
**Ontario
Energy
Board**



**IN THE MATTER OF THE
ONTARIO ENERGY BOARD ACT**

AND

IN THE MATTER OF AN APPLICATION BY

**CANADIAN PACIFIC FOREST
PRODUCTS LIMITED**

FOR A BYPASS COMPETITIVE RATE

E.B.R.O. 471

DECISION WITH REASONS

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IN THE MATTER OF the Ontario Energy Board Act,
R.S.O. 1980, c. 332;

AND IN THE MATTER OF an Application by
Canadian Pacific Forest Products Limited pursuant to
Section 19 of the Ontario Energy Board Act for an Order
approving or fixing a just and reasonable rate that ICG
Utilities (Ontario) Ltd., now known as Centra Gas
Ontario Inc., may charge for services with respect to the
supply of natural gas to the Canadian Pacific Forest
Products Limited plant located at Dryden, Ontario.

BEFORE: C.A. Wolf Jr.
Presiding Member

R.R. Perdue
Member

P.W. Chapple
Member

Decision with Reasons

August 27, 1991

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1. INTRODUCTION

- 1.0.1 This hearing was initiated by an Application ("the Application") by Canadian Pacific Forest Products Limited ("CP Forest Products", "the Company" or "the Applicant") dated September 21, 1990, for an Order of the Ontario Energy Board ("the Board") approving or fixing the just and reasonable rate that ICG Utilities (Ontario) Ltd, now Centra Gas Ontario Inc. ("Centra"), may charge the Company for services rendered with respect to the supply of natural gas by Centra to CP Forest Products' plant in Dryden, Ontario.
- 1.0.2 CP Forest Products filed its evidence on October 18, 1990, and on October 29, 1990 amended the Application to request that any rate resulting from the Application become effective on January 1, 1991.
- 1.0.3 The Company filed a further amendment on December 21, 1990 indicating that it had agreed with Centra on a bypass competitive rate ("a bypass rate") for all gas delivered to its Dryden plant, effective January 1, 1991. On December 28, 1990 CP Forest Products filed supplementary evidence to reflect this agreement, and on May 2, 1991 the Company filed further evidence which indicated that it would not accept the rate offered by Centra if it was conditional on CP Forest Products taking transportation service directly from TransCanada PipeLines Limited ("TCPL").

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1.0.4 In the supplementary evidence CP Forest Products also indicated that it was not willing to accept Centra's position that the effective date of the rate should be a date following the Board's Decision on the Application.

1.1 THE HEARING

1.1.1 The hearing began on June 4, 1991. It was adjourned for one day and continued on June 6. The parties delivered oral argument on June 7, and CP Forest Products filed its written reply argument on June 14.

1.1.2 The parties and their representatives in the proceeding were as follows:

CP Forest Products	P. W. Gilchrist
Centra	D. A. Dadson
Board Staff	J. A. Campion
The Industrial Gas Users Association ("IGUA")	B. A. Carroll

1.1.3 The following witnesses testified in the hearing on behalf of CP Forest Products:

R. Beaudry	Beaudry, Belisle & Associates
G. Scheifle	Gore & Storrie Ltd.
J. H. Sim	V.P. Marketing, White Papers Division, CP Forest Products
B. Antonen	Manager, Engineering Services, CP Forest Products

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1.1.4 The following employees appeared on behalf of Centra:

R. Bourgeault	Manager, Industrial Gas Utilization
P. Hoey	Manager, Rate Design
J. Collier	Supervisor, Cost of Service Studies
R. Reid	Manager, Gas Supply and Planning
D. Alexander	Chief Engineer

1.1.5 The complete transcripts of the proceedings, together with all exhibits presented at the hearing, are available for public inspection. Although the Board in making its decision considered all the evidence presented at the hearing, it has included a summary of only those issues necessary to come to its Decision herein.

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2. BACKGROUND

2.0.1 The issue of bypass rates for some industrial customers with facilities very near the TCPL pipeline was first considered in the late 1980s, shortly after the de-regulation of upstream gas supplies in Canada. The possibility of some of these customers building their own pipeline directly to the TCPL system, thereby bypassing the local distribution company, was made more likely with the ability of those customers to purchase their gas supplies directly and contract for transportation service with TCPL.

2.0.2 This prompted Ontario's distribution companies to consider special rates for such companies using the rationale that: better part of a loaf than none at all. The result was proposals for bypass competitive rates which would become available, upon Board approval, to those customers which could demonstrate their physical and financial ability to capitalize on their proximity to the TCPL pipeline.

2.0.3 The Board examined the whole issue of bypass and bypass rates in relation to each of Ontario's three major distribution companies in a combined hearing under Board file numbers E.B.R.O. 410-I, 411-I and 412-I. The Board said that it would consider each application for bypass on the basis of its individual merits and that potential rate making solutions should be considered as an alternative to a physical bypass in order to ensure that the public is fully protected.

