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**CANADIAN INSTITUTE FOR ENVIRONMENTAL LAW & POLICY**

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**SELLING CONSUMERS' GAS:  
Can it be in the Public Interest?**

prepared by

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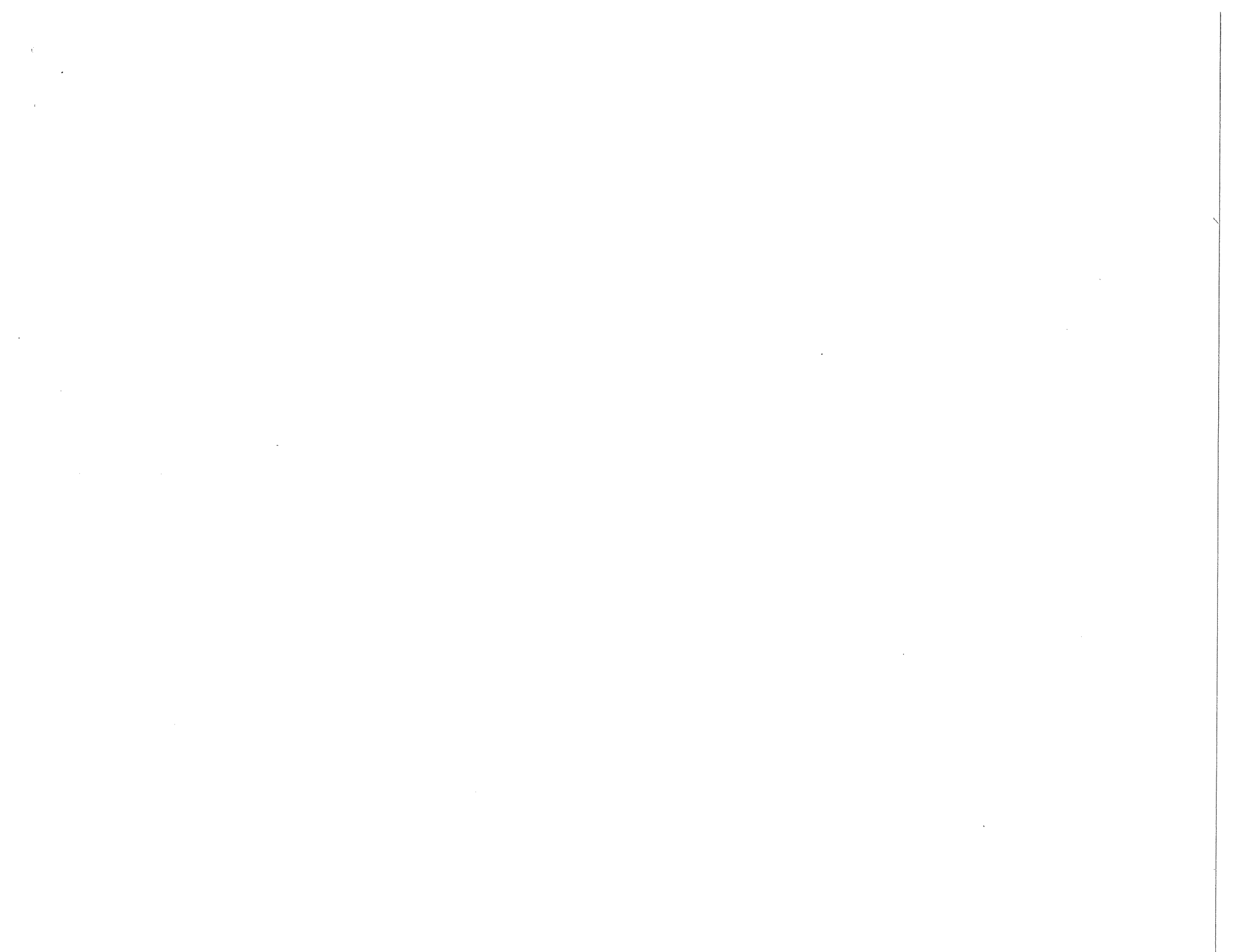
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## 1.0 Introduction

