Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

Enbridge Gas Distribution Inc.

2012 EARNINGS SHARING & DISPOSITION OF BALANCES IN DEFERRAL & VARIANCE ACCOUNTS

EB-2013-0046

October 18, 2013

Introduction

Enbridge Gas Distribution Inc. ("Enbridge") filed an application dated May 24, 2013 with the Ontario Energy Board (the "Board") under section 36 of the *Ontario Energy Board Act, S.O. 1998*, c.15, Schedule B for an order approving the disposition of balances in certain deferral or variance accounts. The Board assigned file number EB-2013-0046 to the application.

On June 13, 2013, the Board issued its Notice of Application and Procedural Order No. 1 which included an Issues List, a process for written interrogatories, and established dates for a Settlement Conference and the filing of a Settlement Proposal.

The Settlement Conference was held on July 24, 2013. Enbridge filed a proposed Settlement Agreement on August 2, 2013. On August 20, 2013, the Board issued a Decision and Order on the Settlement Agreement accepting the agreement and establishing September 20 and September 23, 2013 as the dates for an oral hearing of the unsettled issues.

The Settlement Agreement reflected that parties were able to reach settlement on all issues with the exception of the following:

- Issue 1(v) - 2012 Gas Distribution Access Rule Costs D/A (2012 GDARCDA)
- Issue 1(x) - 2012 Earnings Sharing Mechanism D/A (2012 ESMDA)
- Issue 2 - Is the amount proposed to be cleared in the 2012 Transactional Services deferral account appropriate?

Enbridge filed a letter on September 6, 2013 noting that it no longer wishes to contest two of the three unsettled issues. Specifically, Enbridge stated that it will not seek to include late payment penalty ("LPP") revenue reductions within the 2012 GDARCDA. Enbridge also stated that it will not seek to include revenues received from third-parties for their extraction of by-products from Enbridge's gas within its revenues for ESMDA purposes. As such, Enbridge implemented the financial consequences associated with not contesting those two issues in its deferral account balances and highlighted these changes in its September 16, 2013 letter. The amounts and their impacts on the deferral account balances were implemented as indicated in the Settlement Agreement. Board staff therefore has no concern about the two issues which Enbridge indicates it does not contest.

As a result, the only issue that was left to be heard at the oral hearing was whether revenues associated with capacity release exchange transactions should be treated as Transactional Service revenues and recorded in Enbridge's Transactional Services Deferral Account ("TSDA"), or treated as gas cost reductions and recorded in the Purchased Gas Variance Account ("PGVA").

The examination of this matter was heard orally by the Board on September 20, 2013. At the conclusion of the oral hearing, the Board established October 18, 2013 as the deadline for Board staff and intervenors' submissions.

The following is Board staff's submission in regards to the treatment of amounts generated from Enbridge's capacity release transactions.

Treatment of Capacity Release Related Amounts

Background

Enbridge proposed that its 2012 capacity release revenues be classified and treated as Transactional Service revenues (which are shared 75:25 in favour of ratepayers through the TSDA). Enbridge noted that it generated total net capacity release related revenues of $18.63M. Under Enbridge's proposal, the TSDA would include $13.97M related to capacity release revenues (75% of the $18.63M of capacity release related revenues).

The Board, in its EB-2012-0055 Decision (Enbridge's 2011 ESM proceeding), found that 2011 capacity release related amounts should be treated as gas cost reductions. On that basis, the Board found that the capacity release related amounts should be passed-through, in their entirety, to ratepayers in accordance with Enbridge's IRM Framework.

Board staff notes that if Enbridge were ordered by the Board to treat the capacity release revenues as a gas cost reduction in accordance with the 2011 ESM decision, the TSDA balance would be decreased by $13.97M (75% of the total capacity release revenues) and the total $18.63M of capacity release revenues would be recorded in the PGVA (which is streamed in its entirety to ratepayers). Overall, this finding by the Board would result in an additional $4.66M being shared with ratepayers.

Enbridge's Evidence and Argument

Enbridge noted that its evidence in the 2011 ESM proceeding did not provide a full explanation and context for the background, methodology and nature of Transactional Services, including capacity release transactions. Enbridge noted that it filed, in this proceeding, more comprehensive explanations and context for capacity release transactions.