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2.0.4 Three bypass rates have been approved by the Board but there has been no application to the Board for an actual bypass. In each of the cases where the Board approved a bypass rate, the customer involved used natural gas as a raw material or "feedstock".

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3. POSITIONS OF THE PARTIES

- 3.0.1 CP Forest Products' Dryden operation produces kraft paper, construction lumber and uncoated white sheet paper. The plant is described by its owners as large, modern and well situated to serve the highly competitive North American market and it is Dryden's largest employer.
- 3.0.2 The Company indicated that it was attempting to modernize its facilities further in order to lower its production costs to counter the effects of free trade which, over the next several years, will remove a 12 to 15 percent tariff protection the Company has previously enjoyed. The bypass rate being sought in this Application is one of its cost cutting efforts.
- 3.0.3 CP Forest Products and its predecessors at Dryden have been natural gas customers for more than 40 years. Currently the Company operates under buy/sell arrangements with Centra, and for 1991 it estimated its annual demand to be about 113,000 10³m³, which the Company expects to remain constant for the next 15 years. Based on Centra's current rates, the annual delivery cost for this gas is about \$596,000 which represents about 3.7 percent of the cost of production.
- 3.0.4 In argument, the Company proposed that the Board set a bypass rate of \$3.91 per 10³m³ under its current buy/sell arrangements with Centra or \$2.25 per 10³m³ if CP Forest Products switches to a transportation rate.

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- 3.0.5 In order to show that it was entitled to a bypass rate, the Company called evidence to establish that it would be a credible bypass candidate in that it could finance, construct, operate and maintain its own 3 km pipeline between its facilities and the TCPL main line running just north of the town.
- 3.0.6 The Company testified that it preferred not to build such a pipeline and to remain a Centra customer. However, if it was not granted a bypass rate, it would apply for leave to construct its own pipeline and cease to be a customer of Centra by becoming a transportation customer of TCPL .
- 3.0.7 The Company argued that the current rate structure (i.e. "postage stamp rates"), is outdated because it provides no incentive for industry to "improve plant efficiency through location or re-location near the TCPL pipeline."
- 3.0.8 Centra objected to CP Forest Products seeking a bypass rate while continuing to be served under its existing buy/sell arrangement. Centra argued that a bypass rate should be available to CP Forest Products only if the Company is prepared to switch to transportation service and thus assume responsibility for its load balancing on the TCPL system. Under these circumstances, Centra agreed that CP Forest Products would be a credible bypass candidate and thus be eligible for a bypass rate which it argued should be \$4.20 per 10³m³.
- 3.0.9 Counsel to Board Staff urged the Board to deny CP Forest Products' Application and, in fact, argued that the Board should reject bypass rates altogether. Mr. Champion submitted that postage stamp rates should be applied consistently and should not be based on a customer's individual characteristics such as its distance from the TCPL line. Distance based rates, he pointed out, could impose increased burdens on other customers.

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The more the Board considers subjective criteria [for assessing the eligibility of potential bypass candidates], the more it risks abandoning its mandate to fix just and reasonable rates. The greater the intervention, the less predictable are the indirect, unknown impacts on the economic efficiency principle. The regulatory burden of the Board will increase broadly if it is required to tailor-make rates for every industrial customer in the province who might be a bypass candidate.

- 3.0.10 Much to the objection of the Applicant's Counsel, Board Staff argued that approving this Application could open the floodgates for others. Evidence filed by Centra indicated that the total effect of bypass rates on the utility could be about \$11.7 million per annum based on its latest proposed margins sought in E.B.R.O. 467. Counsel for CP Forest Products cut the number of potential bypass candidates in half using the argument that not all of them would dedicate the necessary funds to obtain regulatory approval after taking into account the savings they might gain. He urged the Board to follow its stated intention to consider each bypass application on a case by case basis.

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4. BOARD FINDINGS

4.0.1 It was urged upon the Board to reject CP Forest Products' Application, in part, because the Company does not use gas as a feedstock. However, the Board is of the opinion that the use to which gas is put is not definitive as to whether or not that customer is entitled to a bypass rate and this argument is therefore rejected.

4.0.2 The Board's past Decisions on this issue, and in particular the Northland Power Decision in E.B.R.O. 458, have yielded certain key principles. These principles form the framework for deciding, on a case by case basis, if the public interest is best met by approving an individual application for a bypass rate. The principles can be identified as follows:

- Postage stamp rates within each class of customers are the accepted norm in Ontario and the Board will not depart from this principle in favour of distance related rates unless there are valid and compelling reasons to do so.
- An applicant seeking such a rate must satisfy the Board that it is a credible bypass candidate and that it is ready, willing and able to build and operate its own pipeline.