British Gas plc of London, England wishes to purchase The Consumers' Gas Company Ltd. of Toronto. For the takeover to proceed it must receive the approval of the federal Minister of Industry, Science and Technology and the Ontario Lieutenant Governor in Council (the Ontario Cabinet). The Minister of Industry, Science and Technology will approve or reject the takeover after receiving the recommendation of Investment Canada. The Lieutenant Governor in Council will make its decision after the Ontario Energy Board (O.E.B.) has held a public hearing and issued its report on the matter.

According to the Investment Canada Act, a foreign takeover should be approved if there will be a net benefit to Canada.<sup>1</sup> The Ontario Energy Board Act does not specify the criteria that the O.E.B. must use to assess a proposed takeover of an Ontario natural gas utility. However, Premier David Peterson has stated that he is not generally in favour of takeovers such as the proposed takeover of Consumers' Gas unless "there are some pretty compelling reasons."<sup>2</sup>

This report will analyze two issues related to the proposed takeover of Consumers' Gas by British Gas:

1. would the takeover, on the proposed terms and conditions, provide a net benefit to Canada; and

2. what undertakings could British Gas make to the Lieutenant Governor in Council to ensure that the takeover would provide a substantial net benefit to Canada?

## 2.0 Would the Takeover of Consumers' Gas by British Gas Provide a Net Benefit to Canada?

### 2.1 The Issues

Consumers' Gas is Canada's largest natural gas distribution utility. It serves more than one million customers in south-central and eastern Ontario, western Quebec and northern New York state. Consumers' purchases most of its gas supplies from third party (i.e., non-affiliated) natural gas producers in western Canada.

Approximately 83 per cent of the common shares of Consumers' Gas are owned by GW Utilities Limited, a subsidiary of Olympia and York Developments Limited. The remaining common shares are widely held.

British Gas has offered to purchase 100 per cent of the common shares of Consumers' Gas at a price of \$34 per share.

Two reasons have been cited in the media as to why the proposed takeover might not be in the public interest. First, according to Bruce Wilson, energy adviser to the Consumers Association of Canada, Consumers' Gas would be under pressure from British Gas to push up its rates to help pay for the takeover.<sup>3</sup> Second, a Toronto Star

editorial has raised the spectre that the takeover would raise rates if British Gas required Consumers' to buy gas from Bow Valley Industries at inflated rates (British Gas owns 51 per cent of the common shares of Bow Valley).<sup>4</sup>

In addition, environmentalists may be apprehensive that the British Gas/Bow Valley link will reduce Consumers' willingness to promote energy conservation.

Finally, the O.E.B. may question the desirability of one company becoming the sole shareholder of Consumers' Gas.

On the other hand, Robert Evans, Chairman of British Gas, has suggested that if the takeover goes ahead Consumers' Gas will benefit from access to British Gas' research and development programme, its advanced technology and its strong financial position.<sup>5</sup>

We will now examine the likelihood and significance of each of these possibilities.

## **2.2 Would Consumers' Rates be Raised to Finance British Gas' Acquisition Costs?**

The Ontario Energy Board (O.E.B.) has exclusive jurisdiction over the rates of The Consumers' Gas Company Ltd.<sup>6</sup> In particular section 19 of the Ontario Energy Board Act requires the Board to set "just and reasonable rates" for the sale of gas. Thus the British Gas takeover costs will only lead to a rise in Consumers' rates if the Board

believes that it is "just and reasonable" for Consumers' customers to bear some or all of these costs. Fortunately the Board has explicitly rejected the proposition that gas customers should bear any takeover costs. In its 1985 Report with respect to the takeover of Union Gas Limited by Unicorp Canada Corporation the Board stated that:

"Acquisition costs incurred by a parent or grandparent holding company of a utility must not be included in the utility's cost of service."<sup>7</sup>

The Board reiterated the above proposition in its 1986 Report with respect to the takeover of Consumers' Gas by GW Utilities.<sup>8</sup>

Furthermore the Lieutenant Governor in Council approved the takeover of Consumers' Gas by GW Utilities on the condition that:

"Consumers' shall not include in its rate base or recover in its cost of service any of the acquisition or reorganization costs, including the cost of "golden parachute" employment contracts..."<sup>9</sup>

Thus, if the British Gas takeover is approved, Consumers' rates will not be raised to finance British Gas' acquisition costs.

