EB-2005-0551

THE ONTARIO ENERGY BOARD

IN THE MATTER OF the Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Schedule B;

AND 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;

WRITTEN ARGUMENT

OF THE CONSUMERS COUNCIL OF CANADA

I – INTRODUCTION

1. This is the argument of the Consumers Council of Canada ("Council") in the Natural Gas Electricity Interface Review ("NGEIR") proceeding.

2. The Council participated in the alternate dispute resolution process, and is a signatory to the settlement agreement.

3. The Council represents the interests of the broad spectrum of residential consumers of natural gas in Ontario. This argument will, therefore, focus on the issues in the NGEIR proceeding relevant to the interests of residential consumers.

4. The relief sought by the two Utilities, Union Gas Limited ("Union") and Enbridge Gas Distribution Inc. ("EGD") (collectively the "Utilities") would, if granted, have little or no impact on the availability or cost of storage in the ex-franchise market in Ontario. It would confer no benefit on residential consumers. It would, however, adversely affect the interests of residential consumers by increasing their distribution rates. The only beneficiaries would be the shareholders of the Utilities, who would benefit from the transfer of money to them from

ratepayers. Given that, it is the Council's position that the relief requested by the Utilities should be denied.

5. This argument is divided into the following sections:

(1) An analysis of the issue of who bears the onus of proof;

(2) A description of the existing regulatory structure for storage;

(3) An analysis of the proposals of the two Utilities with respect to forbearance from regulation;

(4) An analysis of the arguments of the two Utilities with respect to the change in the treatment of revenue from the sale of storage services, including Transactional Services (TS);

(5) The relief requested by the Council.

II — THE ONUS OF PROOF

6. The threshold question is which party, or perhaps more accurately which interest, bears the onus of proof in the proceeding.

7. The Board has constituted this proceeding under s. 29 of the *Ontario Energy Board Act ("Act")* which provides as follows:

> On an application or in a proceeding, the Board shall make a determination to refrain, in whole or part, from exercising in the power or performing in the 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.

8. The fundamental requirement is a factual one: someone must demonstrate that, as a matter of fact, storage will be subject to competition sufficient to protect the public interest. It is the Utilities that bear the onus of proving those things.

9. It is also the case that the question of forbearance does not arise in a vacuum. The Board has created the existing structure for the regulation of storage based on its understanding of the relevant facts and on its presumption of how the public interest is to be protected. The Council's position is that those who propose a change in the status quo bear the onus of showing why it does not protect the public interest and why an alternative arrangement, in this case

forbearing in whole or in part from regulation, would better protect the public interest. The burden of demonstrating that the existing arrangement should change falls on the Utilities, which are the principal proponents of change and the sole beneficiaries of it.

10. Reduced to the most basic terms, the objective of forbearance is to confer the benefits of competition on ratepayers. After forebearance, Consumers should have prices for storage which are at or close to the just and reasonable rates paid under regulation. The evidence establishes that ratepayers will get no benefits from forbearance; on the contrary, they will suffer adverse consequences, in the form of rate increases, if the relief which the Utilities ask for is granted. The Council submits that those considerations also dictate that those who propose forbearance from regulation should bear the onus of proof.

11. Union, in its Written Argument, takes the position that the current practice is that storage services to ex-franchise customers are sold at market rates, and that it is not proposing any change to that, and that, therefore, it does not bear the onus of proof. **[Union Argument, p. 6].**

12. There is, of course, a certain irony in Union's Argument on this point. If the present arrangements are satisfactory, and Union is not seeking to change them, then the relief Union seeks need not be granted. The reality is that Union does seek several forms of relief that, if granted would change the present arrangements. And because Union does seek those changes, it, and EGD, should bear the onus of proof.

13. It is also the case that not all of the relief sought by the Utilities relates to, or flows from, a decision by the Board under s. 29 of the *Act.* There is arguably no link, for example, between the Utilities' proposals to change the arrangements for the allocation of Transactional Services ("TS") revenues and an order under s. 29 of the *Act.* In the case of that relief, the Utilities must demonstrate that the rates resulting from the granting of the relief they seek will be just and reasonable.

14. The question, then, is the nature of the onus which the Utilities bear. We submit it is the following:

(1) With respect to the s. 29 of the *Act* relief, namely forbearance from regulation, the Utilities must prove not only that the wholesale market in storage is competitive, but that the competition is sufficient to protect the public interest. The public interest, in this context, is the interest of all of the consumers of natural gas in Ontario;

(2) With respect to the relief unrelated to s. 29 of the *Act,* namely the relief dealing with the treatment of revenues from the sale of storage services, and TS, the utility must prove that the rate changes which result from the granting of the relief will be just and reasonable.

15. An additional consideration, affecting the nature of the onus which the Utilities bear, is the Board's obligation, set out in section 2 of the *Act*, to protect the interests of consumers with respect to prices and their reliability and quality of gas service. The Council submits that, if the granting of some or all of the relief requested by the utility results in material increases in the prices which consumers must pay, without offsetting benefits in the form of the prospect of corresponding decreases in prices, then the Board should deny that relief. The Utilities bear the onus of demonstrating that granting their relief will not result in material increases in the rates paid by consumers.

III -THE EXISTING REGULATORY STRUCTURE FOR STORAGE

16. Union owns the lion's share of the existing storage capacity in Ontario. Of the 163 Bcf of storage capacity it owns, approximately 91.5 Bcf is for in-franchise customers, with the balance used for ex-franchise customers.

17. By contrast, all of the storage capacity owned by EGD, some 91 Bcf, is, subject to certain exceptions, used for its in-franchise customers. EGD acquires 20 Bcf from Union. Until the spring of 2006, EGD acquired that additional 20 Bcf at Union's cost based rates. Under a new contract, EGD will pay a market based rate. The Board is to address the new contract with Union in EGD's 2007 rate proceeding. The market based rate EGD is to pay Union represents an approximately 180% increase over Union's cost based rate. (Undertaking K.7.3).

