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February 6, 2009

VIA COURIER and E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
Yonge Street
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: Board File No. EB–2008-0106
Commodity Pricing, Load Balancing, and Cost Allocation Methodologies for Natural Gas Distributors in Relation to Regulated Gas Supply

Please find enclosed VECC's interrogatories for the GMG with respect to the above noted proceeding.

Yours truly,

Michael Buonaguro
Counsel for VECC
Encl.

ONTARIO ENERGY BOARD

Methodologies for Commodity Pricing, Load Balancing, And Cost Allocation for Natural Gas Distributors

EB-2008-0106

Vulnerable Energy Consumers' Coalition ("VECC") Interrogatories to the Gas Marketer Group ("GMG")

VECC/GMG - 1

Reference: GMG Evidence page 24, responses to Board questions 3.1 and 3.2.

Preamble: In the response to Board question 3.1 GMG says that a single Ontario-wide reference price should be implemented. However, in the response to Board question 3.2 GMG indicates that "it is unable to propose implementation of a single Ontario-wide reference price in the absence of unbundling of storage and transportation, which had been removed from the scope of this hearing".

Requests:

(a) Is GMG suggesting that while a single Ontario-wide reference price would be desirable, it is not recommending the implementation of such a reference price in this proceeding? Please explain the apparent inconsistency between the responses to Board questions 3.1 and 3.2. and indicate clearly what steps GMG believes the Board should take in this proceeding in relation to establishing a single Ontario-wide reference price.

(b) Under GMG's proposal for the calculation of a reference price would each of the utilities have a different reference price? Why would they be different?

(c) In the response to Board question 3.1. GMG indicates that a single Ontario-wide reference price "could better reflect the increasingly diverse sources of diverse supply sources such as LNG and Arctic Gas." Please explain how a single reference price would "better reflect" diverse supply sources, as opposed to utility-specific reference prices that would reflect the actual mix of supply sources that each utility utilizes.

(d) Please explain (i) what "unbundling of storage and transportation", beyond the level of unbundling that is already available to customers under the Utilities' tariffs, is contemplated in this reference, and (ii) how that unbundling is relevant to the issue of whether a single Ontario-wide reference price is adopted.

<u>VECC/GMG - 2</u>

Reference: GMG Evidence, pages 9-10 and following.

Preamble: In the referenced section of its evidence, GMG appears to propose that the "effective rate" charged to sales customers for gas supply be set on a monthly basis at a level equal to bid week or published indices for monthly supply at some upstream point or points, adjusted for transportation costs to the utility city-gate, plus minor adjustments like the system supply fee. VECC requires clarification of the GMG proposal.

Requests:

(a) Is GMG suggesting that the monthly gas commodity rate be determined for both Enbridge and Union on the basis of the methodology that is used by Direct Energy Regulated Services to determine a monthly Alberta price, as described in point 2 at page 15, plus transportation to Ontario city-gates?

(b) Please confirm that (i) the Alberta price generated by DERS for the purpose of providing regulated sales service to customers on the ATCO Gas system in Alberta is for delivery at AECO/NIT, rather than Empress, and (ii) the Alberta price generated by DERS is calculated by DERS itself on the basis of daily pricing data from NGX, and that no published monthly AECO/NIT index is relied upon.

(c) Alternatively to the mechanism described in (a), would the proposed monthly gas commodity charge be derived on the basis of the average delivered cost of each utility's actual supply portfolio, including Alberta volumes purchased at AECO/NIT or Empress and transported on the TransCanada Mainline system, volumes transported from gas plants in Alberta via Alliance/Vector, gas purchased in Chicago and transported via Vector, volumes purchased at Dawn, etc.?

(d) Alternatively, would the proposed monthly gas commodity charge be derived on the basis of monthly index prices for deliveries at Dawn, or some combination of Dawn and other utility city-gates?