### **2.3 Would the Rates of Consumers' Gas Rise as a Result of Purchases of Gas From Another British Gas Subsidiary?**

British Gas owns 51 per cent of the common shares of Bow Valley Industries Ltd., a major western Canadian natural gas producer. Needless to say, it would be in British



Gas' financial self-interest to require Consumers' to purchase gas from Bow Valley at above market prices if Consumers', in turn, could pass the excess gas costs on to its customers.<sup>10</sup> However, as we have already noted, the Ontario Energy Board (O.E.B.) has exclusive authority with respect to Consumers' rates. Thus Consumers' would need the approval of the O.E.B. in order to recover inflated gas purchase costs from its customers. As a consequence the purchase of gas from an affiliate will only raise Consumers' rates if one or both of the following conditions hold:

1. the O.E.B. is unable to determine whether the gas supply price in an affiliate gas purchase contract is above the fair market price; or
2. the O.E.B. will permit Consumers' to recover inflated gas purchase costs from its customers.

### **2.3.1 Determining the Fair Market Price**

It is very difficult for the Board to assess whether an affiliate transaction price is above the market price for at least two reasons. First, even if the Board had access to a large sample of gas supply contracts, it would be difficult for it to assess the fair market price for the affiliate transactions since gas supply contracts are complicated and each contract has different terms and conditions. Second, it now appears that the Board is no longer requiring the utilities to file their non-affiliate gas supply contracts.<sup>11</sup>

As a consequence it will now be even more difficult for the Board to assess whether an affiliate contract price is appropriate. For the Board will no longer have a set of arms length gas supply contracts which can be used to assess the prudence of affiliate gas supply contracts.

### **2.3.2 Approving Contracts When the Price Exceeds the Fair Market Price**

Consumers' Gas obtains a portion of its gas supplies from an unregulated division. In January 1988 the Board approved the sale of gas from Consumers' unregulated gas production division to Consumers' for re-sale to Consumers' customers. This sale was approved despite the existence of very compelling evidence that the price exceeded the fair market price by at least 19 per cent.<sup>12</sup>

### **2.3.3 Conclusion**

The above analysis suggests that if Consumers' Gas is sold to British Gas and if affiliate gas supply transactions are permitted then it is probable that Consumers' rates will exceed their fair market value.

#### **2.4 Would the British Gas/Bow Valley Link Reduce Consumers' Willingness to Promote Energy Efficiency?**

The aggressive promotion of energy efficiency by Consumers' Gas is in the Ontario public interest for at least two reasons. First, the efficient use of natural gas will reduce Ontario's contribution to global warming. (The combustion of natural gas produces carbon-dioxide, a greenhouse gas.) Second, the efficient use of natural gas will reduce Ontario's total energy bill.

However, energy efficiency is not in the financial self-interest of natural gas producers. For the efficient use of gas will reduce the demand for gas which, in turn, will lead to a fall in natural gas prices. Thus energy efficiency will lower the profits of natural gas producers in two ways. First, by reducing their sales and second by reducing the selling price of their product. As a consequence if Consumers' Gas is owned by British Gas (which owns 51 per cent of Bow Valley Industries, a major Canadian gas producer) then British Gas might direct Consumers' to promote natural gas consumption not energy efficiency.