18. The Board has, since 1996, allowed Union to sell storage to ex-franchise customers at "market" rates. As an ex-franchise customer, EGD must purchase storage from Union at those "market" rates.

19. Union's in-franchise customers pay a cost of service rate for storage. Subject to the Board's approval of the new agreement with Union, EGD's in-franchise customers will pay a blended rate, consisting of EGD's owned storage at a cost-of-service rate and the balance at a "market" rate. Other Utilities, for example, Kingston, purchase storage from Union, at the ex-franchise, or "market", rate.

20. The Board has, in its decision in the Tribute Resources Inc. application, allowed a new storage developer to sell its storage capacity at what amounts to a market rate.

21. From time-to-time, EGD has storage capacity which is excess to its needs. It sells that excess capacity and related services to customers at market rates. Those rates are what generates TS revenue for EGD

22. Union generates revenues from the sale of storage capacity and related assets which may, from time to time, be excess to the needs of their in-franchise customers, to ex-franchise customers. This revenue is in two categories. The first is revenue from long-term storage contracts. The second is revenue from the sale, on short-term arrangements, of storage capacity and related assets which may, from time-to-time, be excess to the needs of its in-franchise customers. Revenue in this latter category will be referred to herein as TS revenue.

23. The excess revenue, that is the difference between the cost of storage and the price at which it is sold to ex-franchise customers, is shared with ratepayers. The proposal to allocate some or all of the premium to in-franchise customers was originally made by Union, in E.E.R.O. 486-02. The sharing of the excess revenue has been agreed to, by both Utilities and their ratepayers, in a series of settlement agreements in rate cases following the decision in that case. Part of the rationale for allowing Union to charge a market rate was to encourage Union to maximize the value of its storage assets for the benefit of its ratepayers. In all cases the Board has approved the sharing mechanisms as an appropriate way to compensate the ratepayers for the use of assets that are used and useful and which are wholly integrated with other utility assets. The Board's position on this issue was expressed in its Decision Reasons in RP-1999-0017 as follows:

> The Board recognizes that the assets necessary to provide both transactional services and long-term storage services have been paid for by Union's customers. Providing that the Company has a

> financial incentive to maximize revenues for these services should increase the benefits to both the customer and the shareholder. Consequently the Board authorizes a sharing of net revenues for transactional services and market premium for a long-term storage services in the ratio of 75:25 between ratepayer and shareholder as an incentive to maximize the revenue associated with both these services.
>
> **[Decision with Reasons, RP-1999-0017, Section 2.505]**

24. It is also important to recognize that the Board's decision to allow market, or "value of service", rates to be charged for storage sold to the ex-franchise market was not premised on any market power analysis, or any finding that the Utilities lack market power, or any finding that the Board can safely forbear from regulating storage in general.

25. EGD's assertion, at page 20 of its Written Argument, that "The fact that those particular business activities have been conducted for many years at market prices in a competitive market at Dawn...makes it abundantly clear that this class of products or services is subject to competition sufficient to protect the public interest" is, with respect, simply wrong. That those services have been sold by the Utilities at market prices is a function of the Board's desire that the Utilities should maximize the revenue from those assets, for the benefit of its ratepayers, and does not reflect any finding by the Board that the market is competitive. In addition, the fact that the Utilities charge a market rate does not imply that the market is in fact competitive, let alone sufficiently competitive to protect the public interest. EGD simply asserts as fact that which it must prove.

26. It is also the case that the distinction between the treatment of in-franchise and ex-franchise customers was not based on any analysis of whether the distinction was based on rational principles or resulted in the fair and equitable treatment of similarly situated customers.

27. The Board, in its report on the Natural Gas Forum, noted that the current situation for storage in Ontario had a number of benefits, as follows:

(1) there is ample storage capacity available to support the seasonal load-balancing needs of Ontario customers and to provide the additional services that had lead to the development of Dawn as a gas-trading hub;

(2) recent and new investment by Utilities has added 21 Bcf of storage in Ontario, with a further 6 Bcf proposed by independent storage operators;

(3) COS-based prices for in-franchise customers ensure that most Ontario gas customers benefit from low-cost storage;

(4) Ontario customers served by Union benefit as well from the sale of excess storage at market rates.

["Report of the Ontario Energy Board Natural Gas Forum", March 30, 2005, p. 46]

28. To this list of benefits flowing from the existing regulatory framework for storage, could be added the following:

(1) Since residential consumers can only purchase storage as part of a bundled service from their distribution utility, paying a regulated cost of service rate for storage protects them from the potential abuses of monopoly pricing;

(2) The sharing of revenue from the sale of storage capacity to ex-franchise customers provides an incentive to Union, and to a lesser extent to EGD, to fully utilize their storage capacity and to develop new storage;

(3) The sharing of revenue from the sale of storage capacity to ex-franchise customers allows ratepayers to benefit from the use of assets which remain used and useful;

(4) Allowing new storage developers to sell their storage capacity at market rates provides an incentive for the development of storage.

29. The Board, again in its Report from the Natural Gas Forum, acknowledges that the existing arrangement "imposes certain tradeoffs that benefit some customers more than others". The Board pointed to the fact that in-franchise customers of Enbridge must pay more for storage than to the in-franchise customers of Union, and that customers in Union's franchise area are, to use the words of the Board, "the substantial beneficiaries of this policy". The Board summed up its concern with the existing storage arrangements by saying that "there is an issue as to whether the current pricing structure for storage is inappropriately discriminatory".

["Report of the Ontario Energy Board Natural Gas Forum", March 30, 2005, p. 46]

30. The Board's concern, expressed in its Natural Gas Forum Report, for the discriminatory effect of the existing storage arrangements, was a major driver for its constituting the NGEIR proceeding. One of the ironies of the NGEIR proceeding, however, is that both Utilities have proposed that their in-franchise customers continue to pay cost-of-service rates for

storage, and thus continue the discriminatory arrangements that the Board cited in the Natural Gas Forum report. To put the matter another way, one of the principal reasons for constituting the NGEIR proceeding has effectively been eliminated by the Utilities with their proposal to continue the distinction between the treatment of in-franchise and ex-franchise customers.

