Ontario Energy Board

EB-2006-0322
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Motions to Review The Natural Gas Electricity Interface Review Decision

ARGUMENT ON BEHALF OF THE CORPORATION OF THE CITY OF KITCHENER

June 12, 2007

Introduction

1. This argument is filed in support of Kitchener's motion for an order canceling the decision in Natural Gas Electricity Interface Review (NGEIR) dated November 7, 2006 that relates to the imposition of a cap or freeze on the level of cost based storage to be made available by Union Gas Limited ("Union") to its in-franchise customers in Ontario at 100 PJs.

Factual Background

2. The findings of fact and conclusions made by the NGEIR panel, essential to this issue, may be summarized as follows:

(a) in 2006 the total Ontario storage capacity was 240 Bcf. Union's total capacity was 152 Bcf and Union's in-franchise requirements were 86 Bcf. Union provided 19.9 Bcf to Enbridge Gas Distribution Inc. ("Enbridge") to provide for that company's in-franchise requirements (NGEIR Decision pp. 7, 8, 10 and 11).

(b) Given the factual findings of the NGEIR panel noted in (a), it is apparent that the current level of Union's storage capacity is sufficient to meet the needs of its in-franchise customers for the foreseeable future. Indeed, given the total storage capacity in Ontario it is clear that there is sufficient capacity in the province to serve the needs of all consumers in the province without the development of new storage. Accordingly, it is submitted that the development of new storage is not a matter of primary importance to the Ontario consumer. Rather, the beneficiary of new storage

development is the shareholder of Union and its ex-franchise or out of Ontario customers.

(c) At page 57 of the NGEIR Decision, the panel made the following finding respecting Union's in-franchise customers:

> The current situation is that these customers are not subject to competition sufficient to protect the public interest; nor is there a reasonable prospect that they will be at some future time.

(d) Notwithstanding the lack of competition to support forbearance for the in-franchise customers, the NGEIR panel imposed a cap of 100 PJs on the amount of cost based storage Union must retain as a reserve for service to this category of customers. The justification for the cap was a desire to facilitate more certainty to the ex-franchise, unregulated, market. As the NGEIR panel stated at p. 82:

> Retaining a perpetual call on all of Union's current capacity for future in-franchise needs is not consistent with forbearance. As evidenced by the arguments of GMi and Nexen, two major participants in the ex-franchise market, retaining such a call is likely to create uncertainty in the ex-franchise market that is not conducive to the continued growth and development of Dawn as a major market centre.

(e) The NGEIR Decision also acknowledged that the cap of 100 PJs could be reached at any time between 2016 and 2024 (NGEIR Decision at p. 83).

(f) the Review Panel of NGEIR concluded that the NGEIR Decision to impose a cap at 100 PJs and, by implication, forbearance for

storage above 100 PJs, was inconsistent with the factual finding noted in (c), above (Decision on Motions to Review NGEIR Decision at p. 48).

Argument

3. As noted, it is submitted that the current level of Union's storage capacity is sufficient to meet the needs of its in-franchise customers for the foreseeable future. Accordingly, while the development of new storage may be desirable, it is not necessary to protect the existing or foreseeable requirements of Union's in-franchise customers. The practical impact on in-franchise customers resulting from the development of new storage is an increase in the average cost of Union storage and therefore an increase for in-franchise rates. The evidentiary record in NGEIR shows that incremental storage can only be developed at higher costs and at greater risks, requiring a greater rate of return than existing storage. (For example, the increased risks and limits to new storage development in Ontario were identified by Mr. Craig of Enbridge Inc. at pages 88 and 89 of the NGEIR Technical Conference on May 18, 2006.) Further, a cap at any level creates the additional impact on the in-franchise customer arising from market pricing for sales above the cap level. These two adverse impacts on the in-franchise customer, coupled with the incremental profits to the shareholder flowing from market pricing, combine to create the perverse result of higher rates and profits above the regulated rate of return. It is submitted that this is a perverse outcome for forbearance and one that is obviously contrary to the public interest as proscribed by the *Act*.

4. It is submitted that a primary obligation of the Board is the protection of the Ontario consumer against monopoly pricing and that unless there is sufficient competition to protect the consumer, the Board must provide regulated pricing. Given the Board's finding in NGEIR that the in-franchise customers of Union are

not subject to competition sufficient to protect the public interest, it is submitted that the obligation to impose regulated pricing continues and that this obligation must be given priority over the desire to promote the development of incremental storage.

5. In summary, it is submitted that the evidentiary record and the factual findings in NGEIR support the conclusion that the establishment of a cap at any level involves errors sufficiently important to warrant cancellation of this part of the NGEIR Decision. These errors are outlined as follows:

(a) the effect of the cap is to implement forbearance and deprive in-franchise customers of regulated pricing for their storage requirements above the cap notwithstanding that there is insufficient competition to justify forbearance under s. 29 of the *Act.* Accordingly, the imposition of a cap in the circumstances of this case is contrary to s. 29 of the *Act.* In other words, if the public interest requires regulation for sales under the cap, the public interest will require regulation above the cap.

