EB-2011-0038

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 an Application by Union Gas Limited for an Order or Orders amending or varying the rate or rates charged to customers as of October 1, 2011.

WRITTEN ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA

I INTRODUCTION AND OVERVIEW

1. Union Gas Limited ("Union") has applied for, among other relief, the following:

    1. Approval of final balances for all 2010 Deferral Accounts and an order for final disposition of those accounts;

    2. Approval of $3.433 million as the customer portion of earnings sharing in 2010, and the proposed disposition of that amount to Union's customers.

2. This is the Written Argument of the Consumers Council of Canada (CCC).

3. This argument is confined to the issue of the calculation and disposition of the amounts in one storage deferral account, namely, the long-term storage account number 179-72. The CCC takes no position on the remaining issues.

4. Union has, historically, been required to share with ratepayers the revenues it has earned from its storage assets, on the premise that those assets had been paid for by its ratepayers. The treatment of those storage assets was changed by the Decision of the Ontario Energy Board in the "Natural Gas Electricity Interface Review" (the NGEIR Decision).

5. The narrow issue for determination is whether Union has properly included, in the calculation of net revenues in the storage account, certain costs. The broader issue, however, is whether, or to what extent, the NGEIR Decision requires that the calculation of the amounts to be shared with ratepayers has changed. The related question is whether, or to what extent, any change effected by the NGEIR Decision changes the traditional regulatory balance between the interests of Union and its ratepayers, and the Board's role in maintaining that balance.

6. The resolution of these questions, and as a result the issue of how amounts in the storage account are to be calculated, requires a principled approach. In the next section of the argument, the CCC considers the principles that should govern the calculation of storage revenue, and the amount to be shared with ratepayers.

7. Canadian Manufacturers and Exporters ("CME") and Union filed motions in the applications. Those motions, reduced to their essence, put in issue whether the Board's decisions in EB-2009-0052 and EB-2010-0039, dealing with, respectively, the disposition of Union's deferral accounts for 2008 and 2009, and the evidence on which those decisions were based, were relevant to the consideration of the issues in this case.

8. The CME and Union motions were resolved by Minutes of Settlement (Exhibit K1.2). The Minutes of Settlement have the following effects:

1. There are no issues before the Board in this application with respect to the evidence on which the 2008 and 2009 decisions were based;

2. No relief is sought with respect to the Board decisions for those two years.

9. As a result of the Minutes of Settlement, the question of whether Union did or did not seek Board approval for the way it calculated the storage deferral account balances in 2008 and 2009 is irrelevant. The only issue for the Board to decide is whether the methods used to calculate the balances in the storage deferral account, for 2010, are correct.

II A PRINCIPLED APPROACH

10. The Supreme Court of Canada, in the foundational case of *Northwestern Utilities Ltd. v. Edmonton (City)*, (*Northwestern Utilities* decision) described the duty of a regulator, in setting rates, in the following terms:

> The duty of the Board was to fix fair and reasonable rates; rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested. By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company's enterprise.

Reference: *Northwestern Utilities Ltd. v. Edmonton (City)*, [1929] S.C.R. 186 at 193

11. In carrying out that function, the Supreme Court of Canada described the role of the utility regulator, in relation to the interests of ratepayers, as a "protective role", to ensure that "utility rates are always just and reasonable".

> Reference: *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, [2006] 1 S.C.R. 140, para. 30

12. The Ontario Court of Appeal found that the directors and officers of a regulated utility have an obligation to balance the interests of a utility's shareholder against those of its ratepayers. The Court stated as follows:

> The principles that govern a regulated utility that operates as a monopoly differ from those that apply to private sector companies, which operate in a competitive market. The directors and officers of unregulated companies have a fiduciary duty to act in the best

> interests of the company (which is often interpreted to mean in the best interests of the shareholders) while a regulated utility must operate in a manner that balances the interests of the utility shareholders against those of its ratepayers. If a utility fails to operate in this way, it is incumbent on the OEB to intervene in order to strike this balance and protect the interests of the ratepayers.
>
> **Reference:** *Toronto Hydro-Electric System Ltd. v. Ontario Energy Board*, [2010] ONCA 284, para. 50

13. Those cases express what might be termed the traditional regulatory rules or obligations. On the basis of those cases, Union's obligation, in calculating the balances in its storage accounts, would be to maximize the revenue for its ratepayers. Union would be obligated to maximize the revenue for its ratepayers, and not calculate the amount to be shared in a way that benefits Union's shareholder at the expense of those ratepayers.

14. However, the NGEIR decision arguably altered the application of the principles expressed in those cases. In the NGEIR decision, the Board determined that a portion of Union's storage assets was to be treated as a non-utility asset. Revenues from the use of those assets were to accrue entirely to Union, subject to sharing with ratepayers, on a declining percentage basis, over a four-year transition period.

15. It is clear from the NGEIR Decision that, with respect to the non-utility storage assets, the traditional regulatory rules would no longer apply after the four-year transition period. What is not clear is whether or to what extent those rules would apply during the four-year transition period.

16. As a non-utility asset, Union is arguably at liberty to account for the revenues and costs without constraint of the traditional regulatory obligations. The question, however, is whether the obligation to share a portion of the revenues required Union, in the calculation of the revenues and costs, to use existing regulatory accounting rules.

17. The Board has, in two decisions, considered the question of how the NGEIR Decision should be applied in calculating the amounts in the long-term storage account.