(e) Please discuss in detail the rationale for the choice of whichever of the mechanisms described in (a), (c), and (d) is being proposed by GMG. If GMG's actual proposal differs from all of those, please describe the actual proposal in detail and explain the rationale for it.

(f) If the proposal is that the gas commodity charge to sales customers be based on an Alberta monthly price plus transportation via NGTL and TCPL, how would variances between that delivered cost and the delivered cost of the utilities' actual supply portfolios be treated? Please discuss, with reference to the choice between allocating all of that variance to sales customers (so that ultimately sales customers pay the portfolio price anyway) versus allocating that variance to a broader base of customers as a "balancing" cost, as is done by Enbridge. (For background, see VECC/Union-1, VECC-EGD-1, the evidentiary passages referred to therein, and the responses of Union and EGD to those questions)

<u>VECC/GMG - 3</u>

Reference: GMG Evidence page 15 – description of DERS methodology for determining regulated default supply prices in Alberta.

Preamble: GMG describes the rate-making approach used by DERS in Alberta for the purpose of providing sales service, and appears to suggest that a similar approach would be appropriate for the Ontario utilities.

Requests:

(a) Please confirm that DERS does not utilize storage for the purpose of providing regulated sales service to customers in Alberta. If not confirmed, please indicate how much storage capacity DERS utilizes, DERS's total annual load, and how the costs of that storage are recovered from sales customers.

(b) Please confirm that all of the gas delivered by DERS to sales customers in Alberta in any month is acquired by DERS in that month. If not confirmed, please explain, and indicated the approximate percentage of DERS's annual load that is acquired in a month other than the month it is delivered to customers.

<u>VECC/GMG - 4</u>

Reference: GMG Evidence, page 9 and following – monthly pricing proposal.

Preamble: GMG appears to suggest that the gas commodity rates charged to sales customers should reflect monthly prices for gas in one or more supply areas remote from Ontario. VECC requires clarification of how such a mechanism would operate where, as in Ontario, the utility makes extensive use of market-area storage.

Requests:

(a) Does GMG agree (i) that both Union and Enbridge utilize storage in the course of their operations, (ii) that because of their extensive use of storage both Union and Enbridge utilize their upstream pipeline transportation entitlements on the TransCanada Mainline, Alliance, Vector, and other pipelines at essentially a 100% load factor, and (iii) that gas volumes delivered by both utilities to their sales customers during the winter period consist of a mixture of volumes purchased at monthly prices in Alberta and other producing areas during that winter period and volumes withdrawn from storage, where the volumes withdrawn from storage were purchased at monthly prices during the preceding summer injection period? If GMG disputes any of these propositions, please explain in what way the proposition is wrong and GMG's basis for reaching that conclusion.

(b) Please confirm that the long run market expectation, as shown by the illustrative forward curve shown in Figure 2 at page 6 of the GMG evidence, is that monthly prices during the winter period in supply areas will be higher than monthly prices in the preceding summer period, so that the market's general expectation is that the purchase cost of gas withdrawn from storage during any winter period will be lower than the prevailing monthly market price during that winter period. If not confirmed, please explain.

(c) Please provide a narrative description of how, under GMG's proposal, the cost of gas purchased during the summer period and stored by the utilities will be reflected in the gas commodity rates charged to sales customers.

VECC/GMG - 5

Reference: GMG Evidence, page 9 and following – monthly pricing proposal.

Preamble: Please consider the following simplified hypothetical example:

Suppose that the Board accepts GMG's proposal that the utilities be required to utilize monthly index prices in setting gas commodity rates for sales customers. Suppose as well that the utilities wish to calculate a gas commodity rate for January, where the facts are as follows:

- Forecast volumes purchased ex-Ontario in January are 50 units
- Forecast volumes withdrawn from storage in January are 50 units
- Total forecast sales volumes therefore equal 100 units
- Delivered monthly index price of ex-Ontario supply is $10/unit
- Historical average cost of gas withdrawn from storage is $8/unit
- The utilities forecast actual cost of gas delivered to customers in January is therefore (50 units x $10/unit) + (50 units x $8/unit) = $900
- Forecast actual unit cost of gas sold is therefore $900/100 units = $9/unit.

