Ontario Energy Board

Commission de l'énergie de l'Ontario

Ontario

EB-2014-0012

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, pursuant to section 36(1) of the *Ontario Energy Board Act, 1998*, for an order or orders approving rates and other charges for an interruptible natural gas liquefaction service.

BEFORE: Christine Long
Presiding Member

Marika Hare
OEB Member

Cathy Spoel
OEB Member

Decision with Reasons
April 9, 2015

Union Gas Limited (Union) filed an application with the Ontario Energy Board (OEB) pursuant to section 36 of the *Ontario Energy Board Act, 1998*, S.O. c.15, Schedule B, for an order or orders approving a new interruptible natural gas liquefaction service. Union proposed to provide this new service at its Liquefied Natural Gas (LNG) facility at Hagar, Ontario (the Hagar facility). The Hagar facility is a storage facility that meets the system integrity requirements in Union's Northern service area. Under the new service, LNG would be made available, on an interruptible basis, to wholesale distributors for use as vehicle transportation fuel or for remote power, marine, mining and/or rail applications[1].

[1] Union Argument-in-Chief, Page 1, December 5, 2014

Union requested a rate to accommodate the interruptible liquefaction service and proposed a cost allocation methodology that allocates the different cost components to the new service. Union has excess liquefaction capability at Hagar because liquefaction is currently needed only to replace LNG volumes that are vaporized for purposes of meeting a system integrity event, or as a result of regularly occurring boil off. In addition to the excess liquefaction capability, Union plans to create additional capacity by replacing the current measuring device in the tank for greater measurement accuracy. The replacement of the device will increase the amount of working storage space by an estimated 7,000 GJ. Union proposes to use this excess capacity to provide LNG to wholesale distributors.

Union has estimated a total capital cost of approximately $9.9 million to provide the new service. Union is forecasting an increase of approximately $2.0 million to the average annual utility revenue from this new service until the end of 2018 (before rebasing in 2019).

The Hagar facility

The Hagar facility has been in operation since 1968. To date, however, it has only been used as a winter “peaking” facility – it operates essentially as a storage reserve that can be accessed to preserve system integrity in times of tight supply. The 2013 OEB approved revenue requirement for the Hagar facility is approximately $6.2M.

The Hagar facility conducts three operations: liquefaction, storage, and vaporization. The liquefaction function cools natural gas to -162 degrees Celsius, at which point it condenses into a liquid. The liquefied gas is then pumped into a storage tank where it is kept until needed. The vaporization function converts the LNG back into a gas as necessary to support any system integrity requirements. Although Union has used the Hagar facility to meet system integrity requirements a number of times, it has never used the entire amount of gas stored in the storage tanks.

Although Union still requires the Hagar facility for system integrity, for much of the year it is not actively using the liquefaction function. Once the storage tank has been filled, the liquefaction function is not needed again until the tank becomes depleted. For this reason, much of the time Union is not actually using the liquefaction function. Union proposes to maximize the value of the Hagar facility by providing the liquefaction service to third parties on an interruptible basis. Third parties would send special storage trucks to the Hagar facility, where Union would use the liquefaction service to fill

them. The trucks would then transport the LNG elsewhere for an ultimate end use. Although Union would not have any control over the end use of the LNG, it is anticipated that it would be used primarily as a vehicle fuel – for example, for long haul trucking, although other uses are also possible.[2]

The Motion With Respect to Forebearance

Northeast Midstream L.P. (Northeast), an independent company involved in providing LNG services and an intervenor in this proceeding, filed a motion dated October 15, 2014, pursuant to section 29(1) of the *Ontario Energy Board Act*, 1998 requesting that the OEB refrain from regulating and approving the terms, conditions and rates for the interruptible natural gas liquefaction service requested by Union.

The OEB held an oral hearing to address all aspects of the Northeast motion and the application. The OEB directed all parties to present their final arguments on the motion at the oral hearing. The OEB reserved its decision on the section 29 motion, but directed all parties to file written submissions on the application.