31. It is important to note that the position which Union takes, with respect to the competitiveness of the market for storage in Ontario, in this case, differs from the position it took in the Natural Gas form. In its Report in that matter, the Board noted that "In its final submission, Union argued that all storage in Ontario should be priced at market rates".

["Report of the Ontario Energy Board Natural Gas Form", March 30, 2005, page 41]

32. Union's argument, in the Natural Gas Forum, that the entire storage market was competitive was based on essentially the same evidence from the same experts as Union relies on in this proceeding. That Union, and its experts, have so fundamentally changed their view of the Ontario storage market calls into question the credibility of their evidence, and the arguments that flow from it.

33. If the Utilities' proposals were adopted, the only certain beneficiaries would be the shareholders of the Utilities, because of the re-allocation of the TS and storage premium revenues. The re-allocation of those revenues would be a detriment to residential consumers, and would run contrary to the Board's objective, set out in s. 2 of the *Act,* to protect the interests of consumers with respect to prices. As set out in greater detail below, the Council will also argue that there are no benefits which flow to residential consumers from either forebearing from regulation, even on a limited scale, or from the re-allocation of TS and storage revenues.

34. One matter which the Board did not address in the NGF Report was the sharing of the market premium and revenue from TS. That it is an issue in the NGEIR proceeding is a result of its having been grafted on from the forum where it was, in the case of Union, first raised, namely the 2007 rates case. In the case of EGD, there has never been a proposal to end the sharing of TS revenue. The Council will argue, below, that the factors bearing on the proper resolution of this issue are different from, and so must be treated differently from, the s. 29 of the *Act* issues that are the central outgrowth of the NGF Report.

35. The arrangement today allows Union and EGD to charge market rates for the sale of excess storage capacity in certain markets. Under the Utilities' proposals in this proceeding, that would not change. All that forebearance would mean is that the Utilities would be allowed to transfer their revenue from the sale of that excess storage capacity from the ratepayers to their shareholders.

IV -THE UTILITIES' PROPOSALS TO FOREBEAR FROM REGULATION

36. Both the Union and EGD ask the Board to find that the ex-franchise wholesale storage market is competitive and that storage should be priced at market rates. They both ask, in other words, that the Board forebear from regulating the ex-franchise wholesale storage market.

37. However, both Union and EGD also propose that the existing arrangements for the in-franchise market continue and that the storage sold to in-franchise customers be at cost-based rates. Both Utilities take the position that the in-franchise market is not workably competitive because in-franchise customers must rely on bundled gas delivery whereby storage is bundled with monopoly distribution and transmission services.

38. In addition to asking the Board to forego from regulating storage in the ex-franchise market, Union is also asking the Board to fix the allocation of storage capacity allocated to in-franchise requirements, effective January 1, 2007. Any additional in-franchise requirements arising after allocation will be procured in the market. To the extent any more storage space is required, after the allocation is fixed, the cost of storage for all in-franchise customers will be a blend of cost of service and market prices.

39. EGD proposes a further exemption, in effect an exemption from the exemption. EGD seeks approval to charge new customers with what it describes as unique requirements at market rates. In practice what this exemption would allow EGD to do would be to charge gas-fired generators a market rate. In cross-examination, EGD conceded that this exemption would, as a practical matter, apply only to in-franchise gas-fired generators. **[TR7, page 107 following]**.

40. EGD argued that it was a matter of "regulatory principle" that new services to customers should be provided at market-based rates. **[Technical Conference Transcript, May**

19, 2006, page 11]. However, EGD also conceded that it did not, in any other case, distinguish among customers based on their particular needs. **[TR7, page 114]**. It would appear, thus, that EGD's "regulatory principle" is one which it does not itself follow.

41. In cross-examination about this proposal, EGD conceded that it does not differentiate among customers based on their unique requirements. In light of that, EGD's proposal for an "exemption from the exemption" amounts to nothing more than an attempt to extract more money from a particular class of customers.

42. Union's request that the Board fix the allocation of storage capacity allocated to in-franchise requirement will require the Board to regularly review and approve the split in rate base, costs and revenues. Union argues that this allocation will not impose an additional burden on the Board. It is the Council's position, however, that this allocation will add an additional regulatory burden.

43. Union argues that, since it is not proposing any fundamental change to the current regulatory framework as it relates to in-franchise services "the considerable time spent in these proceedings on in-franchise customers' options and the relationship between cost of service rates and market values for storage was therefore misdirected". **[Union Argument, page 3]**

44. That assertion ignores the fact that the Board is free to make whatever decision it feels is appropriate. The Board could, for example, decide that it should forebear from the regulation of storage for both in-franchise and ex-franchise consumers. As noted above, the Board's concern about the discriminatory effect of the distinction between the treatment of in-franchise and ex-franchise customer was a major driver for the creation of the NGEIR proceeding.

45. Were the Board to forbear from the regulation of storage for both in-franchise and ex-franchise customers, and thus permit both the Utilities to charge their in-franchise customers market rate, the impact on consumers would be the following:

(1) In the case of EGD, an increase in in-franchise rates of about $67.2 million **[TR7, page 13]**;

(2) In the case of Union, an increase in the in-franchise rates of about $56 million **[TR2, page 20]**.

These financial impacts would be in addition to the $44.5 million annual loss to ratepayers if Union's proposal to stop sharing surge premiums is accepted and the $6 million annual loss to EGD's ratepayers if EGD's proposal to stop sharing the revenue from TS services is accepted.

[TR6, p. 85; TR7, p. 1] and [Undertaking K.7.1]

46. Accordingly, the Council submits that it is neither idle nor "misdirected" to examine the potential impact on in-franchise residential consumers of a decision by the Board to completely forebear from regulating storage, including both in-franchise and ex-franchise customers.

