RP-2003-0063
EB-2004-0542

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, C.15 (Schedule B);

AND IN THE MATTER OF an Application by Union Gas Limited for an order or orders amending or varying the rate or rates charged to customers under the M16 rate schedule.

BEFORE: Paul Vlahos
Presiding Member

Paul Sommerville
Member

Pamela Nowina
Member

DECISION WITH REASONS

May 19, 2005

THE APPLICATION, BACKGROUND AND OVERVIEW OF THE PROPOSAL

Union Gas Limited ("Union") filed an application with supporting prefiled evidence, dated December 23, 2004, with the Ontario Energy Board ("the Board") under section 36 of the *Ontario Energy Board Act, 1998* for an order or orders to amend or vary the rates and other charges charged to customers served under the M16 rate schedule. Union also provided copies of the application to Intervenors of record in the RP-2003-0063 proceeding and to Tribute Resources Ltd./Tipperary Gas Corp. ("Tribute"), Northern Cross Energy Limited ("Northern Cross" or "NCE"), Enbridge Gas Distribution Inc. ("EGDI"), and Market Hub Partners ("MHP"). The Board assigned file number RP-2003-0063/EB-2004-0542 to Union's application.

Below is the background and overview of Union's proposal. Copies of the evidence by Union and by others, exhibits, arguments, and transcripts of the proceeding are available at the Board's offices. The Panel has considered the full record but has summarized it throughout this decision document only to the extent necessary to provide context for its findings. More details of the proceeding itself are set out in appendix A of this decision document.

Union is applying for approval of new M16 rates for transportation service for embedded storage pools, i.e., pools that are connected to Union's transmission or distribution system. Union currently has one active customer served under the current M16 rate schedule, EGDI, and the existing M16 rates were designed to apply specifically to EGDI's Chatham 7-17-XII pool.

Since the current M16 rates were designed, other parties, such as Northern Cross and Tribute, have expressed interest in developing storage in other locations in Union's franchise area. One issue in the RP-2003-0063 proceeding (Union's 2004 rates) was the appropriateness of the existing M16 schedule for embedded storage companies in general. During this proceeding, some parties, notably Northern Cross, argued that the existing M16 rate did not recognize the system benefits realizable by connecting embedded storage pools to Union's distribution system. Northern Cross also proposed in the above proceeding that storage operators should be offered a service of a lower priority than that provided to consumers and producers.

In the Board's RP-2003-0063 Decision With Reasons, the Board made the following directive:

> The Board directs Union to review the cost causality associated with NCE's storage operations with special emphasis on the allocation of storage costs. Union should take into consideration the reduced level of service and the ability of a storage operation to inject and withdraw at a different rate and time versus the service requirements of a pure gas consumer in its rate design. The Board also directs Union to review the cost allocation and rate design applicable to distributed storage pools such as the Ashfield Pool and submit such evidence as part of its 2005 rates application.

Union's application for a redesigned M16 rate was filed in response to this directive. The timing of the application was driven by the fact that Union had already signed a contract to provide firm transportation to Tribute's Tipperary pool as of the later of April 1, 2005, or one month following the satisfaction of all conditions precedent, and, as such, Union required approval of a firm transportation toll that would be applicable to that pool.

Under Union's M16 rate proposal, service would be differentiated between east and west of Dawn and an interruptible service would also be offered. EGDI's Chatham 7-17-XII pool would be classified as west of Dawn. Tribute's Tipperary pool and Northern Cross' prospective Ashfield pool would be classified as east of Dawn. Only one of these two Huron County pools could be accommodated by Union's current physical infrastructure on a firm transportation basis.

The following types of charges would apply for firm transportation service:

- A monthly charge to recover specific meter station costs;
- Different demand charges for customers east and west of Dawn to reflect the different transmission assets used by such customers;
- A transportation commodity charge that is independent of distance; and
- Distinct commodity charges to recover fuel and unaccounted-for-gas (UFG) that reflect the transmission system used and seasonal fuel requirements (M16 customers may choose to provide their own fuel).

For interruptible service, Union's proposals are similar to firm service except that there would be no demand charges.