#### **2.5 Is it in the Public Interest for Consumers' Gas to Have Only One Shareholder?**

In its Report on the takeover of Consumers' Gas by GW Utilities the Ontario Energy Board (O.E.B.) stated that it is in the public interest for Consumers' to have more than

one shareholder:

"The Board is of the view that it is healthy to have enough public or independent shareholders with interests that may differ from the majority shareholder to achieve the above-noted benefits [provide the Board with reliable market data and facilitate access to the market for additional common equity to finance capital expansion] and also to assist in assuring the Board of Consumers' independence from the interests of the controlling parent and grandparent."<sup>13</sup>

As a result of the Board's concern, the Lieutenant Governor in Council approved the takeover of Consumers' by GW Utilities on the condition that GW Utilities would not take any action which would reduce Consumers' public float of voting common shares below 15 per cent of all voting securities without the Board's prior approval.<sup>14</sup> (At the present the public float is equal to approximately 17 per cent of the voting common shares.)

Under the British Gas takeover proposal, British Gas would be the sole shareholder of Consumers' Gas and hence the above noted benefits, that flow from the trading of Consumers' shares on the Toronto and Montreal Stock Exchanges, would be lost.

## **2.6 Would the Purchase of Consumers' by British Gas Provide Consumers' With Research and Development Benefits?**

According to Robert Evans, Chairman of British Gas, a benefit of the proposed takeover is that Consumers' Gas would gain access to British Gas' research and development (R&D) programme and its advanced gas technologies. Unfortunately, no

details of the imputed transfer of R&D information and gas technology have been provided. Nevertheless, some questions can be raised about the significance of the R&D and technological benefits which are alleged to flow from a change in the ownership of Consumers' Gas. First, since Consumers' is Canada's largest natural gas utility it is not unreasonable to assume that it is relatively well aware of the latest gas-related technological developments and that it can typically purchase new gas-related equipment at reasonable prices. Second, if British Gas has R&D information or gas-related equipment that it wishes to sell and that Consumers' wishes to buy then the sale can be executed without British Gas becoming Consumers' controlling shareholder.<sup>15</sup> Furthermore, it would be easier for Consumers' to purchase information or equipment from British Gas if British Gas is not Consumers' controlling shareholder. For Consumers' Gas cannot enter into an affiliate transaction aggregating \$100,000 or more without the prior approval of the O.E.B.; whereas non-affiliate transactions do not require the prior approval of the O.E.B.<sup>16</sup>

## **2.7 Would British Gas' Strong Financial Position Benefit Consumers' Customers?**

British Gas' strong financial position would benefit Consumers' if it reduced its cost of borrowing capital.<sup>17</sup> However this is unlikely to occur since Consumers' is already a

financially strong corporation and the attractiveness of Consumers' debt issues to lenders will be a function of Consumers' financial integrity (unless British Gas guarantees Consumers' debt). Furthermore, even if Consumers' cost of capital fell as a result of a British Gas takeover the cost saving would not be passed on to Consumers' customers. For the O.E.B. sets Consumers' rates on a "stand-alone basis". That is, its rates are a function of what Consumers' costs and revenues would be if it did not have a controlling shareholder. As the Board stated in its 1990 Report with respect to the takeover of the ICG Utilities by Westcoast Energy:

"The Board has accepted the principle as expressed by Westcoast in the hearing, that the costs and revenues to ICG Ontario should be respectively no higher and no less than it would realize on a stand-alone basis."<sup>18</sup>

## **2.8 Would the Takeover of Consumers' Gas by British Gas Provide a Net Benefit to Canada?**

The above analysis suggests that, as it stands, it is unlikely that there will be a net benefit to Canada from a takeover of Consumers' Gas by British Gas.

First, our analysis suggests that Consumers' customers will not receive any benefits as a result of the sale.

Second, as a result of British Gas' ownership of Bow Valley Industries (a major Canadian natural gas producer), Consumers' might be subject to pressure to purchase

gas from Bow Valley Industries at above market prices and to promote natural gas consumption instead of energy efficiency.

Third, the Ontario Energy Board has determined that it is in the public interest for at least 15 per cent of the common shares of Consumers' Gas to be widely held. However, under the takeover proposal there would be only one shareholder, namely, British Gas.