47. The Council submits that the Board should not forebear from regulating storage with respect to in-franchise customers. Quite apart from the immediate, and dramatic, impact of such a decision on the prices paid by consumers, there is no evidence on which the Board can conclude that the market for storage services for in-franchise customers is competitive. There is no evidence to contradict assertions of Union and EGD that in-franchise customers purchase bundled services, that they depend on their distribution utility for storage, and that there are not alternatives to the distribution utility for the purchase of storage.

48. Even limiting the forbearance to ex-franchise customers, the proposals of both Union and EGD would, if approved, result in their in-franchise customers paying increasing amounts for storage to reflect market-based rates. This is the result of proposals, discussed below that would limit the number of in-franchise ratepayers paying the cost of based rates. Both Union and EGD suggest that this is an appropriate transitional step. For example, EGD, in its argument, states that its proposal that future increments as storage capacity and deliverability be at market prices for its in-franchise customers "produces a measured transition to the end state of full forbearance at the burner tip" **[EGD Written Argument, page 18]**. There is no evidence that there is competition for storage at the burner tip and no evidence that such competition is on its way. In the absence of such evidence, there is no basis on which the Board can conclude that there is a "transitional" state. The suggestion that there is a transitional state is, as Council submits, simply a cover for the real objective of the Utilities, which is to maximize the revenue from storage payable to their shareholders.

49. The Council submits that the Board should not approve Union's proposal to fix the allocation of storage capacity allocated to in-franchise customers. It is worth noting that, when Union first sought approval for range rates for long-term services, the Board acknowledged as legitimate the concern of residential consumers that ratepayers might suffer if it developed over time that there was insufficient storage left in Union's system to meet its in-franchise needs. The Board approved the rates, without requiring a right of recall in the storage contract, only because it was satisfied that Union's forecast of its in-franchise storage needs was reasonable.

[Decision with Reasons, EBRO 486-02, January 11, 1996, s. 2.2.14, 2.2.27 and 2.2.29]

50. The Council submits that the Board's reasoning in the EBRO 486-02 Decision reflects the view that storage for in-franchise customers should, wherever possible, be at cost-based rates. This view is consistent with the position taken by Union itself in this case, namely that there is no competition for in-franchise customers and so they should continue to pay cost-based rates. It is, the Council submits, contradictory to say that in-franchise customers do not have access to the competitive market and yet require them to pay market prices, in part, simply by reason of an arbitrary fixing of storage allocation.

51. The Council submits that Union should be required to make its storage available to all in-franchise customers at cost based rates until either it has more storage capacity or the Board determines that the market is sufficiently competitive, for all customers, to protect the public interest. Each time rates are re-based, the needs of Union's in-franchise customers and the storage allocation required to meet those needs should be reviewed.

52. The Utilities contend that they lack market power in relation to storage, and that the wholesale market for storage for ex-franchise customers is sufficiently competitive to protect the public interest and ask the Board to forbear from regulating that market. The basic framework in support of that proposition consists of the following:

(1) the relevant product market is underground storage;

(2) the relevant geographic market is not limited to Ontario, but consists as well of Michigan, Pennsylvania and New York;

(3) in that broader market the Utilities have a low market share;

(4) there is an active secondary market in storage;

(5) price comparisons at various points in that geographic market are evidenced that there is a competitive market in storage.

53. A number of groups representing the interest of consumers sponsor the evidence and the testimony of Mark Stauft. Mr. Stauft began his analysis of the storage market by observing that Union is able to extract a "market" price for its storage which is well above, indeed more than three times above, the cost based rates that would give Union a fair return on its invested capital. He concluded that that is itself evidence of market power.

[Exhibit X.8.1: page 33]

54. Mr. Stauft then addressed the framework of analysis for determining market power. Mr. Stauft agreed with the experts called by the Utilities on what that framework consists of. He disagreed, however, on the relevant evidence and the conclusions to be drawn from it.

55. In assessing whether the storage facilities areas around Ontario are viable competitive alternatives, Mr. Stauft begins with the following observation:

> In order for them to be viable competitive alternatives, i.e., alternatives whose existence will constrain any market prices charged by the Utility to Ontario customers to adjust any reasonable cost-base level, it must be shown to be available to Ontario consumers in sufficient quantities and at a sufficiently low price, and with sufficient reliability and quality, that they will prevent the Utilities from increasing their prices above their competitive level.

[Exhibit X.8.1: page 43]

56. Union's basic criticism of Mr. Stauft's evidence, and that of others, is that it "suffers from a lack of recognition of the integrated nature of natural gas markets in North America and the implications of this integration in identifying the relevant geographic market for Union storage services".

[Union Written Argument, page 14]

57. The Council submits that, to the contrary, the signal virtue of Mr. Stauft's evidence is that it is based on a realistic assessment of the nature and extent of that integration.

We submit that Mr. Stauft's basic assessment of the transportation infrastructure, essential to support the utility's view of the relevant geographic market, more accurately reflects the underlying reality. Mr. Stauft makes the following observations:

> For all market areas where storage is used to meet peak demand, the fact is that the transportation infrastructure has over time been designed and built for the purpose of accommodating required average and peak gas flows given the storage capacity that is available and the established pattern of use for that storage.
>
> **[Exhibit X.8.1, page 49]**
>
> The point is that the existing transportation infrastructure has not been designed and built for the purpose of transporting gas into and out of U.S. storage facilities from, or for the ultimate use in, Ontario, or for that matter, anywhere in Canada.
>
> **[Exhibit X.8.1., page 50]**
>
> The firms that design and build pipeline infrastructure do not purposely build such massive amounts of infrastructure purely in the hope that some day Ontario consumers might be motivated to use Michigan, New York, or Chicago storage facilities in preference to the ample amounts of Ontario storage that already exists.
>
> **[Exhibit X.8.1, page 50]**

58. The Council submits that it is the Utilities and their experts who distort the underlying reality of the market by arguing that gas can move freely, over amply available pipeline capacity, and at comparable prices among the facilities in the areas around Ontario.

