - Core/in-franchise Customers

As stated previously, it is the BHT's position that storage services provided to core/in-franchise customers should remain at regulated rates and should continue to be regulated by the Board, as there is not sufficient evidence for the Panel to find that a competitive market exists sufficient to protect the public interest.

In contrast to the gas commodity market, where the end-use customers have different suppliers to choose from (the gas utility or gas marketers), customer choice does not exist for the end-use customer in the storage market. As Mr. Grant put it "there aren't a lot of people banging on people's doors in the

[36] Ex. Y2, p. 21
[37] NGF Report dated March 30, 2005, p. 31

residences, making a lot of storage offerings at the burner tip”. [38] The BHT believes that customer choice is an essential component of a competitive market.

In arriving at its position the BHT analyzed the documentary and oral evidence. As with the non-core/ex-franchise market, the BHT looked at the evidence concerning buyer behaviour and the existence of a workably competitive market. It should be noted that current in-franchise storage requirements represent 83 Bcf or 55% of Union’s total storage requirements and virtually all of Enbridge’s storage capacity.

Starting with the utilities:

- **Union** gave evidence that as of the date of the hearing, in-franchise customers could choose from bundled, semi-bundled or unbundled delivery service options;
- Most end-use customers have elected bundled or semi-bundled services;
- Although unbundled services have been available to contract customers since 2001 and retail customers since 2003, most have chosen to bundle their storage services with distribution and transmission services;
- Mr. Baker gave evidence at the hearing that it was Union’s position that the “in-franchise market is, at this point in time, not workably competitive due to the in-franchise customers predominantly exercising their choice to elect a bundled gas delivery service option whereby storage is bundled with monopoly distribution and transmission services”.[39]

[38] 7 Tr. 24
[39] 1 Tr. 63 and 64

- **Enbridge** gave similar evidence regarding the preferences exhibited by its in-franchise customers. Only one customer has chosen to unbundle storage; all others have chosen a bundled service.[40]
- The lack of evidence of product alternatives in the in-franchise market was discussed in Enbridge's cross examination. Mr. Grant stated that Enbridge would seek market prices for in-franchise customers when "a situation where the market had been – where we had unbundled rates for some period of time, that there was a lot of choice that people were making in the market to go from bundled to unbundled, where we saw a clear drive on the part of end-use consumers to – toward a fully competitive market at the burner tip".[41]
- That is not the current market; repeating Mr. Grant's words: "there aren't a lot of people banging on people's doors in the residences, making a lot of storage offerings at the burner tip."[42]
- The expert for Enbridge, Richard Smead, agreed that storage services at the burner tip offered by the incumbent distributors in the geographic market do not constitute a workably competitive market.[43]

Additional evidence on this issue is found in the identity of the Canadian customers who had storage contracts in Michigan and New York. Given that the great majority of end-use customers in Ontario have chosen the bundled service option, it is not surprising that the evidence revealed the Canadian customers with storage contracts in Michigan and New York are exclusively Ontario gas utilities and marketers.[44] This evidence confirms that no core/in-franchise customers are using these primary market product alternatives in Michigan and/or New York as a substitute for Union or Enbridge storage.

[40] Enbridge, Ex. E, Tab 1, Sch. 1, p. 9, paras. 24, 26
[41] 6 Tr. 83
[42] 7 Tr. 24
[43] 7 Tr. 35
[44] Reply to Intervenors Evidence, Bruce M. McConihe, May 26, 2006, p. 10 of 14

Finally, the evidence concerning core/in-franchise buyer behaviour in the secondary market was supplied by Mr. Acker of BP. As you will recall, the majority of BP's business in Ontario is the sale of the natural gas commodity. BP also sells a delivery/re-delivery service which it considers to be a product alternative to storage. Mr. Acker said: "…I have never been approached, nor have I found any, in-franchise end use customer who is interested in purchasing storage services from the secondary market."[45] As Mr. Reed agreed, a storage substitute is only a substitute if customers perceive it to be a substitute.[46]

The BHT concludes that there is no evidence that the primary and/or secondary markets provide end-use customers with competitive storage alternatives in the marketplace. The only evidence of parties purchasing product alternatives in the primary or secondary market are gas utilities and marketers.