(b) it is submitted that ss. 2 and 36 of the *Act* require the Board to give primacy to the Ontario public interest and therefore to the Ontario consumer. Based on the evidence in NGEIR respecting the difference between cost based storage pricing and market pricing, it is evident that removal of rate regulation for requirements above the cap will add significantly to the cost of Ontario consumers. Accordingly, it is submitted that the cap prejudices the Ontario public interest and is therefore contrary to ss. 2 and 36 of the *Act*.

(c) the only rational advanced for the cap in the NGEIR Decision or argued by Union and its ex-franchise customers, is the desire to

support the development of a competitive market in the unregulated, storage market. It is submitted that these objectives cannot be used to justify forbearance under s. 29 of the *Act*. Nor should they be used to displace the Board's requirement under Section 2 and 36 of the *Act* to protect the Ontario consumer from the rate increases resulting from forbearance.

(d) in addition to the inconsistency found by the Review Panel at p. 48 of its Decision between the imposition of a cap and the finding in NGEIR that competition is insufficient to protect the public interest, it is submitted that the NGEIR Decision contains another inconsistency; that is, that the Board should support the ex-franchise, unregulated, market by eliminating a perpetual recall on Union's capacity. If the competitive level in the ex-franchise market is sufficient to protect the public interest (as found by the NGEIR panel) then surely the withdrawal of a portion of the supply by only one of the suppliers of storage to this market should not adversely affect it. If competition in the ex-franchise market is sufficient to meet the requirements of s. 29 of the *Act*, (as found by the Board) it should not require the ongoing protection of the Board provided by a cap.

Response on the Three Questions at p. 49 of the Review Decision

(a) If the cap of 100 PJ of storage for in-franchise Union customers remain in place in perpetuity, what is the basis for forbearance (under s. 29) of required storage above 100 PJ for in-franchise customers?

6. It is submitted that the only basis under s. 29 for removing regulated pricing from the in-franchise market is a Board finding, as required by s. 29, that

the in-franchise customer group "is or will be subject to competition sufficient to protect the public interest". The NGEIR Decision makes no such finding and as noted, it specifically finds the opposite. Accordingly, the answer to this question is that there is no basis, in law, to impose a cap and forbearance for sales above the cap.

7. It is further observed that the only basis asserted in the NGEIR Decision for a cap is a need to support the ex-franchise market. This is not a factor contemplated by s. 29 of the *Act* and therefore it is irrelevant to the question of whether a cap, and its forbearance implications, can be imposed. Accordingly, it is submitted that any discussion of Question (a) at p. 49 of the Review Decision illustrates the appropriateness of canceling the NGEIR Decision in this respect.

(b) If the cap of 100 PJ of storage for in-franchise Union customers does not remain in place in perpetuity, what mechanism should the Board use to monitor the likelihood of the cap being exceeded?

8. It is submitted that this question involves an inquiry into the ramifications of a moving cap, which is designed to provide a degree of certainty for the ex-franchise market, which does not involve in-franchise forbearance, and therefore a breach of s. 29 of the *Act*. Fundamental to this question, it is submitted, is the proposition that the obligation to provide certainty for an unregulated market rests with Union, not with the Board. It is also submitted that Union is well equipped to meet this challenge. On this point, it is worth observing that, excluding storage sold by Union to Enbridge, the existing ex-franchise market is approximately 46 bcf and that a significant portion of this capacity is sold under longer term contracts to parties such as out of province utilities. The longer-term contract provides certainty to these parties. The remaining storage available for ex-franchise sales (perhaps significantly less than 20 bcf) is sold on a shorter-term basis, typically under more flexible arrangements. It is submitted that Union, given the windfall benefits of storage premiums, is well placed to

manage the risks and develop a means of providing guidance or assurances to this market with respect to the availability of storage capacity to meet these requirements flexibly.

9. With respect to the unregulated ex-franchise market therefore, it is submitted that Union is best placed to balance its obligations to in-franchise customers, its own level of risk and its objective of supporting the ex-franchise market in a way which avoids the removal of in-franchise regulation and a breach of Sections 29, 2 and 36 of the *Act*.

(c) If the cap of 100 PJ of storage for in-franchise Union customers is likely to be exceeded, what, if any, remedy is available to in-franchise customers?

10. It is submitted that this question must be addressed within the framework of the factual findings of the NGEIR panel and in particular the finding that the in-franchise market is not subject to competition sufficient to protect the public interest. Thus, any remedy, to be appropriate, must acknowledge that even when the cap is exceeded, there can be no basis under s. 29 for forbearance and the removal of price regulation. Accordingly, if Union purposes to impose market pricing once the cap is exceeded in the future, it must seek a finding under s. 29 to permit it to do so. Unless the state of competition in the in-franchise storage market has changed since the NGEIR Decision, it can be assumed that such an application will not succeed. In any event, so long as this finding by the NGEIR panel continues to be valid, the only remedy available to in-franchise customers is to oppose forbearance.

Conclusion

11. On the basis of the errors and inconsistencies in the NGEIR Decision, described in this argument, it is submitted that the Decision relating to the imposition of a cap ought to be cancelled. Further, it is submitted that the Board can invite Union to develop its own approach to provide guidance and certainty to that portion of the ex-franchise market that is not covered by long term contracts along the lines of Kitchener's response to question (b) posed at p. 49 of the Review Decision.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

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