Assume that there is no PGVA balance from December to be cleared, and that in the actual result volumes and prices for January are exactly as forecast.

Requests:

(a) Under the commodity pricing model that GMG is proposing, would the rate charged to sales customers for gas commodity be $10/unit, i.e. the index price for the month as described in the GMG evidence, or $9/unit, i.e. the actual cost to the utility of the gas sold to sales customers in the month? Please explain.

(b) If the response is that the gas commodity rate would be $10/unit, so that the utility would over-recover its actual cost of gas by $100, would the utility retain that $100 as incremental shareholder return? If so, please explain why that would be a reasonable outcome.

(c) Alternatively, would the $100 over-recovery be allocated as a credit to all customers through a distribution or load balancing charge? If so, please explain the rationale for that approach, and in particular explain why it would be fair or reasonable to confer a financial benefit on marketers and/or their customers from amounts paid by sales customers in excess of the utility's actual cost of providing sales service.

(d) Alternatively, would the $100 over-recovery be refunded to sales customers only in the February period through a PGVA adjustment? If so, please explain the rationale for that approach.

(e) If the proposed approach is (d), i.e. refunding the over-collection to sales customers in a subsequent period, why would the utility not simply reflect that forecasted over-recovery in the rate set for sales customers for January, i.e. by setting the gas commodity rate at the $9/unit forecast average cost?

(f) If the rate were set at $10/unit, and none of the options identified in (b), (c), or (d) for dealing with the over-collection of gas costs by the utility were utilized, what approach would GMG propose for dealing with the over-recovery, and why?

VECC/GMG - 6

Reference: GMG Evidence, page 9 and following – monthly pricing proposal.

Preamble: As discussed in the previous question, one possible definition or specification of the GMG proposal appears to involve setting a monthly gas commodity rate based on the weighted average (i.e. weighted by forecast purchase and storage volumes) of monthly index prices and historical costs for gas withdrawn from storage. Under such a mechanism the monthly gas commodity rate would be adjusted (typically downward, i.e. when winter prices exceed prices in the previous summer injection period) on a backward-looking basis to account for the benefit of storage.

Requests:

(a) If such an approach were adopted, and average market prices were expected to increase over time (i.e. if the pink line in Figure 2 at page 15 were upward sloping) does GMG agree that the sales commodity rate would on average understate the expected actual cost of gas in future periods? If not, why not? If so, does GMG consider that such a mechanism would provide an appropriate price signal to sales customers? Why or why not?

(b) If such an approach were adopted, and average market prices were expected to decrease over time (i.e. if the pink line in Figure 2 at page 15 were downward sloping) does GMG agree that the sales commodity rate would on average overstate the expected actual cost of gas in future periods? If not, why not? If so, does GMG consider that such a mechanism would provide an appropriate price signal to sales customers? Why or why not?

VECC/GMG - 7

Reference: GMG Evidence at page 6 and following.

Preamble: In the referenced section of its evidence and elsewhere GMG criticizes the use by the utilities of a 12-month forecast of monthly prices and a 12-month recovery period for PGVA balances. At page 6, first full paragraph, GMG says "...the notion that the use of the 12 month strip aids gas consumers in understanding competitive retail fixed price offerings in relation to the default supply offering is fundamentally flawed". VECC requires further clarification of GMG's position.

Requests:

(a) Does GMG agree that it would be reasonable for a sales customer who is considering whether to remain a sales customer or to enter into a long term fixed price contract with a retail marketer to be interested in the expected average cost of the sales service over as long a period as possible? If not, why not?