The BHT is supporting the position taken by Enbridge and Union in their filed and oral evidence that there is a lack of competitive storage offerings for core/in-franchise customers and as a result, this market is not workably competitive.[47]

Implications: Core/in-franchise Customers

Union proposed that any incremental in-franchise storage service requirements, beyond those identified for the purpose of determining 2007 cost of service rates (based on the aggregate excess methodology), be met through Union acquiring incremental assets or services at market prices.[48] To the extent that additional storage space is required, the cost of storage for all in-franchise customers will

[45] BP, July 19, 2006, vol. 13, p. 75, ls. 20-25
[46] 5 Tr. 153
[47] MHP Canada and Mr. Reed did not conduct an analysis as to whether there is sufficient competition for bundled sales service (5 Tr. 33).
[48] Union Reply, Ex. C, Tab 1, p. 16

be a blend of cost-based and market prices leading, perhaps, to a more efficient use of storage by those customers.[49]

Similarly, Enbridge proposed that the regulated storage rate be rolled-in and include the price of standard storage services developed or procured from third-party service providers to meet the needs of existing and new in-franchise customers.[50]

The BHT supports the gas utilities' proposal. This means that base deliverability storage (e.g., 1.2 %, racheted) would be provided at regulated rates for all core/in-franchise customers. Storage requirements in excess of the aggregate excess space allocation methodology and/or 1.2% deliverability would be provided at market prices on a user pay basis.

Union stated that it would purchase additional in-franchise requirements in the marketplace through a Request for Proposal process rather than developing its own storage or "clawing back" its ex-franchise contracts. Enbridge has stated that it will either procure storage capacity through a market tender or develop its own storage space. Both Union[51] and Enbridge[52] recognized that the Board should take an active role in reviewing these processes.

The BHT also agrees that the Board should conduct a prudence review for gas utilities purchasing or developing regulated storage services to ensure that the outcome is fair and reasonable. This prudence review process could be either pre-approved or occur after the fact. The BHT believes that a review after the fact would suffice. The Board could also establish a blanket approval process for

[49] EEA/Schwindt Reply evidence, Ex. D, Tab 3, p.9 and 33; 4 Tr. 125
[50] 6 Tr. 26
[51] 3 Tr. 147
[52] 7 Tr. 24

storage services under a specific threshold (in terms of capacity, length and/or contract value).

With respect to the rate making implications of forbearance in the non-core/ex-franchise market, Union estimated in its final submission in the NGF Forum that the move to market-based prices for in- and ex-franchise storage sales would cost a typical residential customer less than $15 per year.[53] Since this figure depicts the rate making implications for all storage sales, and given that the ex-franchise market accounts for 45% of Union's market, it would appear that a phase-in period is not warranted.

Re-Classification of Customers: Core and Non-Core Customers

In its RP-1999-0017 Decision with Reasons, the Board allowed Union to renew storage contracts originally at cost-based rates, at market-based rates. As a consequence, gas customers in Kingston now pay market-based rates for storage, and customers in Union's areas are the substantial beneficiaries of this policy. While Enbridge's existing storage contract with Union is based on cost-of-service rates, a new contract effective in 2006 charges market-based rates for this storage. While these measures were in part implemented to encourage storage development, the Board, in its NGF Report dated March 30, 2005, went on to say that "there is an issue as to whether the current pricing structure for storage is inappropriately discriminatory".[54]

The BHT is concerned that under the current policy, a residential customer located in Union's franchise area pays a subsidized regulated rate for storage, while a residential customer located in Kingston will be subject to market-based

[53] NGF, Union's Final Submission, p. 60
[54] NGF Report, p. 46

rates for the same service. Similarly, a residential customer in Enbridge's franchise area would pay a blend of market-based and cost-based rates.

As a matter of principle and policy, the BHT is of the view that location within the province should not dictate the pricing regime under which customers will be charged for storage services. Rather, end-users within the province should be subject to the same pricing regime. Price differentiation should be driven by consumers' load profile and characteristics, and the utilities' specific costs.