In fairness to the British Gas takeover proposal it must be acknowledged that Consumers' existing parent (GW Utilities) and grandparent (Olympia and York Developments Limited) have ownership interests in natural gas producers (Home Oil and Gulf Canada Resources) and hence the above noted type of conflicts of interest with respect to natural gas purchases and the promotion of energy efficiency already exist. Nevertheless, the existence of these conflicts of interest under the status quo ownership regime does not condone a takeover which will perpetuate them.

### 3.0 What Undertakings Could British Gas Make to the Lieutenant Governor in Council To Ensure That a British Gas Takeover of Consumers' Gas Would Provide a Substantial Net Benefit to Canada?

#### 3.1 Introduction

According to Premier Peterson, he is not generally in favour of takeovers such as the proposed takeover of Consumers' Gas unless "there are some pretty compelling reasons." The above analysis suggests that, as it stands, the proposed takeover of Consumers' by British Gas does not pass the Premier's "compelling reasons" test.

In the past, the Lieutenant Governor in Council has approved takeovers of Ontario's natural gas utilities subject to the receipt of certain undertakings from the utility and its proposed parent. As the O.E.B. has recently noted, undertakings are a currently accepted mechanism for the Government of Ontario to promote the public interest:

"The Board, in examining these areas and the interests of the stakeholders, notes that undertakings have been given to the Lieutenant Governor in Council by the companies which control the main regulated gas utilities in Ontario. Undertakings, therefore, are the currently accepted mechanism by which the Government of Ontario attempts to ensure protection of the Ontario public interest..."<sup>19</sup>

In our opinion the proposed takeover of Consumers' Gas would provide substantial net benefits to the global environment and Consumers' customers if British Gas makes the following undertakings to the Lieutenant Governor in Council:

1. to transform Consumers' Gas into a conservation utility as well as a natural gas distribution utility;



2. to prohibit Consumers' Gas from purchasing gas from its subsidiaries or affiliates; and
3. to accept the undertakings given by GW Utilities to the Lieutenant Governor in Council with respect to the control and management of Consumers' Gas.

### **3.2 Transforming Consumers' Gas Into a Conservation Utility as well as a Natural Gas Distribution Utility**

A conservation utility is a utility whose mandate is to substantially reduce its customers' energy consumption by aggressively promoting energy efficiency. Consumers' Gas could aggressively promote energy efficiency by providing (selling, financing, renting and installing) its customers with energy efficiency equipment (e.g., super-efficient furnaces, hot water heaters, dryers, stoves, windows and doors).

As a conservation utility, Consumers' Gas would be furthering the public interest by providing significant environmental and economic benefits.

#### **3.2.1 Environmental Benefits**

The greenhouse effect or global warming is one of the most serious environmental problems facing humankind. The rising concentrations of greenhouse gases in the

atmosphere are predicted to cause the earth's average temperature to rise by 1.5 to 4.5 degrees Celsius before the middle of the twenty-first century. If this occurs, the climatic change over the next 60 years will substantially exceed that experienced over the last 5000 years. Greenhouse warming will diminish global food security; raise sea-levels; alter precipitation patterns; accelerate the extinction of animal and plant species; and change the productivity and diversity of our forests.

The cause of global warming is the imbalance in atmospheric "greenhouse" gases, especially carbon-dioxide. In the industrialized world the major source of carbon-dioxide emissions is the combustion of fossil fuels (coal, oil, natural gas). As a conservation utility, Consumers' could reduce its customers contribution to global warming by reducing their natural gas consumption.