(b) Please assume for the purposes of this question that the Board accepts GMG's suggestion that the utilities base their pricing forecasts on bid-week indices or forward prices immediately before the period for which gas commodity rates are set, but that the utilities otherwise maintain the QRAM mechanism as it exists today. In that case, does GMG agree that, given the use of a 12 month forward strip and a 12 month recovery period for expected PGVA balances, the QRAM mechanism provides the best available estimate of the expected average cost of utility sales gas over the following 12 month period at the time the QRAM rates are put into effect? If not, why not?

(c) Does GMG agree that the price of one-year gas at AECO/NIT is essentially the same (i.e. ignoring any bid/offer spread) as the 12-month strip of forward monthly prices for the same period? If not, why not?

(d) Does GMG agree that for a customer who is interested in the expected average cost of monthly gas purchased at 100% load factor at AECO/NIT over a forward

12 month period, the best estimate of that average cost is the then-prevailing 12 month strip of AECO monthly prices? Why or why not?

(e) Does GMG agree that for a customer who is interested in the expected average cost of gas purchased at 100% load factor at AECO/NIT over a forward 12 month period, the then-prevailing 12 month strip of AECO monthly prices is a better indicator than the forward price for any individual month? Why or why not?

(f) Please confirm that information regarding expected or forward monthly prices at AECO/NIT and other liquid supply points (other than Henry Hub) is not readily available to members of the public, i.e. to persons not involved in the gas industry or who do not subscribe to the services or publications that report that data. If not confirmed, please indicate where that information can be readily obtained at no cost.

(g) Does GMG agree that, if GMG's proposal that gas commodity rates be set monthly on the basis of index prices for the relevant month were implemented, the individual monthly utility rates would be useless as an indicator of the expected average cost of utility sales gas over any extended forward period? Why or why not?

(h) Does GMG believe that, in order to facilitate the proper functioning of the competitive market, it is necessary to withhold from customers information concerning the expected average cost of utility sales gas over future periods? If so, please explain why withholding that information is necessary and how withholding it would facilitate the proper functioning of the market.

(i) Does GMG believe that, when customers are considering entering into a long term fixed price contract with a retail marketer, they will compare the long term fixed price offered by the marketer with the then-prevailing price of utility sales gas? If not, does GMG agree that the then-prevailing price of utility sales gas is irrelevant to the decisions made by customers and therefore to the functioning of the competitive market? If not, what other market indicators will customers reasonable use to evaluate the value of fixed-price offerings?

(j) With respect to the passage from GMG's evidence quoted in the preamble, is it GMG's position that (i) it is inappropriate for the utility gas commodity sales rate to function as a "comparator" for, or to provide information that will assist consumers in evaluating, retail marketer fixed-price offerings, or (ii) that, while it is appropriate for the utility gas commodity sales rate to provide information that will assist consumers in evaluating fixed-price offerings, the existing QRAM mechanism fails to do so? Please explain fully the rationale for whichever position GMG supports. If the response is "neither", please explain what was meant by the quoted passage.

VECC/GMG - 8

Reference: GMG Evidence, page 9 and following – monthly pricing proposal.

Preamble: VECC is interested in GMG's views on how its monthly pricing proposal would benefit market participants.

Requests:

(a) Please confirm that under GMG's proposal the utilities would continue to recover, over the long run, exactly their actual purchased gas costs. If not confirmed, please explain why not.

(b) Please confirm that one effect of implementing GMG's approach would be to increase the volatility or variability of the utilities' gas commodity sales rates. If not confirmed, please explain why not.

(c) Does GMG agree that, for most small-volume customers, rate volatility is a "dis-benefit" or cost, so that in relation to that factor implementing the GMG proposal would make sales customers worse off than they are under the existing QRAM mechanism? If not, why not?

(d) Please explain what benefits implementing the GMG proposal would create for sales customers that would offset the cost to them of any increased rate volatility, so that the utility sales service would become a more attractive service for small-volume customers than it is under the QRAM mechanism.