In its evidence and argument, Enbridge provided a discussion of its gas supply plan and its Transactional Service activities. Enbridge also explained how Transactional Services revenues are generated.

Gas Supply Plan

Enbridge noted that it procures natural gas supply, transportation and storage in order to ensure that it is able to meet demand throughout the year. Enbridge stated that when developing its gas supply plan it balances reliability of supply and transportation, diversity of production sources and pipelines and a need for a level of flexibility to respond to variation in demand against cost to arrive at a robust and manageable plan suited to meet the needs of its customers.[1]

Enbridge provided a summary of the roles of the different departments involved in the development and implementation of the gas supply plan. Enbridge stated that transactional services optimization is not considered by the planning group when preparing Enbridge's gas supply plan as it is not possible to predict when transportation will be surplus on the day (due to fluctuations in demand) or the daily pricing that will drive the value of optimization deals. However, Enbridge noted that it is expected, at a general level, that there will be surplus transportation capacity that can be made available for optimization on certain days throughout the year and particularly in the summer months when the gas is not needed on the day.[2]

Transactional Services

Enbridge noted that the concept of Transactional Services was first introduced in the mid-1990's under the premise that if circumstances arose where the assets acquired by Enbridge to meet customer demand were not fully required then those assets could be made available to generate third-party revenue.

Enbridge stated that for a given transaction to be considered Transactional Services related, the transaction must be unplanned, a third-party must be requesting a service and Enbridge must have temporarily surplus capacity.[3]

In its argument-in-chief, Enbridge described the above noted criteria as follows:

[1] Enbridge Application, Exhibit C, Tab 1, Schedule 6 at page 1.
[2] Ibid. at pages 4 - 7.
[3] Ibid. at page 7.

Unplanned: The transaction opportunity must be unplanned in the sense that it is not forecast or known at the time that Enbridge prepares its gas supply plan for the coming year, which is during the spring of the preceding year. A transaction can only said to be planned if both the amount of surplus capacity and the value that can be extracted from third-parties for that surplus capacity are known at the time that the gas supply plan is prepared. The result is that optimization transactions are considered to be "unplanned", since the actual amount and value of surplus capacity in the coming year are not yet known at the time that gas supply planning is done to meet forecast winter and peak customer demand for the upcoming gas year.

Third-Party Service Request: The transaction opportunity must involve a third-party. Enbridge is not permitted to bundle the sale of gas and transportation, meaning that the only way to extract value from excess transportation is through the sale of excess capacity to third-parties.

Temporarily Surplus Capacity: The transaction opportunity must relate to transportation or storage capacity that is temporarily surplus. Transportation and storage assets are acquired to meet customer demand in Enbridge's franchise areas. Capacity is temporarily surplus if it is not required to meet the needs of the customer in the franchise on the day(s) in question.[4]

Enbridge noted that the capacity release exchange transactions are possible because Enbridge must contract for a significant amount of firm long haul transportation ("FT") from TCPL in order to meet peak day demand in its Eastern Delivery Area ("EDA"). While the full amount of this FT capacity is needed to meet winter and peak demand, the capacity far exceeds the average summer demand in the EDA. Enbridge noted that, during the summer period, it continues to use its EDA FT capacity to transport gas from Empress but uses an attribute of the FT service to divert the gas not required in the EDA to storage at Dawn.[5]

Enbridge stated that diversions to storage create Transactional Service opportunities. These opportunities arise where a counterparty is prepared to pay some amount for the benefit or use of Enbridge's surplus transportation capacity (using gas purchased by Enbridge) and at the same time provide Enbridge with an equivalent volume of gas at Dawn (to be injected into storage).[6]

[4] Enbridge Argument-in-Chief at pages 3 - 4.
[5] Ibid. at page 4.
[6] Ibid. at pages 4 - 5.