In order to remedy this issue, the BHT recommends that customers be split into two groups: core and non-core customers. This classification would replace the current in- and ex-franchise customer classification.[55] Core customers would receive services from the gas utility at regulated rates. These customers would include all end-use customers in the province of Ontario that take bundled or unbundled regulated services from the gas utilities, including customers within the City of Kingston and Enbridge's franchise area. Non-core customers would include customers that have opted out of the regulated rate protection and take the total risk of their total portfolio management, including storage. Non-core customers would also include marketers and out-of-province LDCs. This separation would ensure a consistent treatment of customers across all gas utility franchises in Ontario.

Implications: Re-classification

End-use customers located in the City of Kingston would be charged cost-based rates for their storage capacity requirements as of January 1, 2007, as determined by the aggregate excess methodology. Similarly, the existing storage contracts between Union and Enbridge would be renewed under cost-

[55] This structure has been adopted by the California Pubic Service Commission as outlined in Appendix C of BHT's May 1, 2006 filed evidence and Mr. Reed's testimony on June 27 and June 29, 2006.

based rates, and that capacity would continue to be priced under cost-based rates until the market for core/in-franchise storage is deemed to be workably competitive in Ontario. The same would apply to the contract between Union and Kingston Public Utilities Commission.

Additional storage requirements for core/in-franchise customers post January 1, 2007 would be sold at a blend of cost-based and market prices.

Conditions of Forbearance

To ensure a vibrant competitive storage market in Ontario, the Board should be governed by the following principles:

1. Create a level playing field for market participants;
2. Adopt rules and practices to govern affiliate behaviour that protect the public interest;
3. Support open and non-discriminatory access to transmission; and
4. Establish a transparent storage/transmission market so market participants can make informed decisions.

The application of these principles will enhance the storage market for all market participants by removing market barriers to encourage new entrants into the Ontario storage market, and create an environment which will encourage end-use customers to purchase unbundled storage and ultimately enter into the marketplace for storage services.

The BHT believes that the creation of a level playing field, ensuring non-discriminatory access to transmission, and establishing a transparent storage/transmission market should be achieved before the Board forbears from storage regulation in the non-core/ex-franchise market.

To achieve those goals the BHT recommends that the Board implement certain conditions, which will be discussed in detail shortly.

Create a level playing field

In its final submission during the Natural Gas Forum, the Bureau stated that the "removal of the ability and incentive to use access to monopoly functions to harm competition in competitive markets is most clearly achieved by structurally separating monopoly functions from competitive ones. However, where there are substantial costs associated with such separation, alternative measures may be considered such as enforceable chinese walls, ring fencing, and codes of conduct".[56]

The Board indicated in its NGF Report that "utility control of most of the key infrastructure surrounding the Dawn Hub and the lack of transparency in gas transportation system operations function raise the question of whether the systems operations function of Union is non-discriminatory or whether unbundling these operations from the utility would be desirable."[57]

Union owns both gas storage and transmission. This integrated structure creates an opportunity for the storage and transmission service provider to slow down the process of providing a new storage provider an interconnection and thus the ability to reach its customers in a timely fashion. Also, it allows Union access to

[56] Ontario Energy Board Natural Gas Forum Consultation on the Ontario's Natural Gas Market (RP-2004-0213): Final Submission of the Commissioner of Competition.
[57] NGF Report, March 30 2005, p. 49

customer and market information that is not available to other market participants, information that can be used to enhance its position in the market.[58]

Under Union's and Enbridge's proposals, both the regulated and competitive storage operations would reside together within the utility. This type of structure could lead to cross-subsidization between regulated and non-regulated services, and, again, it allows the gas utilities to have access to privileged customer information that is not available to other market participants.

As stated previously, the BHT believes it is essential to create a level playing field for competition especially if the Board decides to forebear from rate regulating approximately half of Union's storage capacity.

To achieve the goal of a level playing field, the BHT recommends that the transmission facilities owned by Union should be functionally separated from its storage operations. Union and Enbridge should also separate their regulated and competitive storage services. Both of these separations would protect access to privileged customer information and minimize the potential for cross-subsidization between regulated and non-regulated functions. This in turn would also ensure the continued development of a competitive storage market and provide encouragement to third-party entrants.