Union testified that its M16 rate proposal offers the lowest possible transportation rate consistent with the Board's established cost allocation and rate design principles, including postage-stamp ratemaking, cost causality, and a reasonable contribution to the cost of facilities by all customers. Union also asserted that any system benefits that may be caused by a particular customer should not be streamed to that customer. Union noted that this principle has been previously endorsed by the Board.

BOARD FINDINGS

The issues for the Panel are as follows:

- Should independent embedded storage be viewed as a special case?
- Should there be an interruptible transportation service option?
- Should there be a differentiation of transportation service between west and east of Dawn?
- Should there be a contribution to fixed costs for assets not caused by storage customers?
- Are there any system benefits from embedded storage and if so should such benefits be streamed to embedded storage?
- Are the allocated unaccounted-for gas costs reasonable?

The Panel deals with each of these issues below.

<u>Should independent embedded storage be viewed as a special case?</u>

Union's written evidence covered all aspects of the costs allocated and rates derivation for the proposed revised M16. The oral evidence of Union, the evidence sponsored by Tribute, cross-examination of witnesses for both parties, and submissions by all parties focused on the firm transportation component east of Dawn, as Tribute's prospective Tipperary storage pool would be served under this part of the proposed revised M16 rate schedule.

The thrust of the evidence of Messrs. Knecht and Fisher sponsored by Tribute and Tribute's submissions is that independent embedded storage is the new frontier in the natural gas market in Ontario and, as such, it should be supported by cost allocation and rate setting principles or arrangements that may depart from those applicable to other users of Union's transmission system. According to Tribute, independent embedded storage providers should not be viewed in the same manner as any other customer classification; rather they should be viewed and treated as competitors to Union's own storage activities and as an enterprise that enhances the reliability of the natural gas system in Ontario. Tribute also grounds its position on the Board's recently released report entitled *Natural Gas Regulation in Ontario: A Renewed Policy Framework* resulting from the Natural Gas Forum.

What Tribute in effect is seeking from this Panel is special status. Union and other Intervenors opposed such treatment for Tribute. True Oil, a potential storage developer, adopted Tribute's position.

Over the years, the Board has had many requests for special status for a customer group or a customer. The Board has been consistent in its response to such requests by adhering to its established principles in dealing with cost allocation and rate setting. Principled ratemaking involves the creation of a unified and theoretically consistent set of rates for all participants within the system. It begins with the establishment of a revenue requirement for the regulated utility and proceeds to design rates for the respective classes according to well-recognized and consistent theory respecting such elements as cost allocation. This is an objective and dispassionate process, which is driven by system integrity and consistent treatment between consumers on the system. Principled ratemaking typically does not involve a ranking of interests according to a subjective view of the societal value of any given participant or group of participants. This approach is not unique to Ontario. A departure from these principles should only be undertaken where the evidence and all other circumstances outweigh the inherent virtue of an objective process.

In the above referenced report resulting from the Natural Gas Forum, the Board raises a number of matters regarding storage. The Board intends to proceed to explore the possible approaches to the issues identified in the report in appropriate fora, where all interested parties would be given the opportunity to participate. Special status for embedded independent storage and the provision of incentives for such operations represent an approach that may be seen as departing from current ratemaking principles, a departure that in the Board's view is not supported by the evidentiary base presented in this case. One controversial suggestion made by Tribute and Northern Cross involves the so-called "streaming of benefits" to the embedded storage operator. The proponents of this approach would reduce the rate level charged to the embedded storage operator to the extent that its presence within the overall gas distribution system provided a benefit to the system as a whole through enhanced reliability, security of supply and the avoidance of system expansion, reinforcement costs or fuel costs. The streaming of such benefits to a particular class of system users is not typically an attribute of distribution systems. In this case it is even more problematic. First, it is not clear that either of Tribute or Northern Cross will provide any reliable benefit to the system. Neither party demonstrated that their proposed operations offer any reliable system benefit, which can be counted upon by the system operator and other system users. Second, the valuation of such benefits, were they to be demonstrated, would be a complex undertaking, requiring substantial additional evidence. Third, other user classes may well raise the same kind of issues with respect to the benefits they provide to the system. Similar arguments could be made by virtually every rate class and class of customer. The streaming of benefits can create a very tangled matrix. In fact the distribution system is based on the interdependence of all customers and classes of customers. This element will be discussed further below.