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- An applicant must show that the construction of a bypass pipeline is within the public interest and that, inter alia, there are compelling reasons to authorize construction of duplicating services.
- An applicant for a bypass rate must satisfy the Board that such a rate is the appropriate response to the applicant's particular problem.
- The Board must be satisfied that it is within the overall public interest to allow a bypass rate and that the amount of the toll itself is neither unjust nor unreasonable in relation to other rates.

4.0.3 The first point does not require justification nor a lengthy explanation --- postage stamp rates within each class of customers are a basic building block of utility regulation in Ontario. It can be argued that without such rates the Province's regional development would have been severely hampered.

4.0.4 However, that does not mean that in today's climate of competitive gas rates, such rate setting basics should continue unamended. The Board is acutely aware that not even postage stamp rates will remain inviolate for every customer class forever and, in fact, the Board has substituted distance related rates (or bypass rates) for postage stamp rates in three cases. It is therefore accepted that, on a case by case basis, it may be within the public interest to substitute distance-based rates for postage stamp rates.

4.0.5 Dealing next with an applicant's credibility as an actual bypass candidate, the Board's criteria in this regard should not present a particularly formidable burden for large, sophisticated and well financed companies close to the TCPL pipeline, such as CP Forest Products.

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4.0.6 However, the remaining principles of those listed above pose serious and complicated questions for the Board while simultaneously imposing a substantial burden of proof on an applicant. Some of the questions which the Board must consider are:

- Other than its proximity to the TCPL pipeline, what is there about the circumstances surrounding this customer which sets it apart from other customers in its class? That is:
 - Is the applicant under some economic threat or is it simply able to bypass economically?
 - Is there a real threat of load disappearing from the utility's system that may obligate other customers to higher costs?
- What is the purpose of the application? Seeking a bypass rate solely to decrease an applicant's costs, may be perfectly worthy from the applicant's point of view. However, it may not be so worthy from the point of view of the public interest which includes those customers burdened thereby with extra costs.
- Is the magnitude of an applicant's total annual saving as a result of the bypass rate, substantial within the context of the applicant's goal of reducing costs?
- Compared with an applicant's total annual cost of operations, is the saving from a bypass rate significant?
- What is the effect on the utility and its remaining customers if the applicant leaves the system and how many other customers will likely apply to do the same? Would the negative effect on the

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public interest be disproportionate to the benefit of a bypass rate to the applicant?

- If a bypass rate is found by the Board to be an appropriate response to an application, what should that rate be, bearing in mind the Board's statutory requirement to set rates which are just and reasonable and not unduly discriminatory?

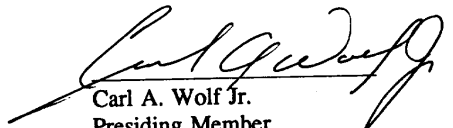
- 4.0.7 The Board considers the approval of a bypass rate to be a serious issue. This is not just a discount program available to large customers, it is a cost shifting rate with public interest impacts which the Board must find is justified beyond the worthy but narrow concerns of an individual applicant.
- 4.0.8 An applicant for a bypass rate must therefore convince the Board that it is seeking more than just a cost reduction. Bypass rates are beyond the ordinary and the applicant must show that its circumstances are also extraordinary. Furthermore these same concerns would be paramount in an application for actual bypass and it should also be kept in mind that, except in the most unusual of circumstances, an appropriate bypass rate is preferable to an actual bypass.
- 4.0.9 In applying the foregoing principles to the instant case, the Board finds that the benefits to CP Forest Products occasioned by the institution of a bypass rate are not significant enough to outweigh the negative impacts on the public interest, such as extra costs being transferred to the remaining customers in the class. As well, the Board finds that the Applicant is not under any economic threat and there is no real danger that its load will disappear from the system.
- 4.0.10 The Board does not find any compelling reasons to conclude that approving a bypass rate in these circumstances would be in the public interest and this Application is therefore denied.

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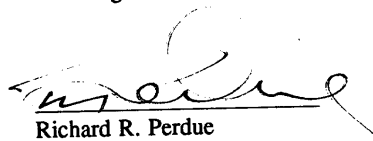
5. **COSTS**

- 5.0.1 No party applied for an award of costs. The Board's costs of and incidental to this proceeding shall be paid by the Applicant upon receipt of the Board's Cost Order and invoice.

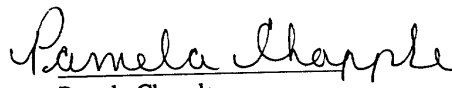
DATED AT Toronto August 27, 1991.



Carl A. Wolf Jr.
Presiding Member



Richard R. Perdue
Member



Pamela Chapple
Member