59. Mr. Stauft's analysis of pipeline capacity is that there is not a significant amount of uncontracted for at transportation capacity. The real test of the availability of pipeline capacity, he suggests, is to ask what alternatives would be readily available, at reasonable cost, should Union decide to significantly increase the price of charges for storage. In those circumstances, people wanting alternative storage capacity in substantial volumes would have to have sufficient transportation capacity at competitive rates in order to move gas to and from more remote storage facilities. In those circumstances, Mr. Stauft argues, there would not be sufficient capacity to affect the Utilities pricing.

[TR9, page 163]

60. The Council submits that the analysis of Union's experts, EEA, of the relevant geographic market is fundamentally weakened by their failure to account for the necessary transportation capacity. They give no consideration to how much transportation capacity would be needed to discipline the Utilities' pricing behaviour. Also, they gave no consideration to how much transportation capacity there actually is, if any, and no consideration to how much of this alternative to storage and transportation, if it exists at all, costs and whether on a cost basis it would be an adequate substitute for utility storage.

[TR9, page 163]

61. Mr. Stauft also makes the point that it is unrealistic to assume that the storage facilities, particularly those of distribution Utilities, in the adjacent U.S. jurisdictions, have unlimited capacity available to Canadian customers. Mr. Stauft observes that "their storage facilities have been developed primarily for the purpose of serving their own in-franchise customers, and they are not free to sell that capacity to Ontario industrials, or Ontario marketers, and tell their own customers to go away and buy competitive storage from Union, for example".

[Exhibit X.8.1., page 54]

62. Mr. Stauft, using a test employed by the Federal Energy Regulatory Commission, states that "the relevant test for market power should be whether the utility in question will be able to increase its rates by something in the order of 10%, relative to its conventionally determined cost-based rates.

[Exhibit X.8.1., page 33]

63. He points out, however, that the identifiable costs of alternative storage capacity, in the areas around Ontario, is substantially higher than Union's costs.

[Exhibit X.8.1., page 58, as amended]

64. The conclusion to be drawn from that price comparison is that Union has sufficient market power to substantially increase its rates without losing any business.

65. Union and its experts also rely on the existence of what they claim is a viable "secondary" market as evidence that the storage market is sufficiently competitive to protect the public interest. At the same time, Union criticizes Mr. Stauft, among others, because "the role of commercial transactions collectively refer to as the 'secondary market' and other sources of capacity that connect storage facilities and provide competitive alternatives for storage services in Ontario have been almost entirely ignored". **[Union Written Argument, page 14]**.

66. Contrary to Union's argument, Mr. Stauft directly addresses the alleged relevance of the secondary market. The Council submits that, unlike Union and its experts, Mr. Stauft understands the basic function of that market and its limited significance, when he makes the following observation:

> ...it must be recognized that the main function of storage in Ontario is not to assist with the management of price risk, but simply to augment the delivery system via "seasonal load balancing". The product that end-use consumers need is annual, ever-greened firm load balancing services, which will enable them to balance the volumes they are obliged to deliver each and every day of the year with their end-use consumption. That product is not available from the substitutes that are used to hedge against price volatility...The portion of the overall set of storage customers for whom price hedging is the primary motivation for holding storage is likely a small fraction of the total, and on an aggregate basis the existence of "storage alternatives" of this nature would have no measurable effect on the prices charged by the Utilities if their storage rates were not regulated.
>
> **[Exhibit X.8.2., page 6]**

67. It is submitted that Mr. Stauft has a more realistic and credible view of what the "secondary market" is actually about than do the Utilities and their experts. Mr. Stauft's description of what the marketers do, and the limited significance of what they do, is accurately summarized in the following observation:

> Anyways, what marketers are able to do is, because they have economies of scope and scale, they are able to utilize existing transportation and storage infrastructure much more efficiently than an individual end user, for example, could.

> That doesn't mean, though, that they are able to move gas around the system by magic or by some kind of "Star Trek molecular teleportation device or anything like that.
>
> What they do and what they have to do is utilize the same basic infrastructure that is available to any other customers for the purpose of delivering gas to where it is needed in the market. **[TR9, page 169]**

68. It is, the Council submits, noteworthy that Mr. Stauft's description of the limited role that marketers play in the storage market is consistent with the evidence given by Ms. Worthy and to Mr. Acker on behalf of BP Canada. In cross-examination, those witnesses conceded that the majority of their business in Ontario is the sale of the gas commodity and that the sale of delivery/redelivery was not a major component of their services available in Ontario.

[TR13, page 51]

69. Those witnesses further conceded that those delivery/redelivery services may or may not actually involve physical storage at Dawn or physical storage at any other location, with the result that it is inappropriate and incorrect to refer to them as a storage service.

[TR13, page 73]

70. Finally, those witnesses conceded that they are limited in the services they can provide to, among other things, the transportation and storage infrastructure in place.

[TR 13, page 70]

71. Mr. Stauft summarized his view of the role of the secondary market in responding to the example, originally put to him by Mr. Brett in cross-examination, of certain purchases made by Centra Manitoba. Mr. Stauft made the following observations:

> What marketers and those types – the types of transactions we have been discussing – is make the market more efficient than it would otherwise be. It makes the utilization of the existing infrastructure higher, I would say, on average, and it sort of creates benefits for the market as a whole in that way.
>
> **[TR9, page 238]**

> But the point I did make with Mr. Brett is that the people that, the marketers that, are able to set that kind of thing up use, ultimately, the same physical infrastructure that the customers themselves would and have to pay the same costs. So they are not a discreet substitute for Union storage as against, you know, other physical substitutes. They are not a separate class of substitute for you Utilities storage.