Proponents and opponents of the special status sought will be able to address these issues in the appropriate process arising from the Natural Gas Forum.

This Panel therefore has proceeded to assess Union's proposals, the proposals made by others, and the parties' submissions on their merits from the perspective of the principles discussed above.

Should there be an interruptible transportation service option?

Union proposes an M16 rate design that offers firm and interruptible transportation service for embedded storage pools. Northern Cross' position is that there ought not to be firm service. No other party supported this position.

Acceptance of Northern Cross' position would in effect render the contract entered into between Union and Tribute inoperative as that contract was entered into on a firm basis. This would then release the current lock by Tribute on the available capacity of the Forest-Hensall-Goderich line and place Tribute and Northern Cross on an equal footing in contracting for that line on an interruptible basis. Also, as some charges associated with firm service would not apply, the service would be provided at a lower cost to the users, thereby improving the economic feasibility for new embedded storage.

There was no evidence before the Panel that forcing an interruptible service only for transportation related to storage would enhance the prospects of more embedded storage in the Province. What is before the Panel is the submission by Counsel to Tribute that neither the Tribute nor Northern Cross project will be viable without firm transportation service, and the submission by True Oil, a potential storage developer in Ontario, that it regards firm service as a requirement on its part to be able to move gas in an out of storage any particular day.

While the Board is not bound by third party contracts, the Board strives not to unnecessarily frustrate pre-existing commercial arrangements. The Panel is not convinced that the position of Northern Cross, in this instance, would serve the public interest. The Board's first-come-first-serve principle espoused by the Board in the EBO 188 guidelines have served the industry well over the years and should continue to apply until the Board replaces those guidelines.

The Panel finds that the proposed introduction of an interruptible transportation service for storage as an option, while maintaining a firm service offering, is reasonable and provides the greatest flexibility to customers.

<u>Should there be a differentiation of transportation service between west and east of Dawn?</u>

Union's proposed M16 rates differentiate between transportation west and east of Dawn and apply different demand charges. The proposed demand charge for west of Dawn is 1.049 cents per gigajoule compared to a proposed demand charge of 0.726 cents per gigajoule east of Dawn.

Enbridge argued that the proposed east-west differentiation is an artificial boundary and it would tilt the playing field regarding the development of storage fields in Ontario. The

Board notes that Enbridge did not pursue this matter through the filing of evidence or through the interrogatory process and raised the issue for the first time in argument. The Board also notes that the proposed Transportation Commodity Charge component of the rate is identical in both the east of Dawn and west of Dawn rates.

The Panel notes that transportation service west of Dawn utilizes capacity on the Panhandle transmission system between Ojibway and Dawn and the proposed demand charge is equivalent to the demand charge in the C1 rate schedule that applies for transportation service between Ojibway and Dawn. M16 service to and from the Chatham 7-17-XII storage pool utilizes capacity that could otherwise be used to provide firm C1 transportation service from Ojibway to Dawn. In contrast, for east of Dawn embedded storage uses the Dawn-Trafalgar transportation system. To derive the east of Dawn transportation charge for M16, Union used the easterly Dawn to Parkway M12 transportation rate and adjusted it for distance to reflect the fact that the Dawn-Trafalgar system is only being used as far as the Stratford lateral and to recognize that these demands are only for the summer injection period.

The Panel does not therefore accept that the east-west differentiation is an artificial boundary. Rather, it is based on a sound rationale in the given circumstances.

<u>Should there be a contribution to fixed costs for assets not caused by storage customers?</u>

Union allocates demand-related costs between in-franchise and ex-franchise customers in proportion to distance weighted design day demand. Under this method no costs related to the use of the Dawn-Trafalgar transmission system would be allocated to storage providers located in Huron County since they do not add to the design day demands on that system in the winter. It is Union's view however that M16 customers located in Huron County should pay a demand charge reflecting their use of the Dawn-Trafalgar transmission system in the summer. Union proposed a demand charge of 0.726 cents per gigajoule.

Union also proposes to charge all M16 customers 2.5 cents per gigajoule for transportation services from the pool to Dawn. This rate is equivalent to the commoditized cost of the Dawn-Trafalgar transmission system excluding Dawn compression for in-franchise customers.