This decision of the OEB deals with both the motion brought by Northeast and the issue of the allocation of costs between Union's regulated and un-regulated services, which forms the second part of the application.

OEB Findings

The OEB grants the motion brought by Northeast and will forebear from regulating the provision of LNG. The OEB comes to this decision based on a number of factors as discussed below.

Northeast presented evidence that there is already a competitive market for liquefied natural gas as a transportation fuel, and that the OEB should forebear from regulation. Union did not dispute the fact that LNG as a transportation fuel competes with diesel fuel, but argued that the unique circumstances of the Hagar facility require that the new service be regulated by the OEB. For the reasons described below, the OEB finds that the new service that Union proposes to provide is already competitive and thus will not set rates or otherwise regulate this activity.

[2] Exhibit A, Tab 1, pp. 4-6, 7-10.

Northeast argued as a preliminary matter that, irrespective of section 29, Union's proposed liquefaction service is exempt from regulation under section 36 of the OEB Act by virtue of section 2(2) of O. Reg. 161/99, which states:

> (2) Section 36 of the Act does not apply to,
>
> (a) a Class A distributor in respect of the sale, transmission, distribution or storage of motor vehicle fuel gas if,
>
> (i) the value of the gas immediately before it was liquefied or compressed into motor vehicle fuel gas is recorded in a special account,
>
> (ii) the value recorded is approved by the Board, and
>
> (iii) all amounts recorded in the special account are reported as revenue for the purposes of section 36 of the Act; or
>
> (b) any other person in respect of the sale, transmission, distribution or storage of motor vehicle fuel gas.

Northeast argued that the end use of the liquefied natural gas will be as motor vehicle fuel, and that the exemption therefore applies and Union should not receive a rate for the service under section 36.

Union replied that the exemption under the regulation was not mandatory, and that a distributor could decide if it wanted the exemption to apply. Union relied on the word "if" in section 2(2)(a), and the additional conditions that are set out in 2(2)(a)(i), (ii) and (iii). In Union's view, if a distributor wants to be exempt from regulation for the sale of motor vehicle fuel gas, it must meet the three conditions in 2(2)(a)(i), (ii), and (iii). If it does not wish to be exempt under section 36 – i.e. if it wishes to continue to be regulated – it can simply choose not to fulfill the conditions and thereby continue to be covered by section 36. The choice, in Union's view, is the distributor's, and not the OEB's.

Given its findings on the section 29 question, the OEB finds that it is not necessary to make a finding on whether the new service is exempt from regulation pursuant to O. Reg. 161/99.

The OEB considered the test under section 29 as follows.

Northeast brought its motion under section 29 of the Act, which states:

> **29.** (1) On an application or in a proceeding, the Board shall make a determination to refrain, in whole or part, from exercising any power or performing any duty under this Act if it finds as a question of fact that a licensee, person,

product, class of products, service or class of services is or will be subject to competition sufficient to protect the public interest.

Scope

(2) Subsection (1) applies to the exercise of any power or the performance of any duty of the Board in relation to,

(a) any matter before the Board;

(b) any licensee;

(c) any person who is subject to this Act;

(d) any person selling, transmitting, distributing or storing gas; or

(e) any product or class of products supplied or service or class of services rendered within the province by a licensee or a person who is subject to this Act.

As several parties observed, the use of the word "shall" in section 29(1) means that the OEB has a positive obligation to forbear from regulation where it finds that there is or will be competition sufficient to protect the public interest. If the factual record indicates that there is sufficient competition, the OEB has no discretion and must refrain (in whole or in part) from regulating the activity.

In considering section 29, the OEB is further guided by its statutory objectives. Of particular note is the OEB's first objective with respect to natural gas: "to facilitate competition in the sale of gas to users."[3]

The OEB's most thorough review of section 29 date was in the EB-2005-0551 proceeding (the NGEIR Decision). The key factors considered by the OEB were: the identification of the relevant product market, the identification of the relevant geographic market, a calculation of market share and market concentration measures, an assessment of barriers to market entry, and an overall analysis of the public interest.