[TR10, page 53]

72. Union's experts, in support of their analysis of the relevant geographic market, rely on an analysis of price relationships between various points on the existing pipeline in the existing pipeline infrastructure. They use this analysis in support of the proposition that there are no significant transportation constraints between the points within the suggested geographic market. Mr. Stauft, however, argues that that price analysis does not give "useful information about the cost of either firm storage or firm transportation services that may constitute competitive alternatives to Union storage".

[Exhibit X.8.2., page 16]

73. Mr. Stauft points out that that analysis is a little more than a snapshot indicating that, at the period of time that was studied "the existing pipeline infrastructure was large enough to accommodate the flows that the market wanted, that market forces were generating".

[TR9, page 167]

74. Mr. Stauft, also points out that the analysis does not allow any conclusion that the infrastructure could accommodate "anywhere near the amount of volumes that you would need to discipline the Utilities pricing behaviour" in the circumstance where, for example, Union increased significantly its storage rates.

[TR9, page 168]

75. Mr. Stauft concludes that the relevant geographic market is Ontario and that there is not sufficient competition in that market to protect the public interest. He also points out that "it is very unlikely that we will see competitive market entry on a scale that would have any effect on the pricing power of the utility".

[TR9, page 164]

76. In support of that, he asserts that "in order for there to be sufficient capacity to make alternative storage facilities in Michigan or Illinois viable as alternatives to Union, you would need massive amounts of new pipeline capacity going from Chicago or Michigan into Dawn".

[TR9, page 164]

77. Mr. Stauft asserts that no one is likely to make the investment in that new pipeline capacity because, he argues, "if your attempted market entry fails, then you have basically lost the entire investment that you have made in those pipeline facilities, which could be hundreds of millions of dollars. And that's why people don't do it".

[TR9, page 165]

78. The Council submits that Mr. Stauft's evidence presents a more realistic view of the operation of the storage market than does the evidence of Utilities and their experts. The Council submits that the evidence that Mr. Stauft demonstrates that there is not sufficient competition in storage to protect the public interest.

79. There is no evidence that forbearing from the regulation of storage for the ex-franchise market would have any benefit to Ontario consumers from new storage development. The Utilities failed to establish that transferring enormous amounts of money from their ratepayers to their shareholders would do anything to encourage new storage development. In addition, the evidence suggests that the opportunity for storage development in Ontario may be more limited than suggested during the Natural Gas Formal process. There is little or no evidence from storage developers or investors to the effect that forbearing from the regulation of storage would effect their decision to invest in new storage capacity. That is not at all surprising given the Board's recent decision to allow a new storage developer to charge market rates. Union has been willing and able to develop new storage capacity, in the form of enhancing its existing storage capacity, under the existing regulatory framework. **[Undertaking K 3.1]** EGD's position is that even if the Board were to remove the existing regulatory constraints, Enbridge would not necessarily enhance its existing storage facility.

[TR6, p. 87]

V -THE PROPOSED TREATMENT OF REVENUE FROM THE SALE OF STORAGE SERVICES

80. The existing arrangements for the treatment of the revenue from the sale of storage services was described in Section III of this Written Argument. The Utilities are seeking approval for three changes in those arrangements, as follows:

(a) EGD proposes to end all sharing of TS revenue and to eliminate the deferral accounts in which that revenue is recorded;

(b) Union proposes to fix the amount of revenue it receives from TS, and eliminate the deferral account which captures the excess of the revenue over that forecast. The result would be that the amount of revenue shared with ratepayers would be fixed, with all excess revenue going to Union's shareholder;

(c) Union proposes to end the sharing of the premium, from the sale of storage under long-term contracts, with ratepayers. It proposes, instead, that all revenues and costs associated with those contracts be born by its shareholder. If approved, this would result in the loss of approximately $44.5 million annually in revenue for ratepayers, based on Union's forecast of 2007 revenue.

We will deal with each of these requests for relief separately.

(a) EGD's proposal to end the sharing of TS revenue

81. EGD's TS revenue is derived from the use of assets which are, from time to time, not required to serve its distribution customers. Its forecast TS revenues, for 2006, are $10.7 million. Of that, approximately 60% is attributable to a sales storage service.

82. EGD conceded that there is no link historically between the sharing of TS revenue and whether there is a competitive market in storage.

[TR6, p. 73].

83. EGD seemed to be taking the position that it was only proposing to end the sharing of TS revenue because the Board put the issue in the Issues List in the NGEIR proceeding.

[Technical Conference Transcript, May 19, 2006, p. 27]

84. EGD conceded that the existence of a competitive market for storage was in fact a reason to have the sharing mechanism.

[TR6, p. 73; Technical Conference undertaking response 53]

85. In addition to conceding that the existence of a competitive market in storage may, historically, have been a reason for the sharing of TS revenue, EGD characterized the sharing arrangement as a "great success story".

[Technical Conference transcript, May 19, p. 29]

86. EGD's concern with the sharing arrangement was not with its underlying rationale, or indeed with the existing sharing arrangement itself, but with the fact that it was not getting enough money. In response to questions at the Technical Conference, Mr. Grant observed that "so I can't say the company's completely happy with the incentive arrangement that exists today. It is not. It is not rich enough. But by and large, as a regulatory mechanism, it has been a success for all involved".

[Technical Conference transcript, May 19, p. 57]

87. In support of its position, EGD argues that the Board has implicitly acknowledged that the sale of storage to ex-franchise customers is competitive. **[EGD Written Argument, page 20]**. As set out above, the Council submits that the Board has never, directly or by necessary implication, found that the ex-franchise storage market is competitive. In addition, what EGD does not account for, in advancing that argument, is that the Board has continued to require the sharing of TS revenue notwithstanding its implicit acknowledgement that the sale of storage to ex-franchise customers is competitive. EGD does not, in other words, account for the fact that the Board has already, by necessary implication, made a decision that the sharing of TS revenue should take place regardless of whether there is a competitive market for storage.