Due to their concern about the consequences of global warming Canada's Ministers of Energy have implicitly called for our natural gas utilities to become conservation utilities:

"Ministers underlined the key role of electric and natural gas utilities in encouraging energy efficiency. In particular, they noted that there exists scope for significant action by utilities to develop demand management programs and welcomed the first steps of some utilities in this area. They strongly encouraged all utilities to develop aggressive programs in this area." (emphasis added)<sup>20</sup>

Furthermore, Ontario's Minister of Energy, the Honourable Lyn McLeod, has stated that she supports "a greater role for the Ontario natural gas utilities in promoting efforts to conserve energy and to reduce the global-warming effects of gas use."<sup>21</sup>

### **3.2.2 Economic Benefits**

In addition to providing global environmental benefits, the transformation of Consumers' into a conservation utility could also reduce its customers' costs. This potential exists because Consumers' customers do not undertake all the energy efficiency investments that are economically profitable from a social perspective given today's energy prices. There are a number of reasons for this state of affairs. First, Consumers' customers are not fully aware of the cost-effectiveness and reliability of all of their energy efficiency options. Second, many energy efficiency options which are economically rational for society are not economically rational for an individual. For example, if a homeowner cannot recover the cost of energy efficiency investments in the re-sale price of the house then it is only rational for a homeowner to invest in a high-efficiency furnace or extra insulation if the cost can be recovered before the house is sold. On the other hand, from a social perspective home energy efficiency improvements are economically rational if they will pay for themselves over the house's

expected life. Third, homeowners and many businesses are unwilling or unable to borrow the money needed to undertake all of their energy efficiency options that are economically rational from a social perspective.

As a result of the above factors, most homeowners and businesses demand pay-back periods of 2 to 5 years or less for energy efficiency investments. On the other hand, Consumers' is able to borrow all the money it needs on favourable terms and accept pay-back periods of up to 55 years.<sup>22</sup> A required pay-back period of 2 to 5 years implies a required real (net of inflation) rate of return of approximately 22 to 65 per cent.<sup>23</sup> On the other hand, Ontario's natural gas utilities are willing to accept real rates of return of 8 to 10 per cent.<sup>24</sup>

The shorter pay-back periods and higher rates of return for energy efficiency relative to energy supply investments implies that Consumers' customers' energy needs could be met at a lower economic cost if society increased its energy efficiency investments and decreased its energy supply expenditures. This could be achieved by converting Consumers' into a conservation utility.

Furthermore the economic benefits (energy cost savings) of transforming Consumers' into a conservation utility will increase as the price of natural gas rises. The price of natural gas could rise dramatically during the 1990s for a number of reasons. First, as a result of the de-regulation of the natural gas commodity market and the

Canada-U.S. Free Trade Agreement the price of Canadian natural gas will be increasingly determined by continental market forces. Under these circumstances, if there is a significant increase in the demand for natural gas or reduction in its supply in the U.S. then the price of Canadian natural gas could rise dramatically. Second, if the Governments of Ontario and/or Canada adopt a system of carbon taxes to reduce Canada's fossil fuel consumption and hence carbon-dioxide emissions, then the after-tax price of natural gas could rise significantly.

### **3.2.3. Implications for Consumers' Gas and the Ontario Energy Board**

The O.E.B. sets the rates of Consumers' Gas on the basis of its forecast of Consumers' costs and sales volumes for the upcoming year. Consumers' cost of service can be divided into three broad categories: gas costs, operating costs and capital costs. Consumers' can recover in its rates the Board-approved level of gas and operating costs. Consumers' Board-approved capital costs are determined by multiplying its rate base (total book value of all utility-related capital investments minus accumulated depreciation) by the Board-approved fair rate of return on capital.

Consumers' Board-approved average rate for gas service is determined by dividing, the Board-approved total cost of service by the Board-approved forecast of Consumers'

sales volumes.

The Board's method of rate setting has two important implications. First, on average and in the long run, Consumers' profits will be a function of its rate base. That is, the higher is its rate base the higher will be its aggregate profits and vice versa.

Second, in the short run, that is, between rate cases, Consumers' profits will be a function of the quantity of gas it sells or delivers. That is, if Consumers' gas sales or deliveries exceed its forecast then its rate of return will exceed the Board-approved rate of return. Conversely, if it sells or delivers less gas than forecast its rate of return will fall short of the Board-approved rate of return.<sup>25</sup>

Under this method of regulation, if Consumers' aggressively promotes energy efficiency by leasing, financing or renting energy efficiency equipment (e.g., super-efficient furnaces and hot water heaters) to its customers then its rate base and hence long run profits will rise. However, its short run profits will fall. For the promotion of energy efficiency will decrease its gas sales and hence profits. That is, given the status quo method of regulation it is always in Consumers' short run financial self-interest to promote energy consumption. Conversely, it is never in Consumers' short-run financial self-interest to promote energy efficiency.