The OEB is satisfied that there is competition sufficient to protect the public interest for Union's proposed liquefaction service (which will chiefly be used as vehicle fuel), and it will not regulate Union's proposed provision of its liquefaction service.

There does not appear to be any serious dispute between the parties that the LNG service Union proposes is or will be competitive. Most of the elements of the section 29

[3] OEB Act, section 2.1.

test are not actively contested. It is agreed by Northeast and Union that the relevant product market is the market for motor vehicle transportation fuel. Currently the chief competitor for LNG as a motor vehicle transportation fuel is diesel fuel, which is widely available. It is also generally agreed that the relevant geographic market is Ontario, Quebec, and portions of the Northeast and Midwest United States.

Northeast filed evidence from Dr. Gaske. Dr. Gaske concluded that the relevant product market is fuel for heavy duty transportation engines: diesel and LNG. Diesel fuel is widely available, and there are a number of existing LNG fuel suppliers that serve Ontario (in addition to new entrants, such as Northeast). He further concluded that the market for this product is workably competitive, and that if Union were permitted to operate a regulated service this could harm the existing competitive industry, and hamper new entrants to the market.

Union did not file any expert evidence to challenge Dr. Gaske's conclusions. In fact, Union concedes that there is and will be competition in the market it is seeking to enter. In its written response to Northeast's motion, Union stated:

> In Union's view, the market for LNG as a transportation fuel will be competitive. Union made this same assertion both in its pre-filed evidence and interrogatory responses. In fact, aside from certain assertions which Union disagrees with and corrects below, Union does not oppose the overall basis of the Motion, particularly in respect of LNG facilities that are greenfield.[4]

Union argued instead that there were "special and unique circumstances" associated with the Hagar facility which spoke in favour of OEB regulation, and that forbearance would be premature at this time. The unique circumstances are largely the fact that most of the assets that will be used for the new service are already providing utility service (and are therefore part of rate base), and that it would be difficult from an accounting perspective to separate the services and allocate the costs between regulated and unregulated services. Union also points to Hagar's role as a system integrity asset, the relatively small amounts of gas that will be available for sale, and the interruptible nature of the proposed new service.

The OEB does not accept that the circumstances related to the Hagar facility and the proposed new service provides a strong rationale to regulate the new service. Section 29 is clear that where the OEB finds that there is, or will be, competition sufficient to

[4] Union's response to Northeast's motion, para. 4.

protect the public interest; it will refrain (in whole or in part) from regulation. The OEB has found that the new service is subject to competition sufficient to protect the public interest. It therefore has little choice but to refrain from regulation, whatever the difficulties.

Regardless, the difficulties do not appear to be insurmountable. Many utilities, both gas and electric, have regulated and unregulated services, and are able to account for that appropriately. The NGEIR decision allowed the gas utilities to de-regulate a portion of their storage services; however, functionally they are still the same assets as the regulated storage. Union argues that the separation in the case of Hagar is more complex than the NGEIR separation. However, Union concedes that an allocation can be done.

The OEB is similarly not convinced that Hagar's primary function as a system integrity asset, or the interruptible nature of the new service, is a strong argument in favour of regulation.

The OEB will therefore not regulate Union's proposed new liquefaction service. As required by section 29(4), the OEB will promptly notify the Minister of Energy of this decision.

Costs of the Motion

In Procedural Order No. 1, the OEB found that Building Owners and Managers Association, Canadian Manufacturers and Exporters, Industrial Gas Users Association and Energy Probe were each eligible to apply for an award of costs under the Board's *Practice Direction on Cost Awards*. The School Energy Coalition, a late intervenor in the proceeding was also found eligible to apply for cost awards. In its request for intervention Northeast did not seek costs.

However, in its Notice of Motion dated October 15, 2014, Northeast did seek costs of the motion. At the oral hearing, Union submitted that Northeast's request for costs awards should be denied. Union noted that Northeast did not raise the issue of costs when it first intervened in the proceeding and Northeast was before the OEB for its own commercial interest.

In reply, Northeast argued that it was entitled to the costs of the motion on the basis that it raised a broader policy issue in the motion, as opposed to only representing its own commercial interests.