88. EGD conceded that it obtain its TS revenue from the use of utility assets which remain used and useful, and are an integral part of EGD's operating system. **[Transcript, Volume 7, page 34]**. EGD provided no satisfactory rationale for its requests to be allowed to end the sharing of TS revenue. Whether there is competition in the ex-franchise market, and whether the Board formally forebears from the regulation of storage in that market, are both

irrelevant to the question of whether EGD should be allowed to stop sharing TS revenue. Reduced to its essence, EGD's request for relief is simply an effort to enrich its shareholders at the expense of its ratepayers under the cover of a s. 29 of the *Act* analysis. EGD's request for this relief should be denied

89. Notwithstanding EGD's request that it be allowed to keep all of the storage revenue which it earns from TS, it wants the storage assets to remain within rate base. That proposal underscores the fundamentally contradictory nature of EGD's request for relief on this point. It also illustrates that the reality that EGD has no confidence that there is a competitive market for storage. EGD wants its ratepayers to continue to pay EGD a secure return on the assets, while denying the ratepayers the benefit of the use of those assets. EGD's proposal is, with respect, wrong-headed and should be rejected.

(b) Union's proposal to fix the amount of TS revenue

90. Union's proposal implicitly concedes that the underlying rationale for the sharing of TS revenue remains valid. It implicitly concedes, therefore, that whether the ex-franchise storage market is competitive is irrelevant and that a decision by the Board to forebear from regulation under s. 29 of the *Act* is irrelevant. Union's proposal also implicitly contradicts the rationale underlying EGD's proposal that it be allowed to keep all of its storage revenues from TS. Finally, it implicitly concedes that the decision of the Supreme Court of Canada in the ATCO case is irrelevant to the circumstances of the use of storage assets, which remain an integral part of the utility's operations, to generate revenue.

91. Accordingly, Council submits that Union's proposal must be evaluated using traditional cost-of-service criteria and, in particular, whether the rates which would result from accepting this proposal would be just and reasonable.

92. Historically, Union has underestimated its TS revenue.

93. The Council submits that if, as Union implicitly concedes, the sharing of TS revenue is acceptable, then it should be based on a reasonable forecast of actual revenue, with a mechanism to record amounts in excess of the forecast, as is now the case. If it is not based on a prudent forecast of revenue, and the sharing of revenues above the forecast, the resulting rates are neither just nor reasonable. Accordingly, the Council submits that the Board should deny

Union's requests to fix the amount of TS revenue and to end the deferral account. It is also the case that TS revenues have been difficult to forecast, with the result that a deferral account is essential to ensure that TS revenues are recorded and allocated fairly.

94. One of the arguments, advanced by Union, in support of its request that the deferral account be eliminated, is that the Board, in its Natural Gas Form Report, stated that it did not intend for earnings sharing mechanisms to form part of incentive regulation plans. The Council submits that the Board has not, and could not, make a decision on the form and content of any particular incentive regulation plan in the absence of evidence of what the plan should consist of.

(c) Union's proposal to end the sharing of the premium from the sale of storage under long-term contracts

95. In its Written Argument, Union advances two reasons why the sharing of the premium from the sale of storage under long-term contracts in the ex-franchise market should be eliminated.

96. The first reason is that, if the Board decides to forebear from regulation, all aspects of regulation should fall away, including the sharing of revenue from long-term storage contracts. The Council has, above, argued that Union has not made the case that the Board should forebear from regulation with respect to the ex-franchise market. However, even if the Board were to forebear the regulation of the ex-franchise storage market, Union's proposal is that the Board continue to regulate the in-franchise market for the protection of the interests of in-franchise customers. Accordingly, the Board is not, based on Union's proposal, forebearing from all regulation. If the Board chooses, as Union suggests it should, to regulate some aspects of storage, the Board could, and in the Council's view should, regulate other aspects of storage, including the allocation of this storage revenue. The Council submits that the protection of the interest of consumers with respect to prices requires that the revenue from the sale of storage under long-term contracts be shared with ratepayers.

97. Union argues that, once the Board finds that there is sufficient competition to protect the public interest, ex-franchise customers will pay market prices and "the risks or rewards associated with market prices are assumed by those who provide the services". [**Union Written Argument, page 3**]. In support of that proposition, Union relies on what it categorizes

as "Canadian legal principles as determined in *City of Calgargy v. Atco Gas and Pipelines Ltd.*" (the "**ATCO**" decision).

98. It is important to note that, on Union's argument, the Board does not have to consider the applicability of the ATCO decision unless it first finds that there is sufficient competition to protect the public interest. For the reasons set out above, the Council submits that the Board should not make that finding. Accordingly, the Council submits that the Board does not have to consider whether the ATCO decision applies.

99. However, the Council submits that the ATCO decision does not apply. The facts underlying the ATCO decision are fundamentally different from the facts in this proceeding. The starting point in the ATCO decision was the sale by utility of an asset which was surplus to its needs and, therefore, no longer an integral part of its operations. The Supreme Court of Canada framed the issue in the following words:

> Against this backdrop, the Court is being asked to determine whether the Board has the jurisdiction pursuant to an enabling statute to allocate a portion of a net gain on the sale of a now discarded utility asset to the rate-paying customers of the Utilities when approving the sale. (emphasis added) (*ATCO Gas & Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, [2001] S.C.R. 140, page 152.

100. Further, in reciting the facts the Court cited the evidence of ATCO to the effect that "the property was no longer used in useful provision of the utility services and the sale would not cause any harm to customers.

[ATCO, page 153]

101. This is not a case involving the sale of a "now discarded utility asset". Rather, it is a case which, depending upon the Board's findings with respect to competition and the protection of the public interest, involves a question of the treatment of revenues from the use of assets which continue to form an integral part of the utility asset base, and as such may continue to be used and useful for utility ratepayers. The Council submits that, on the facts alone, the ATCO decision is distinguishable from the facts in this case. The Council submits that the reasoning in the ATCO decision does not apply in this case.