Tribute's position is that these value-of-service charges apply to notional flows in both directions on the Dawn-Trafalgar line, even though the gas physically flows in only one direction. Mr. Fisher, a witness for Tribute, testified that in his view there should be no contribution at all by embedded storage operators. Mr. Knecht, also a witness for Tribute, testified that the contribution should be lowered. Mr. Knecht also suggested that the Union's proposal results in a much higher contribution for embedded storage east of Dawn compared to west of Dawn. True Oil was the only party that supported Tribute's position.

Tribute did not effectively refute the proposition that, although a customer may not have caused the fixed costs to be incurred in the first place, that customer should still be contributing to the recovery of such fixed costs if it makes use of the assets. This principle has been reflected in past decisions by this Board. The Board also agrees with Union and other parties that, with respect to the question of notional flow versus physical flow, it should be the contractual arrangements that govern ratemaking, not the physical movement of gas.

While there is some discretion exercised by Union in attributing certain fixed costs to the M16 class that are not directly caused by customers served under that class, Union has satisfied the Panel that its proposed demand charge of 0.726 cents per gigajoule for east of Dawn is reasonable given that it starts from existing demand charges on Dawn Trafalgar, adjusted to reflect distance and seasonality of the firm demand. Union's proposal reflects the fact that demand charges do tie-up capacity. With respect to commodity charges, the Panel notes that the proposed 2.5 cents per gigajoule commodity charge is the lowest transmission-related unitized cost that Union has anywhere in any of its delivery rates.

<u>Should any fuel system benefits from embedded storage be streamed to embedded storage?</u>

Mr. Knecht testified and Tribute argued that Union's proposal does not recognize the fuel cost savings associated with winter counter-flows as it is based on a notional flow from the pool to Dawn during the winter season. During the winter (withdrawal) season, gas will not physically flow back to Dawn; rather it will be consumed in the local distribution area. Therefore the fuel component of the Dawn-to-pool charge should be offset by an equal pool-to-Dawn fuel credit for volumes withdrawn from the pool and used to serve Union's local customers.

Union and other parties recognized that there may be fuel cost savings but any such savings should not be applied to an individual customer. The Panel agrees. The Board has in recent decisions declined to stream benefits that arise from one customer to that customer. In the case of the Delivery Commitment Credit that previously applied to direct purchase customers who were obligated to provide firm deliveries 365 days a year to specified points on Union's system, the Board directed that this credit be phased out.

In its recent decision RP-2003-0063 in respect of a request to stream a benefit to local gas producers served under Union's M13 rate schedule, the Board stated as follows:

> Union operates a fully integrated gas distribution system. Its operation is dependent upon the maintenance of a balanced series of inputs and outputs. Gas supplied by Ontario producers necessarily augments and displaces other sources of supply within the pipeline. The fact that any given producers' gas contribution to the system may be withdrawn prior to the end point of the distribution system should not result in any particular or preferential treatment. It is impractical and inefficient to attempt to track specific gas molecules within the system in order to tune transportation charges according to presumed and unverifiable distances. Such a practice would be inconsistent with the most cost effective operation of a fully integrated broad service distribution network.

The Board's findings in that case are equally applicable in the instant case on the issue of streaming any benefits resulting from the physical, rather than the contractual flows of gas.

<u>Are the allocated unaccounted-for gas costs reasonable?</u>

Unaccounted-for gas volumes include those associated with the transportation of gas, plus those gas volumes associated with storage. Union allocates unaccounted-for gas costs on a volumetric basis. The proposed unaccounted-for gas charge is 2.9 cents per gigajoule. While there was conflicting evidence as to the number of passes which attracted unaccounted-for gas charges for M16 customers, Mr. Knecht's suggestion is that unaccounted-for gas costs be charged to M16 customers once only on the basis of the physical, not the contractual flows. This position was rejected by Union and most Intervenors on the grounds that it is the contractual, not the physical flow that should drive cost allocation and ratemaking. The Board reiterates that it is the contractual, not the physical flows that should govern ratemaking.

Further, the Panel is satisfied on the evidence that no portion of unaccounted-for gas costs allocated to Union's own storage is allocated to M16 customers in Union's proposal, as Tribute claims.

CONCLUSION AND ORDER

The Panel finds that Union's proposed changes to its current M16 rate schedule and proposed rates and charges are reasonable and are hereby approved. The Board orders that the attached M16 rate schedule shown in Appendix B shall be effective June 1, 2005.

