

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.

**WRITTEN ARGUMENT OF
ENBRIDGE ENERGY DISTRIBUTION INC. – Y3
August 11, 2006**

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The Party

1. These submissions are made by Enbridge Energy Distribution Inc. (“EEDI”), a wholly owned subsidiary of Enbridge Inc. EEDI has been in the business of exploring and evaluating pools for the purpose of developing new gas storage pools in Ontario.

Issue

2. The Ontario Energy Board (the “Board”) framed the issue as follows:

Whether [the Board ought] to refrain, in whole or part, from exercising its power to regulate the rates charged for the storage of gas in Ontario by considering whether, as a question of fact, the storage of gas in Ontario is subject to competition sufficient to protect the public interest.

Procedural Order No. 9, EB 2005-0551, dated
July 13, 2006

Background – Cost of Old Storage versus Cost of New Storage

3. In Ontario, the current costs of developing gas storage are significantly higher than the past costs of developing gas storage. At the Board Hearing (the “Hearing”) on July 14, 2006, Robert J. Craig, Director of Gas Storage Development at Enbridge Inc., in response to a question posed by Mr. Kaiser, provided three reasons for the increase in costs:

MR. KAISER: There's been some discussion in these proceedings about the cost of new storage compared to the cost of old storage, storage that was developed back in the days when you were -- do you have any view on that, as to whether the cost of developing new storage is significantly above the cost of the storage that's typically in rate base?

MR. CRAIG: Yes, I do. And there are a couple of factors for that.

The first reason provided by Mr. Craig related to the smaller economies of scale:

One is a lot of the reefs that were developed, and I can kind of give you the ballpark number, but the average size of a pinnacle reef that was developed for storage in Ontario pre-1990 was in the range of 10 to 15 Bcf in size. Ten to 17, actually. So you had the economies of scale in terms of a larger size reefs.

The average size of a reef that's been developed from 1990 to, oh, let's say the last 15 years or the last 10, or up 'til 2001, I think, was the last one, has been around 3 Bcf in size.

So you still need pipelines, you still need wells, you still need compression, but you're working with something that's a bigger warehouse, if you like, that needs -- but it still needs -- the smaller ones still need some of the same facilities.

Mr. Craig's second reason related to the remoteness of some of the smaller reefs:

The second reason is that, with the some of the smaller ones, they've been a little more remote from existing facilities so you've got longer pipeline tie-ins.

The third reason provided by Mr. Craig related to the increase in the cost of base pressure gas:

But probably by and large the biggest factor is the cost of base pressure gas. Historically, if you look at Enbridge Gas Distribution's rate base, and I knew these numbers years ago, but the average cost of base pressure gas was less than a dollar an Mcf. Well, if you're developing a pool today, and you're buying gas at \$8 or \$10 an Mcf, you still need the same amount of base gas. It's huge in terms of that cost.

...

Well, today, if you develop a pool, a pinnacle reef pool, for storage, and it's costing you \$10 -- or \$8 for the gas, it's probably 50 percent of the rate base.

Transcript of Hearing EB-2005-0551, Volume 11,
Sworn Testimony of Robert J. Craig, dated July 14,
2006, page 156 line 17 to page 158 line 11

The Need to Explore for New Reef Pools

4. At present, there are only a limited number of known pinnacle reef pools in Ontario that are suitable for conversion to gas storage. Most of the remaining known pools are:
- (a) Remote from the Dawn storage hub;
 - (b) Of poorer quality than those previously developed;
 - (c) Smaller in scale than those previously developed; and/or
 - (d) Technically or otherwise challenged, e.g. pools with brine.

Technical Conference May 16-19, 2006 EB-2005-0551, Testimony of Robert J. Craig, dated May 18, 2006, page 88 at line 23 to page 89 at line 3.

5. Given the smaller scale of and limits to the known pools, it has become increasingly necessary to undertake further exploration programs to locate new reef pools in Ontario suitable for storage development. These exploration and development activities are costly and risky.

Prior Board Treatment of Exploration and Development Activity

6. Prior to the Board's E.B.R.O. 403 Decision (the "Decision"), dated September 25, 1985, with respect to the Application by the Consumers' Gas Company Ltd. ("Consumers Gas") for Rates, the risks and costs associated with Consumers Gas' exploration and development activities were borne by the ratepayers of Consumers Gas. However, in the Decision, the Board removed exploration and development costs from Consumers Gas' rate base because it found that the ratepayers ought not to bear the high risks and costs associated with those activities. The Board made the following comments:

5.11 Further, should Consumers' elect to explore for new gas reserves, the customers may benefit from any success. Conversely, the customers will be at risk for capital investment, changes in government tax policy and gas pricing policies.

5.12 There is now no shortage of gas in Canada and since E and D involves considerable risk, it is the Board's opinion that all E and D activities should be removed from Consumers' utility operations effective September 30, 1986...

In the Matter of an Application under the Ontario Energy Board Act by the Consumers' Gas Company Ltd. for Rates, E.B.R.O. 403, Reasons for Decision, dated September 25, 1985, at paragraphs 5.11 and 5.12

EEDI's Exploration and Development Activities

7. On the basis of the Decision, EEDI has been conducting, at its own risk and cost, exploration and development activities with the ultimate objective of locating new pools suitable for conversion to gas storage. In its Pre-Filed Evidence dated May 1, 2006 (the "Pre-Filed Evidence"), those activities were described as follows:

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

4. While to this point this activity has not lead to the development of any new gas storage, at this point, this effort continues with the hope of a successful outcome in the future.