18. The interpretation of the NGEIR Decision, in determining how net revenues would be calculated in the storage accounts, was an issue in EB-2008-0034. In that case, Union included in the calculation of net revenues only actual and forecast net revenues in respect to storage contracts entered into prior to the NGEIR Decision. The Board rejected that approach, finding that "the Board did not find that Union should separately tract its margins on pre- and post-NGEIR Decision transactions". The Board found that "the NGEIR Decision does not require or permit Union to modify the method of calculating the balance in account 179-72 for 2007".

Reference: *Decision and Order*, EB-2008-0034, June 3, 2008, pp. 7-8

19. Union appealed that decision. The Board dismissed Union's appeal, upholding the earlier panel's conclusion that the NGEIR Decision required Union to include revenues and expenses from both pre- and post-NGEIR Decision storage contracts.

Reference: *Decision on Motion*, EB-2008-0154, October 23, 2008, pp 4-5

20. As noted above, the Board, in its Decision in EB-2008-0034 found that "the NGEIR Decision does not require or permit Union to modify the method of calculating the balance in Account 179-72 for 2007." That statement gives rise to the question of whether the Board has, in so saying, determined that there can be no changes, of any kind, in the way Union calculates revenues and costs for account 179-72.

21. CCC submits that the Board's decisions in EB-2008-0034 and EB-2008-0154 do not finally resolve the question of how Union could calculate revenues and costs included in account 179-72. The decisions only apply to the calculation of the amounts in that account for 2007, and only dispose of one issue, namely whether Union must include revenues and expenses from both pre- and post-NGEIR Decision storage contracts. CCC submits that the Board must look at what Union has done in calculating the accounts in 2010 to decide whether doing so is consistent with the NGEIR Decision.

III THE LONG-TERM STORAGE ACCOUNT 179-72

22. There are two issues with respect to the determination of the amount of revenue to be included in this account, and thereafter shared with ratepayers. Both relate to the inclusion of certain costs in the calculation of net revenues.

23. The first issue arises from Union's use of an internal "hurdle rate" rather than a Board-approved rate of return, in the calculation of the costs. Union's rationale is that its investment in non-utility storage assets is inherently riskier and should attract a higher rate of return. Union expressed its position as follows:

> And to the extent that we needed an offset to the incremental risk that the shareholder was adopting in terms of investing in storage assets, we went to the minimum threshold as a number that would be used to calculate an incremental return, in addition to the Board-allowed return for regulated assets, again, these being non-regulated storage investments.

Reference: Transcript, Vol. 1, p. 113

24. In support of that position, Union relies on those portions of the NGEIR Decision in which the Board found that the storage development market was a more risky capital investment than a utility asset.

Reference: Transcript, Vol. 1, p. 114

25. There is an argument that Union's approach is consistent with one component of the NGEIR Decision, namely that storage investments in a competitive market are riskier, and that Union's revenues should be commensurate with the assumption of those risks. CCC submits, however, that it is inconsistent with the Board's broader conclusion, in the NGEIR Decision, that the risks associated with long-term storage contracts should be borne by Union's shareholder and not by ratepayers. The effect of Union's use of the hurdle rate is to shift the risk from Union's shareholders back to the ratepayers. This is inconsistent with the NGEIR Decision. More importantly, it is inconsistent with the regulatory principle that obliges Union to balance the interests of ratepayers with those of its shareholders.

26. CCC acknowledges that, if Union is to assume the full risk of investments, it should have the full reward. That is the essence of Union's argument, at page 22 of its argument-in-chief. That argument ignores what the Board was doing, in the NGEIR Decision, in creating the four-year transition period. The operation of the traditional regulatory rules was intended to constrain Union's ability to earn the full return on its long-term storage assets, if only for a short period. It would be inconsistent with the purpose of creating a transition period to allow Union to earn some revenue from the long-term storage contracts while allocating the risk to its ratepayers.

27. The second issue, with respect to this deferral account is whether Union is entitled to what it refers to as a "return on purchased assets".

28. Union's evidence is that it enters into long-term leases for storage. These "assets" are not purchased, and so are not, in any common use of the term, "assets". In addition, Union leases storage, in substantial measure, from affiliates. The evidence is that the affiliates are earning a return on those storage assets.

29. In calculating costs associated with the "purchased assets", Union includes both the leasing costs and a return on the assets. Union's rationale for including a return is that, again, there is a risk to investing in this long-term storage and that risk should be accompanied by the appropriate reward.

Reference: Transcript, Vol. 1, pp. 116-118

30. Union, when asked in cross-examination whether earning a return on the asset was consistent with accepted accounting principles, could not point to any such principles. CCC is troubled by what appears to be the use of a wholly artificial accounting mechanism, simply for the purpose of maximizing the return to Union's shareholder at the expense of ratepayers.

31. In the absence of any explanation from what appears, on the surface, to be an artificial attempt to generate revenue at the expense of ratepayers, CCC submits that the Board should reject Union's attempt to calculate costs of its long-term storage using a return on purchased assets.

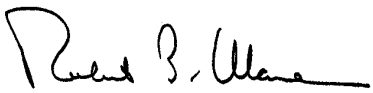
32. In addition, Union's inclusion of a "return on purchased assets" has the same effect as its use of the internal hurdle rate, namely shifting risks associated with long-term storage contracts from its shareholder back to its ratepayers. As noted above, this is inconsistent with both the NGEIR Decision and broader regulatory principles.

IV RELIEF REQUESTED

33. The CCC submits that Union should be required to calculate the revenues in deferral account 179-72 without using either its internal hurdle rate or a return on purchased assets. The amount flowing from that calculation should be distributed to ratepayers.

34. The CCC asks that it be awarded 100% of its reasonably-incurred costs for its participation in this proceeding.

ALL OF WHICH IS RESPECTFULLY SUBMITTED



Robert B. Warren
Counsel to the Consumers Council of Canada
3911580.1