The Panel awards Intervenors eligible for cost awards 100% of their reasonably incurred costs. The final awards shall be fixed following the Board's cost assessment process.

DATED at Toronto on May 19, 2005

Original Signed By

Paul Vlahos
Presiding Member

Original Signed By

Paul Sommerville
Member

Original Signed By

Pamela Nowina
Member

THE PROCEEDING

RP-2003-0063/EB-2004-0542

May 19, 2005

THE PROCEEDING

On February 1, 2005, the Board issued a Notice of Written Hearing and Procedural Order No. 1 setting out the following deadlines:

- February 4, 2005, for the filing of any objections to proceeding by way of written hearing;
- February 10, 2005, for the filing of written interrogatories to the Applicant;
- February 17, 2005, for the filing of the Applicant's interrogatory responses;
- February 28, 2005, for the filing of Intervenors' submissions; and
- March 7, 2005, for the filing of the Applicant's reply submissions.

On February 4, 2005, the Board received a letter from Tipperary seeking an amendment to Procedural Order No. 1, allowing for a settlement conference and, possibly, an oral hearing of the evidence in the proceeding.

On February 9, 2005, the Board issued Procedural Order No. 2, which made provision for convening a Settlement Conference on February 24, 2005, with the objective of reaching a settlement among the parties on as many of the issues as possible.

On February 10, 2005, parties filed interrogatories to Union. On February 17, 2005, Union provided responses to these interrogatories.

On February 17, 2005, Tribute informed the Board that it was submitting "supplementary Interrogatories" and, further, that it intended to file evidence in the proceeding.

On February 22, 2005, the Board issued Procedural Order No. 3, which set out the following deadlines:

- February 24, 2005, for Union to file responses to Tribute's "supplementary Interrogatories;
- March 3, 2005, for the filing of intervenor evidence;
- March 8, 2005, for filing interrogatories on intervenor evidence;

- March 15, 2005, for filing responses on interrogatories on intervenor evidence; and

- March 18, 2005, as the date of the re-scheduled Settlement Conference.

In response to Procedural Order No. 3, the Board received written evidence prepared by Bob Knecht and Jamie Fisher on behalf of Tribute.

By letter dated March 1, 2005, Northern Cross asked the Board to make allocation of capacity an issue in this proceeding.

On March 4, 2005, the Board invited submissions in respect of Northern Cross' request, setting March 9, 2005, as the deadline for any such submissions.

The Board received submissions on Northern Cross' request from Union on March 8, 2005; the Industrial Gas Users Association on March 9, 2005; and Tribute on March 9, 2005. Northern Cross filed a response to these submissions on March 14, 2005.

On March 18, 2005, the Board issued Procedural Order No. 4 which accepted capacity allocation as an issue in this proceeding and set the following dates:

- April 5, 2005, as the deadline for filing any agreement arising out of the Settlement Conference; and

- April 12, 2005, as the date for an oral hearing to deal with any matters arising from the Settlement Conference and to hear any remaining unresolved issues.

The Settlement Conference was held on March 18, 2005. The following parties participated: Union, MHP, True Oil LLC, TransCanada PipeLines, Northern Cross, the Vulnerable Energy Consumers Coalition, the London Property Management Association and the Wholesale Gas Service Purchasers Group, EGDI, Tribute, the Industrial Gas Users Association, and the Federation of Northern Ontario Municipalities.

By letter dated March 21, 2005, Union informed the Board that parties to the Settlement Conference were unable to reach agreement on any issue in the proceeding.

The oral hearing commenced on April 12, 2005, and concluded on April 13, 2005.

PARTICIPANTS AND THEIR REPRESENTATIVES

Below is a list of participants and their representatives that were active either at the oral hearing or at another stage of the proceeding. A complete list of Intervenors is available on the record.