**Exhibit 4, Pre-Filed Evidence of Enbridge Inc.,
Submission on Issue II (EB-2005-0551), dated May
1, 2006, at paragraphs 3 and 4**

8. EEDI has had no expectation that its exploration and development costs will be included in a rate base and recovered on a cost of service basis. EEDI has been proceeding on the basis that competitive market forces should and will dictate storage development and operating activity.
9. At the Technical Conference (the "Technical Conference") on May 18, 2006, Mr. Craig testified as to the long lead time involved in these activities:

... the activities that we have conducted under this unregulated entity [i.e. EEDI] have gone on for probably seven to eight years.

Technical Conference May 16-19, 2006 EB-2005-0551, Testimony of Robert J. Craig, dated May 18, 2006, page 88 at line 23 to page 91 at lines 8 to 10

10. In response to a question by Mr. Kaiser at the Hearing, Mr. Craig provided additional testimony about the long lead time involved in the activities:

MR. KAISER: Mr. Craig, this activity that you're describing by Enbridge Inc., is that a new activity?

MR. CRAIG: We've been doing that [brine removal] since 2002.

Transcript of Hearing EB-2005-0551, Volume 11, Sworn Testimony of Robert J. Craig, dated July 14, 2006, at page 155 at lines 11 – 13

11. Mr. Craig further elaborated on the long lead time involved in the brine removal and, hence, the long lead time before gas storage could commence, as follows:

If they had taken the brine at the rates they were going to take it, we felt that we would have had a storage project that would have come forth certainly within the next 5 years ...

The update is that, ... that is less certain as to whether that's going to happen within the five-year time frame or not.

Transcript of Hearing EB-2005-0551, Volume 11, Sworn Testimony of Robert J. Craig, dated July 14, 2006, at page 141 at lines 9 – 17

12. Mr. Craig also noted the risky and high cost nature of this activity:

... This storage initiative, in particular this brine removal project, is a long lead time, a risky project. It's high costs.

**Transcript of Hearing EB-2005-0551, Volume 11,
Sworn Testimony of Robert J. Craig, dated July 14,
2006, at page 142 at lines 8 – 10**

Affiliate Relations with Enbridge Gas Distribution Inc. (“EGD”)

13. EEDI intends to develop storage independent from EGD. As noted in the Pre-Filed Evidence:

5. All of this activity has been and will continue to be conducted by EEDI at EEDI's sole cost and risk.

...

7. EEDI intends to undertake any such storage development totally independent from and at arms length to EGD without any cross subsidy or preferred status from EGD or its customers.

**Exhibit 4, Pre-Filed Evidence of Enbridge Inc.,
Submission on Issue II (EB-2005-0551), dated May
1, 2006, at paragraphs 5 and 7**

14. In other words, EEDI would not obtain from EGD any form of competitive or economic advantage with respect to EEDI's storage development or storage operating activities.
15. EEDI is prepared to abide by the *Affiliate Relationships Code for Gas Utilities*, July 31, 1999, as amended. Further, in the event that EEDI discovers or is able to create, through brine removal, sufficient gas storage space in one or more pools (and subject to acceptable economics), EEDI intends to apply to the Board for storage designation, development and operation.

**Exhibit 4, Pre-Filed Evidence of Enbridge Inc.,
Submission on Issue II (EB-2005-0551), dated May
1, 2006, at paragraph 6**

Market Power

16. EEDI does not currently operate any gas storage facilities and does not have any storage market power. If, in the future, some of the EEDI Ontario pools are developed and operated for storage, EEDI would do this as a stand alone independent operator with no market power. At the Technical Conference, Mr. Craig elaborated on this matter, as follows:

In that regard, we believe we would be completely separate from EGD, and we would not have market Power (sic), and we would seek to be treated no differently than other independent storage development operators.

Technical Conference May 16-19, 2006, EB-2005-0551, Testimony of Robert J. Craig, dated May 18, 2006, page 89, lines 23 – 26

Forbearance from Rate Regulation

17. EEDI's position on rate regulation for new storage was set out in its Pre-Filed Evidence, as follows:

8. EEDI believes that market rates will be required to support the costs of any such new storage development and believes it is appropriate that competitive market forces be the determinant as to if, or when, any such new storage development is undertaken.

**Exhibit 4, Pre-Filed Evidence of Enbridge Inc.,
Submission on Issue II (EB-2005-0551), dated May
1, 2006, at paragraph 8**

18. Mr. Craig elaborated on this position in his direct testimony at the Hearing:

And in our view the project will take forbearance to allow it to continue or to attempt to allow it to continue and move forward in the future.

So our position with respect to if we bring forth a pool would be that we would continue to do it and seek forbearance for the development of that pool.

Transcript of Hearing EB-2005-0551, Volume 11,
Sworn Testimony of Robert J. Craig, dated July 14,
2006, at page 142 at lines 10 – 15

19. EEDI also believes that a decision to forbear would reduce the barriers to entry into the gas storage industry. As stated in the Pre-Filed Evidence:


EEDI believes this action will serve to encourage the entry of new storage developers in this Province thereby increasing the level and type of competitive storage services offerings to Ontario customers.

Exhibit 4, Pre-Filed Evidence of Enbridge Inc.,
Submission on Issue II (EB-2005-0551), dated May
1, 2006, at paragraph 13

20. EEDI's ability and willingness to continue to try to develop new gas storage pools in Ontario will be influenced by whether forbearance from rate regulation will apply at least to new storage capacity developed in Ontario.

21. Given the costs, risks, long lead time, uncertainty of success, the need for additional storage services, the need for new and competitive storage service providers in Ontario and the Board's previous Decision on exploration and development activity, it is EEDI's submission that the Board should forbear from regulating the rates charged with respect to new storage development, regardless of whether or not the storage developer and storage operator is an affiliate of a regulated company.

ALL OF WHICH IS RESPECTFULLY SUBMITTED



Robert J. Howe