In its argument, Union indicated that "there is no evidence that there have been any problems with respect to the integrated nature of Union's storage, transmission and distribution business to date".[59] The BHT submits that currently there are no independent storage providers currently operating other

[58] BHT Report, May 1, 2006, pp. 28-29
[59] Ex. Y2, p. 20

than Enbridge connected to Union's transmission system. It is therefore not surprising that there have been no issues to date in that regard. In addition, Union and Enbridge are currently the only storage providers operating in Ontario.

Union also stated that the costs to functionally separate storage from transmission and distribution would be significant, and any benefits are unknown. Moreover, there are other ways of addressing these concerns such as codes of conduct, oversight and complaints mechanisms.[60] While the BHT acknowledges that the benefits and costs of a functional separation are difficult to quantify, it is the BHT's position that the Board should be guided by the competition principles previously outlined in this section. It should also be noted that these principles are the foundation of the objectives set forth in the Board's Affiliate Relationships Code for Gas Utilities ("ARC"). As the Bureau recognizes, the most effective safeguard to anti-competitive activity is to separate competitive and monopoly services. These separations would establish "market access that allows all existing and potential competitors to succeed or fail based on their ability to provide products that meet customer tastes and needs at the lowest cost."[61]

Union has suggested that these concerns can be addressed through voluntary codes of conduct which rely upon internal policing to ensure compliance. It is the BHT's position that compliance can only be ensured through a mandatory and enforceable rule, such as an amended ARC.

As a result, the BHT believes that the best course of action is for the Board to order the functional separation of Union's transmission system from its storage

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[60] Ibid.
[61] Ontario Energy Board Natural Gas Forum Consultation on the Ontario's Natural Gas Market (RP-2004-0213): Final Submission of the Commissioner of Competition.

operations; and the functional separation of the regulated and competitive storage services for both gas utilities.

Rules and practices to govern affiliate behaviour

The principal objectives of the Board's ARC are to enhance a competitive market while, at a minimum, keeping ratepayers unharmed by the actions of gas distributors, transmitters and storage companies with respect to dealing with affiliates.[62] The current ARC focuses on gas utilities and their affiliated energy service provider which in turn is defined as "a person, other than a utility, involved in the supply of electricity or gas or related activities, including retailing of electricity, marketing of natural gas…and energy management services."

The BHT believes that the ARC should be amended to reflect the evolving competitive environment and its many market participants. Therefore, the BHT recommends that the scope of the ARC be expanded to address:

- The functional separation of regulated and non-regulated storage activities for both Union and Enbridge;
- The functional separation of Union's transmission and storage activities; and
- The interaction between incumbent gas utilities and their affiliate storage providers.

These recommendations would ensure that the amended ARC:

- Minimizes the potential of cross-subsidization between regulated and competitive services within a utility;
- Prevents the exchange of vital customer and market information between these broad and diverse groups; and
- Ensures there is no preferential access to regulated utility services.

[62] ARC, section 1.1

The BHT recognizes that these proposed amendments to the ARC would be dealt with through the Board's Notice and Comment process such that all interested stakeholders can participate. The BHT is accordingly requesting from this Panel a directive to initiate such a review of the ARC. In the course of that review process, the BHT recommends that the gas utilities submit an implementation plan that could include timing, the functions to be separated, and all the necessary protocols between these functions for Board approval.

In addition, both the BHT and MHP Canada[63] agree that the Board should adopt a system whereby customers can register a complaint, if they think they have been harmed by anti-competitive behaviour. For instance, if a potential storage developer encounters difficultly in accessing the transmission system, the Board could review the issue and determine if the customer was unduly discriminated by the transmission provider to block his competitive entry into the market.

Open and non-discriminatory access to transmission

It is essential that transmission services be provided on an open access and non-discriminatory basis to prevent any gaming of the gas infrastructure. This means that the transmission provider (i.e., Union) must accept requests for transmission services on the system in a non-discriminatory manner, with no preference given to its energy affiliates. As the Commissioner of Competition stated in her final submission at the Natural Gas Forum: "a regime of non-discriminatory access to essential facilities is essential…".[64]

[63] Evidence of Market Hub Partners Canada L.P., May 1, 2006
[64] Ontario Energy Board Natural Gas Forum Consultation on the Ontario's Natural Gas Market (RP-2004-0213): Final Submission of the Commissioner of Competition.