Board Counsel and Staff	Mike Lyle
	James Wightman
Union Gas Limited	Crawford Smith Michael Packer Bryan Goulden
London Property Management Association and the Wholesale Gas Service Purchasers Group	Randy Aiken
Vulnerable Energy Consumers Coalition	Michael Janigan Joyce Poon
Industrial Gas Users Association	Vince DeRose
	Peter Thompson
Tribute Resources Ltd.	Peter Budd
	Bob Knecht
	Jamie Fisher
Northern Cross Energy	Joni Paulus
	Bill Farquhar
True Oil	Frank Gentry
Enbridge Gas Distribution Inc.	Robert Rowe
TransCanada PipeLines	Murray Ross

WITNESSES

There were 6 witnesses who testified at the oral hearing.

The following Union employees appeared as witnesses at the oral hearing:

Michael Broeders	Manager, Product and Services Costing
Mark Kitchen	Manager, Rates and Pricing
Steve Poredos	Director, Capacity Management
Chuck Legg	Manager, Distribution Planning

Tribute called the following witnesses:

Robert Knecht	Industrial Economics, Principal
Jamie Fisher	Consultant

M16 RATE SCHEDULE

RP-2003-0063/EB-2004-0542

May 19, 2005

STORAGE AND TRANSPORTATION SERVICES
TRANSPORTATION CHARGES

(A) Availability

The charges under this rate schedule shall be applicable for transportation service rendered by Union for all quantities transported to and from embedded storage pools located within Union's franchise area and served using Union's distribution and transmission assets.

(B) Rates

The identified rates (excluding gas supply charges, if applicable) represent maximum prices for service. These rates may change periodically. Multi-year prices may also be negotiated, which may be higher or lower than the identified rates.

a) Charges Applicable to both Firm and/or Interruptible Transportation Services:

Monthly Fixed Charge per customer station ($ per month) (1)	$525
Transmission Commodity Charge to Dawn ($ per GJ)	$0.025

	Customers located East of Dawn	Customers located West of Dawn
Transportation Fuel		
Fuel Charges to Dawn:		
Commodity Rate - Union provides fuel ($ per GJ)	$ 0.029	$ 0.029
Fuel Ratio - customer provides fuel (%)	0.351%	0.351%
Fuel Charge to the Pool		
Commodity Rate - Union provides fuel ($ per GJ)	$0.037	$0.044
Fuel Ratio - customer provides fuel (%)	0.447%	0.533%

b) Firm Transportation Demand Charges: (2)

	Customers located East of Dawn	Customers located West of Dawn
Monthly Demand Charge applied to contract demand ($ per GJ)	$ 0.726	$ 1.049

Authorized Overrun:

The authorized overrun rate payable on all quantities transported in excess of Union's obligation any day shall be:

	Customers located East of Dawn	Customers located West of Dawn
Firm Transportation:		
Charges to Dawn		
Commodity Rate - Union provides fuel ($ per GJ)	$ 0.078	$ 0.088
Commodity Rate - customer provides fuel ($ per GJ)	$ 0.049	$ 0.059
Fuel Ratio - customer provides fuel (%)	0.351%	0.351%
Charges to the Pool		
Commodity Rate - Union provides fuel ($ per GJ)	$0.061	$0.078
Commodity Rate - customer provides fuel ($ per GJ)	$ 0.024	$ 0.034
Fuel Ratio - customer provides fuel (%)	0.447%	0.533%

Overrun will be authorized at Union's sole discretion.

Unauthorized Overrun

Authorized Overrun rates payable on all transported quantities up to 2% in excess of Union's contractual obligation.

The Unauthorized Overrun rate during the November 1 to April 15 period will be $50 per GJ for all usage on any day in excess of 102% of Union's contractual obligation. The Unauthorized Overrun rate during the April 16 to October 31 period will be $9.373 per GJ for all usage on any day in excess of 102% of Union's contractual obligation.

Charges aforesaid in respect of any given month in accordance with General Terms & Conditions shall be payable no later than the twenty-fifth day of the succeeding month.

Notes for Section (B) Rates:
(1) The monthly fixed charge will be applied once per month per customer station regardless of service being firm, interruptible or a combination thereof.
(2) Demand charges will be applicable to customers firm daily contracted demand or the firm portion of a combined firm and interruptible service.

(C) Terms of Service

General Terms & Conditions applicable to this rate schedule shall be in accordance with attached Schedule "A".

Effective XXXXXXXX 200X
O.E.B. ORDER #RP-2003-0063, EB-2004-0542 Chatham, Ontario

Supersedes RP-2003-0063 Rate Schedule effective January 1, 2004.