The OEB has considered the arguments of both parties and determined that the reasonable costs of the motion (based on the OEB's tariff in the *Practice Direction on Cost Awards*) should follow the success of the motion.

Therefore Northeast will be entitled to its reasonable costs of the motion on forbearance. However, the costs in relation to its appearance and argument on the cost allocation issue will not be recoverable.

Cost Allocation

Although the OEB has determined that it will not regulate Union's proposed new liquefaction service, it is still necessary to allocate costs as between Union's existing regulated service and the new unregulated service to ensure that there are no cross-subsidies.

Union retained KPMG to undertake a comprehensive cost allocation analysis of the current costs of the Hagar facility and to recommend an appropriate cost allocation methodology to allocate costs for the new service. The costs of Hagar were functionalized between liquefaction, storage and vaporization. For costs that could not be directly assigned to one of these functions, KPMG allocated the costs in proportion to the functionalization of directly assigned costs. Union adopted the approach recommended by KPMG and requested the OEB approve the allocation methodology as outlined in its application.

Foreseeing the potential outcome of OEB acceptance of the motion to forebear under section 29, Union requested that the OEB accept Union's functionalization and allocation of costs for purposes of calculating a utility cross charge to be paid by the unregulated service to Union. The cross-charge would be treated as revenue by Union. Submissions from parties focussed on 3 issues:

- Is the resulting proposed cross-charge appropriate, or should the functionalization study be redone?;

- How will benefits to ratepayers be dealt with given Union is under an Incentive Ratemaking (IRM) regime?; and

- What happens upon rebasing?

These issues prompted suggestions from parties which included the establishment of a deferral account and adjusting the revenue requirement by removing expenses associated with the non-regulated business.

The OEB finds many of the concerns expressed by parties to be valid. However, the OEB also believes that there needs to be a level of reasonableness and practicality in arriving at its decision. This will be a new business venture for Union, which may or may not materialize as forecast. Secondly, the arrangements will be in place for less than 2 years before Union is scheduled to file a rebasing application for 2019 rates. There are uncertainties and risks with this proposal, but not to ratepayers, who given the decision that this will be a non-utility business, will not bear these risks. The revenue associated with the venture, if it is successful, will only accrue to ratepayers if the Earnings Sharing Mechanism is triggered. In this respect, the OEB agrees that benefits to rate-payers may be minimal or non-existent in the short-term. But the OEB is also cognizant of the fact that Incentive Ratemaking is supposed to encourage innovation and the pursuit of new business opportunities which may benefit the shareholder and ratepayer. Should this venture be successful, the benefit will be reflected in a reduction in revenue requirement upon rebasing.

For these reasons, the OEB accepts Union's proposed utility cross charge to be paid by the unregulated service to Union, without conditions associated with deferral accounts or revenue requirement adjustment. These revenues will be treated as utility earnings, and would be eligible for sharing with ratepayers where the earnings sharing mechanism is triggered. Union has estimated the cross charge to be $1.59/GJ which works out to approximately $656,594 annually.

This cross charge will be in place from the start of the business period (expected July 2016) until new rates are applied for in 2019. With the rebasing application Union is directed to file a more robust and comprehensive cost allocation study that appropriately allocates costs for the new service.

THE OEB ORDERS THAT:

1. The intervenors shall file with the OEB and forward to Union their respective cost claims for this proceeding within 10 days from the date of this Decision. The OEB reminds Northeast to file costs only related to the motion and not the application.

2. Union shall file with the OEB and forward to the intervenors any objections to the claimed costs within 24 days from the date of this Decision.

3. The intervenors shall file with the OEB and forward to Union any responses to any objections for cost claims within 31 days of the date of this Decision.

4. Union shall pay the OEB's costs incidental to this proceeding upon receipt of the OEB's invoice.

DATED at Toronto, April 9, 2015
ONTARIO ENERGY BOARD

Original Signed By

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Christine Long
Presiding Member

Original Signed By

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Marika Hare
OEB Member

Original Signed By

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Cathy Spoel
OEB Member