Enbridge noted that capacity release exchange transactions allow counterparties to take advantage of credits associated with unused FT capacity (FT-RAM credits). Enbridge noted that the counterparty can only access these credits if it is a shipper on TCPL, meaning that Enbridge has to assign capacity to the counterparty. Enbridge provided an example of a typical capacity release exchange transaction in Exhibit K1.3. The example sets out that Enbridge provides a counterparty with gas at Empress and assigns FT capacity to the EDA to the counterparty for that volume of gas. Then the counterparty transports the gas to Emerson using a less expensive TCPL IT service and leaves the FT capacity empty so that the counterparty can obtain FT-RAM credits. The counterparty sells the gas at Emerson, and provides Enbridge with an equal volume of gas at Dawn, for injection into storage. Enbridge noted that the outcome of the transaction is that it gets gas where it needs it and the counterparty benefits because the value of the gas at Emerson plus the value of the FT-RAM credits exceeds the cost of gas purchased at Dawn (plus the cost of IT transportation acquired from TCPL). The counterparty pays TCPL for the cost of the FT capacity that was assigned, and bills that cost to Enbridge while at the same time crediting Enbridge with a payment of an additional amount (in recognition of the value that the counterparty obtains from the transaction).[7]

Enbridge stated that the net revenues generated from its 2012 capacity release transactions are properly considered Transactional Service revenues as they meet all three criteria for a transaction to be considered a Transactional Service. Enbridge set out the following to support its position.

Unplanned: At the time that Enbridge creates its gas supply plan, it does not know either the amount or the value of transportation capacity that will be temporarily surplus during the coming year. It is only later that Enbridge is able to identify how much capacity will be available to offer for capacity release transactions, and it is only later that counterparties are prepared to value that capacity.

Third-Party Service Request: The capacity release exchange transaction necessarily involves the assignment of Enbridge FT capacity to a third-party. That is what differentiates this type of transaction from a base exchange transaction. Enbridge cannot “unlock” the value of the FT-RAM credits within the FT service without assigning the capacity to a counterparty who becomes the shipper of record, and then pays Enbridge a portion of the value of the FT-RAM credits.

Temporarily Surplus Capacity: Enbridge has confirmed that it does not acquire any FT capacity for the purpose of optimization transactions – all of Enbridge’s FT

[7] Ibid at pages 6 - 7.

transportation to the EDA is required to meet peak day demand. Capacity release exchange transactions involve the assignment of FT capacity that is not needed to serve customers within the EDA during the periods of assignment (generally summertime). That transportation capacity is temporarily surplus and would otherwise be used to divert gas to storage, instead of to the contracted location (the EDA).[8]

Enbridge noted that, in the 2011 ESM decision rendered by the Board, capacity release exchanges were determined not to be transactional services. As such, Enbridge was directed to treat capacity release exchange revenues as a pass-through to ratepayers. Enbridge noted, however, that the Board agreed with Enbridge that capacity release activities were not undertaken on a planned basis and were therefore unplanned.

Enbridge noted that the point of departure between its 2012 ESM evidence and the Board's 2011 ESM decision is in regards to the third element of Transactional Services, temporarily surplus capacity. The Board stated that "…in a capacity release, the gas purchased by Enbridge at Empress is required to serve its customers." Enbridge argued that, in fact, the transportation used to complete capacity release exchange transactions is temporarily surplus capacity as it is not required to meet the demand of its customers on the day. The transportation used to complete capacity release exchange transactions is temporarily surplus capacity in the same way that it is temporarily surplus capacity for base exchanges and for STS-RAM credit exchanges.[9]

Enbridge argued that asset optimization through transactional services ultimately benefits ratepayers through reduced rates. Enbridge noted that it has been a long established practice to incent utilities to maximize these transactions for the benefit of ratepayers through a revenue sharing mechanism. Enbridge argued that the 75:25 sharing mechanism, as established in the TSDA, accurately reflects the incentive Enbridge deserves for optimizing its upstream transportation portfolio.

Board Staff Position

The issue in the current case is the same as the issue that was before the Board in Enbridge's 2011 ESM proceeding. Board staff submits that it is incumbent upon the Board to consider the evidence before it now to assess whether there is any reasonable basis for the Board to depart from the decision and reasons rendered in the 2011 ESM case. The Board is not, however, bound by the 2011 ESM decision.