One way to demonstrate non-discriminatory access to new transmission capacity would be to hold a fair and transparent open season. Typically, an open season includes fair notice and information on procedures for the allocation of capacity; anticipated constraints, if a constraint is expected; and the criteria for and timing of any open seasons.[65] The BHT acknowledges the Settlement Agreement of NGEIR Issue III between Union Gas and various intervenors, as part of the EB-2005-0520 proceeding which requires all of the above information save for the provision of the criteria. On a going forward basis, the BHT suggests that the requirements of future open seasons include the listing of the criteria.

The City of Kitchener suggested the Board use its rulemaking powers to develop and implement a storage and transportation access rule ("STAR") to remove the potential for anti-competitive behaviour. Among other things, the STAR could contain the rules and information requirements for an open season in both transmission and storage services. The BHT supports the creation of a STAR.

Transparent storage/transmission market

The competitiveness of the market would be facilitated by transparency of market information to all market participants. It is essential that there is on-going transparency in the marketplace for both transmission and gas storage services. This will allow market participants to have better information with which to make decisions concerning how to manage their gas portfolios.

Union has agreed to provide much of the information which will assist in creating transparency for market participants. In the course of the hearing, Union gave an undertaking to review FERC Regulation 284 which outlines customer and system

[65] TC, May 16, 2006, pages 182-183 and APPENDIX IIIA, Prepared Direct Testimony of J. Stephen Gaske, On Behalf of TransCanada PipeLines Limited outlined the necessary information for open seasons to eliminate uncertainty in the marketplace.

information which must be filed, and to advise whether Union would be prepared to file such information if forbearance was granted. Union responded by way of answer to Undertaking K.3.3, and indicated that if forbearance was granted, they were prepared to provide most of the information required by FERC. The information to be posted on Union's website would include an index of customers. That index could include: shipper/storage customer; contract number; contract effective date and termination date; and transportation/storage-maximum daily quantity.

Also, Union would be prepared to file with the Board an annual filing of the estimate of peak day transportation, storage capacity and maximum daily delivery capability; and a semi-annual storage report providing information on storage and withdrawals for each customer.

The BHT agrees that Union and Enbridge should not be required to post commercially sensitive information.

In addition, the BHT believes that all storage and transmission providers should be required to report the quantity and availability of storage/transmission capacity on their website or other publicly available forum on a timely basis. Currently, Union indicates on its website the overall system status using a 'stop light' or a 'green light' as a visual signal only. However, the BHT considers capacity/system information necessary so market participants can make informed decisions regarding their gas portfolios. This information will also eliminate uncertainty in the marketplace.

On a matter that is related to the education of the consumer and transparency of information, the bills for Union's bundled service customers separately identifies the charges for distribution, transportation, and storage services. Enbridge currently does not have separate charges for these services. In order to promote price discovery, and to assist in educating consumers about the products they purchase, the BHT recommends that Enbridge be directed to educate customers about these separate charges. This could be done, for example, through a breakdown of charges on the bill, through a mailing insert or a posting on the website.

Finally, the BHT recommends that the Board conduct a review five years after the implementation of market prices in the non-core/ex-franchise storage market to ensure that market is open and competitive, and to assess whether new product alternatives have entered the Ontario market which are being accessed by end-use customers as a substitute for Union or Enbridge storage.

Implementation of conditions

With regard to the timing of the implementation of the conditions, it is difficult to provide a timeline given the BHT's limited knowledge of the operational logistics involved. The BHT suggests that the utilities and other storage service providers are best suited to provide a time estimate for implementation. Prior to full implementation, the BHT recommends that Union continues to charge market-based rates for storage services to non-core customers. Once the implementation is complete, the Board should forbear from rate regulating the sale of storage to non-core customers.