102. The Council submits that the sharing of the revenue from the sale of storage for long-term contracts in the ex-franchise market is based on a simple public policy rationale, namely that the Utilities are using assets which continue to be an integral part of the Utilities' operations and should share the revenue derived from that use with their ratepayers. As noted above, the ATCO decision does not displace that rationale. Revenue which is earned by using assets which are part of a utility's operations should, the Council submits, be shared between ratepayers and the utility shareholders.

103. A further rationale for maintaining the sharing arrangements is the protection of the interests of consumers with respect to prices. The ending of the sharing mechanism would have a significant impact on the prices which the ratepayers of EGD and Union pay for storage.

VI -RELIEF REQUESTED

104. In setting out the issues to be considered in the NGEIR proceeding, the Board posed a number of questions. The Council's answers to those questions are set out in Appendix "A" to this Written Argument.

105. On the fulcrum issue under s. 29, the Board should find that there is no competition in the market for storage services sufficient to protect the public interest and that the Board should not forebear from regulation.

106. The Council submits that the Board should find that there is no competition at the burner tip, or at least no competition sufficient to protect the public interest. The Council submits that that finding requires that there be no forbearance from regulation, directly or indirectly, for in-franchise customers. The Council further submits that the Board should reject EGD's concept of forbearance with an exemption and should reject the argument that what EGD and Union propose is a part of a transition to full competition at the burner-tip.

107. That there is no competition at the burner-tip requires that the Board maintain the distinction between in-franchise and ex-franchise markets. The Council acknowledges that it may be necessary, and indeed appropriate, for the Board to reconsider what constitutes the ex-franchise market.

108. As noted above, the Board accepted Union's proposed distinction between in-franchise and ex-franchise customers without any assessment of whether the distinction was a rational one, or whether the resulting differences in rates were just and reasonable. However, the fact that EGD's in-franchise customers, as well as the customers of other distribution Utilities purchasing storage from Union, must now pay rates which reflect, in part, market rates, begs the question of whether the distinction is correct and, in particular, whether the definition of what constitutes ex-franchise customers needs to be refined. As Mr. Stauft puts it, "the question arises of what principal basis there is for distinguishing between affected classes of customer". **[Exhibit X.8.1., page 73]**.

109. Mr. Stauft refines the issue further in the following observations:

(1) from a regulatory perspective, the difficulty is with understanding why the question of whether a customer is "in-franchise" or "ex-franchise" has anything to do with whether it should be entitled to cost based rates or will be forced to pay rates that reflect the exercise of market power. **[Exhibit X.8.1., page 75]**

(2) although these decisions may be influenced by policy considerations that are outside the normal regulatory sphere, as a matter of economics and regulatory theory, I do not see any rational basis for protecting some consumers from the exercise of market power through cost based rates, while exposing other customers to the potential exercise of market power by the Utility. **[Exhibit X.2.1., page 76]**

110. The Council agrees with Mr. Stauft that it may be more reasonable to distinguish between services which are provided using the integrated storage systems that have been developed by the Utilities for the purpose of providing a "core" or "utility related" delivery services that would be priced on the basis of cost, on the one hand, and discretionary services that are available only because, and to the extent that, the utility storage infrastructure is not needed from time to time to perform the utility function on the other hand. **[Exhibit X.8.1., page 78 to 79]**.

111. The Council submits that the Board should refine the definition of ex-franchise customers so that it includes all Ontario customers of distribution Utilities. Those customers, like the in-franchise customers of Union, should be entitled to cost-based rates.

112. The Council submits that the Board should find that the relevant market is Ontario and that there is no evidence that Union lacks market power in that market. Council submits that the Board should find that Union has failed to discharge the onus of proof on that point.

113. The Council submits that the Board should find what Union proposes is to create an artificial distinction between assets which are used for in-franchise customers and those which are used for ex-franchise customers. The Council submits that storage assets are one integrated whole. The Council further submits that the Board should reject Union's argument that the revenue from the sale using those assets should be kept by Union shareholders. The Council submits that Union should be required to maintain the bargain which it originally proposed, namely that the premium obtained from the sale of storage services at the market prices should be shared with ratepayers.

114. The Council acknowledges that prices paid for storage by electricity generators should be regulated in the public interest and that those operators should pay cost-based rates.

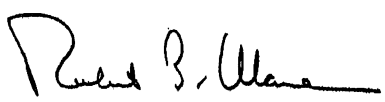
115. The Council submits that all of the revenue from TS should be shared with ratepayers. The Council submits that the Board should find that there is no basis on which that revenue should be limited, as Union proposes, or eliminated as EGD proposes.

116. Finally, the Council submits that the Board should reiterate the obligation of the Utilities to maximize the use of their storage assets to reduce their revenue requirement for ratepayers.

117. The Council submits that the Board should find that there is no credible evidence that forbearance from regulation will encourage the development of storage in the province.

118. The Council asks that it be awarded 100 per cent of its reasonably incurred costs.

All of which is respectfully submitted



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APPENDIX "A"

TO THE WRITTEN ARGUMENT OF THE CONSUMER'S COUNCIL OF CANADA

(1) The Board should not refrain from exercising its power to regulate the rates charged for the storage of gas in Ontario. The evidence does not establish that storage will be subject to competition sufficient to protect the public interest;

(2) Union has market power in the provision of storage services for all categories of customers in Ontario;

(3) It is appropriate for the Utilities to charge market rates for transactional and long-term storage services, consistent with the existing practice, in order to maximize the revenue from those assets for the benefit of their ratepayers;

(4) It is in the public interest that the Ontario customers of the Utilities, whether they are in-franchise or ex-franchise, to whom the Utilities provide utility related delivery services to pay for storage on the basis of cost;

(5) The extra revenue from storage services at market rates should be allocated, according to the existing Board-approved formulas, between the Utilities and their ratepayers;

(6) The distinction between customers receiving storage at market rates and those receiving it at cost should be based on the distinction between customers to whom utility-related delivery services are provided and those who receive discretionary services based on the use of utility assets which are not needed from time to time to perform the utility functions.