(e) Do GMG members, or other retail marketers that GMG members are familiar with, offer sales services priced on the monthly index basis that GMG suggests that utility sales services should be priced? If so, please indicate approximately how many small volume customers have contracted for that option over the past year. If not, why is such a service not offered?

VECC/GMG - 9

Reference: GMG Evidence, page 3, last paragraph

Preamble: GMG attempts to draw an analogy between the mortgage market and the retail natural gas market.

Requests:

(a) Is GMG suggesting that a mortgagor can renew a mortgage without actively choosing a fixed rate or a variable rate? Is the alleged "default" status of a variable rate mortgage established by statute or regulation, or by the terms of the original mortgage?

(b) Please confirm that one or more of the GMG witnesses at the hearing will be an expert in Canadian mortgage agreements and practice.

(c) Does GMG agree that the rates for fixed-rate mortgages, i.e. with the interest rate fixed for one or more years, are market rates for those financial products?

VECC/GMG - 10

Reference: GMG Evidence, page 3, third full paragraph.

Preamble: In the referenced paragraph GMG says that "all costs incurred by the DSP should be included in the default rate and the supporting supply, transportation, and storage transactions should be reported in a transparent and understandable fashion."

Requests:

(a) What are "all costs incurred by the DSP" in this context, and what "default rate" is being referred to?

(b) Does GMG take issue with the way either Enbridge or Union has allocated "supply, transportation and storage" costs between sales and direct purchase customers? If so, please explain.

(c) With respect to the "reporting" of supply, transportation and storage transactions, does GMG believe that the bill presentation used by Union and Enbridge "report" those transactions in a transparent and understandable fashion? If not, please explain.

VECC/GMG - 11

Reference: GMG Evidence at page 4, first full paragraph.

Preamble: In the referenced paragraph GMG says that the current pricing protocols lead to a mismatch between the costs incurred for a specific set of customers and the customers that receive sales service in a given period. GMG goes on to say that "this is due to the fact that rates are set at 3 month intervals, in which many customers can change gas suppliers."

Requests:

(a) Is GMG suggesting the utilities do not adjust their purchases of monthly-priced gas as required over time in order to meet their actual requirements? Please explain in more detail, with an example, what "mismatch" is being alleged, how it arises, and what the magnitude of the potential mismatch is.

(b) Please provide any studies, memoranda, notes, calculations, or other materials the GMG or any of its members have prepared that analyze the extent of any mismatch of the type alleged for either Union or Enbridge over the past five years.

VECC/GMG - 12

Reference: GMG Evidence, page 4, last paragraph

Preamble: In the referenced paragraph GMG says that "[f]orecasting methodologies used by the distributors do not provide a view of current market price and therefore do not facilitate provider choice and influence informed energy consumption."

Requests:

(a) Please confirm that the reference to "current market price" is a reference to monthly prices, as discussed throughout GMG's Evidence.

(b) Does GMG acknowledge that the products typically offered by GMG members, i.e. gas sales with prices fixed for one year or a number of years, do not provide "a view of current market price" and therefore "do not facilitate provider choice and influence informed energy consumption"? If not, why not?

VECC/GMG - 13

Reference: GMG Evidence, page 5, second paragraph.

Preamble: In the referenced paragraph GMG discusses a graph involving various NYMEX forward curves and says that "[t]his demonstrates how large PGVAs should be expected from this pricing method."

Requests:

(a) Is the point of the graph on page 5 to show that forward curves can shift up and down within reasonably short periods?

(b) Does GMG believe that Enbridge or Union, or both, have in fact experienced "large PGVAs", i.e. large PGVA balances, in recent years? If the response is "yes", please provide whatever studies, analyses, workpapers, or other materials GMG relies upon in making that claim, indicate GMG's understanding of the PGVA balances that have been experienced, and explain GMG's basis for saying that those balances are "large", i.e. please define "large" in this context and explain why the definition is reasonable.