BHT Position on MHP's Request for an Expedited Decision on Its Core Points

MHP has asked for an expedited decision on what it calls its 'Core Points'. The Core Points require the following findings from the Board:

- MHP cannot exercise market power;
- MHP should be granted authority to charge market based rates for its services, as would independent storage developers; and
- MHP should be allowed flexibility to contract for services without requiring approval of individual contracts, provided that MHP operates within a base set of service terms and conditions approved by the Board.[66]

With regard to the Core Points, MHP takes the position it is a new market entrant, and 'but for' its status as an affiliate, no application for market based rates would be necessary. Similarly, 'but for' its position as an affiliate of Union, there would be no question that it could not exercise market power.

While Mr. Smith urges the Panel to view MHP as if it was not an affiliate of Union, it is the BHT's position that MHP's status as an affiliate colours any resolution of the Core Points and the request for an expedited decision. Put simply, it is not possible for a decision to be made concerning MHP without regard to the fact that it is inextricably tied to Union and what Mr. Redford refers to as the 'Duke family'.[67]

The closeness of that relationship was illustrated in Mr. Moran's cross examination of Mr. Redford in which it was established that there are eight individual service agreements through which Duke Energy affiliates, including Union, provide day to day operations support to MHP for matters such as legal services, human resource services and what Mr. Redford termed 'shared core corporate services' along with agreements for storage and transmission operations.[68]

[66] Ex. Y4, p. 28
[67] 5 Tr. 69
[68] Ibid., pp. 66-69

The BHT also points out that generally anti-trust authorities regard affiliated companies as one company for the purpose of competition analysis. As Mr. Reed stated, for the purposes of market concentration analyzes, affiliates are included in calculating market shares and levels of competition.[69]

It is the position of the BHT that because of MHP's status as an affiliate of Union, a decision on the Core Points is in effect a decision on the merits of Union's position. It is for that reason that the BHT takes the position that an expedited decision is not appropriate.

Conclusions

The BHT's answers to the questions posed in Procedural Order #2 concerning Issue II (Storage) are as follows:

Should the Board refrain, in whole or part, from exercising its power to regulate the rates charged fro the storage of gas in Ontario? In making this determination, the Board will have regard to a number of considerations including:

Do gas utilities (and/or their affiliates) either collectively or individually have market power in the provision of storage services for all or some categories of customers in Ontario?

Storage services provided to non-core customers should be provided at market prices, subject to certain conditions, as there is sufficient evidence for the Panel to find that a competitive market exists sufficient to protect the public interest, and to forbear regulating the sale of storage to non-core customers in Ontario.

[69] Technical Conference, May 18, 2006, p. 57

Storage services provided to core customers should remain at regulated rates, as there is not sufficient evidence for the Panel to find that a competitive market exists sufficient to protect the public interest.

If gas utilities (and/or their affiliates) do have market power in storage, is it appropriate for them to charge 'market rates' for transactional and long-term storage services?

Not applicable.

If gas utilities (and/or their affiliates) do not have market power, is it in the public interest that all or some customers continue to pay storage rates at cost as opposed to market rates? How should the extra revenue from storage services at market rates be allocated?

As a result of complete forbearance of the non-core market, the BHT believes that rates should be adjusted to exclude all storage costs and revenues associated with non-core storage sales from the determination of the 2007 rates; and that storage related deferral accounts should be eliminated.

If the Board determines, based on considerations of market power and the public interest more generally, that some customers should pay for storage services at cost and others should pay for storage services at market prices, how should the line be drawn between the two types of customers and specifically, should there be a constraining allocation of physical storage facilities to some types of customers based on measures such as aggregate excess or whether customers are considered 'in-franchise' or 'ex-franchise'? How should the extra revenue from storage services at market rates be allocated?

The BHT recommends that customers be split into two groups: core and non-core customers as discussed in the Re-classification of Customers section.

The BHT believes core customers should receive an allocation of storage space as of January 1, 2007, in accordance with the aggregate excess methodology. Additional storage requirements for core customers post January 1, 2007 would be sold at a blend of cost-based and market prices.

Storage services provided to non-core customers should be provided at market prices, subject to certain conditions.

With regard to the 'extra' revenue from storage services, it is the position of the BHT that since the utilities shareholders will be bearing the risk associated with storage transactions in the non-core market, any premiums or shortfalls in excess of or under costs should accrue to the shareholder.