[8] Ibid. at pages 7 – 8.
[9] Enbridge Application, Exhibit C, Tab 1, Schedule 6 at page 17.

The evidence before the Board in the 2011 proceeding led the Board to conclude that revenues generated from capacity release transactions are properly classified as gas cost reductions (and should therefore be passed-through to ratepayers in their entirety).

Board staff is of the view that in the current proceeding, Enbridge provided better, more thorough and complete evidence explaining its capacity release activities than it did in 2011. It is this more comprehensive evidence, key examples of which are provided herein, that Board staff submits allows the Board to make a decision which is different from the decision it made on the same issue in 2011.

Board staff notes that the onus is always on the applicant to file with the Board appropriate and sufficient justification for the relief sought in the application. Enbridge specifically acknowledged in both its written and oral evidence that the evidentiary record on the issue of capacity release transactions in the 2011 ESM case was not complete. For example, in its oral evidence in chief, Enbridge indicated:

> In reviewing our 2011 ESM proceeding, it became clear to us that the level of detail on the evidentiary record was inadequate to explain the nature of our transactional services activities, and did not provide the Board with a full understanding of the nature of these activities.[10]

The Board's decision in Enbridge's 2011 ESM proceeding provided two criteria which need to be considered when determining whether revenues generated from capacity release transactions should be treated as Transactional Service revenues. These two criteria are as follows:

1) The transaction must rely on temporarily surplus assets.

2) The transaction must be unplanned.

Board staff is of the view that the first criterion, as set out by the Board, speaks to whether the assets supporting the transaction are required to serve customer needs on the day(s) that the transaction is in effect. If the assets are not required to serve customer needs at that time, the assets are properly considered temporarily surplus assets.

Board staff is of the view that the second criterion, as set out by the Board, relates to whether generating optimization opportunities is central to the development and management of the gas supply plan. If the utility's gas supply plan is right-sized and

[10] Tr. at page 12.

generating optimization activities are not central to the gas supply plan (and the planning process), the transaction is properly considered unplanned.

Board staff is of the view that these two criteria are appropriate for considering whether revenues from capacity release transactions should be classified and treated as Transactional Service revenues.

In Board staff's view, it is important to address the issue of whether the capacity release transactions rely on temporarily surplus assets as, in Board staff's submission, this is the point of departure between Enbridge's 2012 ESM evidence and the Board's 2011 ESM findings on the appropriate treatment for revenues generated from capacity release transactions.

Board staff notes that Enbridge provided extensive evidence which highlights that its capacity release optimization activities are supported by temporarily surplus assets (i.e. the assets are not required to meet the customer demands at the time).

> Where we believe there was some lack of clarity was with respect to whether the transportation was temporarily surplus or not. And the evidence in this case does define surplus transportation capacity as capacity not being required to meet the needs of the customer in the franchise on the day, because that is what transportation capacity is ultimately secured for, to meet the demands of the customer in the franchise on the day.[11]

Enbridge emphasized that there is excess transportation capacity in the summertime, which is an outcome of the gas supply plan. Enbridge noted that the gas supply plan considers that excess capacity and utilizes the capacity, and the attributes associated therewith, to divert the gas to storage for future use.

> The contracted capacity that we have from Empress to EDA, the level of contracted capacity that we've entered into is to enable us to meet our peak and winter seasonal demands. We recognize that there's going to be excess capacity going to the EDA in the summertime, the excess in what our summer demand is, but as Mr. LeBlanc alluded to, we'll continue to fill that capacity in the summertime knowing that we will then divert that gas back to storage. And that's part of our overall supply plan.[12]

Importantly, Enbridge explained that a capacity release transaction does not affect Enbridge's ability to get the gas where it will ultimately be needed. Enbridge is able to

[11] Tr. at page 18.
[12] Tr. at page 22.

generate additional value from an optimization transactions, but the gas is still exactly as was intended per the gas supply plan such that it can be used in the future for Enbridge's customers.

> By doing the exchange, we still *[sic]* up with the molecules where we want them, but we've done the exchange whereby we've given the gas -- as it's described here, we're giving that gas to a counterparty at a location where they can generate value.[13]
>
> The consequence of that is that we are able to do exactly what we set out to do with that -- had we used the transport ourselves. Buy the gas at Empress and put it in storage at Dawn; that's what the gas supply plan asked us to do.
>
> The consequence of that is that the third party has been able to generate revenues that they're sharing with us. It is no different than the way a base exchange generates revenues that results in lower costs for our customers overall, because there's revenues offsetting those costs.[14]

Board staff submits that the evidence is clear that Enbridge only performs capacity release transactions in the summer months when there are temporarily surplus assets available. Enbridge noted that in the 2012 winter months it did not enter into any capacity release transactions for any period of time.[15] As set out by Enbridge, capacity release exchange transactions are supported by temporarily surplus assets that arise because Enbridge must contract for a significant amount of FT capacity from TCPL in order to meet peak day demand in its EDA. This capacity, while required to serve the demand in the EDA in the winter, exceeds demand in the EDA in the summer. Board staff notes that the excess capacity available in the summer months creates Transactional Service opportunities (including opportunities to enter into capacity release transactions). Board staff is of the view that the excess capacity available to support the capacity release transactions is properly considered temporarily surplus to the needs of Enbridge's customers.

[13] Tr. at page 30.
[14] Tr. at page 33.

[15] Board staff notes that Enbridge did enter into some capacity release transactions in November 2012. Board staff asked Enbridge about these transactions in its cross-examination. Enbridge noted that the design day has never occurred in November (in Ontario) and that there are surplus assets available to support the capacity release transactions during that month. Board staff is convinced that temporarily surplus assets exist in November (in the same way that they exist in the summer months).

Board staff submits that Enbridge's gas supply plan is designed to ensure that the daily, seasonal and design day demands of its customers are met while promoting supply diversity and managing costs. Enbridge also provided substantial and, in staff's submission, credible evidence that upstream transportation optimization activities (including capacity release transactions) are not central to its gas supply plan.[16]

Enbridge specifically addressed the issue of whether capacity release transactions are considered when developing the gas supply portfolio in an exchange with Board Member Quesnelle as follows:

> MR. QUESNELLE: Mr. Quinn, if I could just interject at this point? Could you expand on that as to how you determine in advance what portions, or what proportions, rather, of your transport services would have that feature?
>
> And when do you have to make that, and how do you do the calculation as to how to proportion which has or does not have that attribute?
>
> MS. GIRIDHAR: So there's --
>
> We try and use that long-haul such that we can fully utilize those diversion rights to fill gas in storage, because that way we are utilizing the transport year-long. All through the year. It minimizes costs for our customers.
>
> But we have seasonal demands that exceed what that long-haul can provide. And that, for the remainder, we use a combination of short-haul transport, which also provides some limited diversion rights. But we also use something called short-term firm transport, that comes with no diversion rights.
>
> But we figure that using that short-term transport for three months of the year without diversion rights is more economical than us going and procuring even more long-haul transport, and not being able to use the diversion rights.
>
> So when we do our gas supply planning, we're actually looking at it from the perspective of least cost. We know we have this high-cost transport from Alberta that comes with bells and whistles, and we only contract for as much of it as we need, such that we can utilize all the features of that transport.
>
> So that's how we determine.
>
> MR. QUESNELLE: So the anticipation of having capacity release does not enter into the proportion of which products you're buying, then?
>
> MS. GIRIDHAR: No, it does not.[17]

[16] Board staff notes that the Board in Enbridge's 2011 ESM decision found that optimization activities are not core to Enbridge's gas supply plan.

[17] Tr. at pages 40 - 41.

Overall, Board staff submits that the evidence in this proceeding is clear that generating opportunities to enter into capacity release transactions is not central to Enbridge’s gas supply plan, that capacity release transactions rely only on temporarily surplus transportation capacity that is available in the summer months and that capacity release transactions do not impact Enbridge’s ability to get gas to where it will be ultimately required. On that basis, Board staff submits that the revenues generated from capacity release transactions are properly considered Transactional Service revenues and should be treated as such in the 2012 balance of the TSDA.

All of which is respectfully submitted.