Thus if the Lieutenant Governor in Council approves the takeover of Consumers' Gas subject to an undertaking that Consumers' will aggressively promote energy

efficiency then the O.E.B. will have to amend its method of regulation to ensure that Consumers' short run profits are no longer tied to the quantity of gas it sells or delivers.<sup>26</sup>

### **3.3 Prohibiting Consumers' Gas From Purchasing Gas From its Subsidiaries or Affiliates**

The takeover of Consumers' Gas by British Gas should also be conditioned on an undertaking from British Gas and Consumers' Gas that Consumers' will not purchase gas from its subsidiaries or affiliates. This undertaking is needed for two reasons:

1. to reduce the likelihood that the aggressive promotion of energy efficiency by Consumers' will conflict with the financial self-interest of Consumers' or British Gas; and
2. to ensure that Consumers' costs are not inflated by gas purchase transactions occurring at above market prices.

### **3.4 Acceptance of the Undertakings Given by GW Utilities to the Lieutenant Governor in Council with respect to the Control and Management of Consumers' Gas**

In 1987 the Lieutenant Governor in Council approved the takeover of Consumers' Gas by GW Utilities after receiving a number of undertakings from GW Utilities and Consumers' Gas with respect to the control and management of Consumers'. The purpose of the undertakings was to ensure that the takeover would be in the public

interest. The undertakings addressed a number of issues including: 1) Consumers' public share float; 2) the independence of Consumers' Board of Directors; 3) Consumers' auditors; 4) the location of Consumers' head office; 5) restrictions on the sale of Consumers' shares by GW Utilities to a third party; 6) affiliate transactions; 7) the financial integrity of Consumers'; 8) takeover acquisition and reorganization costs; and 9) diversification by Consumers' into activities that are not regulated by the O.E.B.<sup>27</sup>

To ensure the continued protection of the Ontario public interest, any approval of the takeover of Consumers' Gas should also be subject to the acceptance by the new holding company of undertakings that are substantially similar to those given by GW Utilities in 1987.

#### **4.0 Conclusions**

Our analysis indicates that the proposed sale of Consumers' Gas to British Gas is unlikely to provide Consumers' customers with any benefits.

Furthermore, the sale of Consumers' Gas, on the proposed terms, may be contrary to the overall public interest for the following reasons.

First, as a result of British Gas' investment in Bow Valley Industries (a major Canadian gas producer), Consumers' might be subject to pressure to purchase gas



from Bow Valley Industries at above market prices and to promote natural gas consumption instead of energy efficiency. Second, the Ontario Energy Board has determined that it is in the public interest for at least 15 per cent of the common shares of Consumers' Gas to be widely held. However under the takeover proposal there would be only one shareholder, namely, British Gas.

According to Premier David Peterson he is not generally in favour of takeovers such as the proposed takeover of Consumers' Gas unless "there are some pretty compelling reasons." Needless to say, our analysis indicates that, as it stands, the proposed takeover does not pass the Premier's test. The Premier's test is of crucial significance for the proposed takeover since according to the Ontario Energy Board Act a takeover cannot occur without the permission of the Lieutenant Governor in Council (the Ontario Cabinet).

However the proposed takeover of Consumers' would provide substantial net benefits to the global environment and the customers of Consumers' if British Gas were to make the following undertakings to the Lieutenant Governor in Council:

1. to transform Consumers' Gas into a conservation utility as well as a natural gas distribution utility;
2. to prohibit Consumers' Gas from purchasing gas from its subsidiaries or affiliates; and
3. to also accept undertakings substantially similar to those given to Lieutenant Governor in Council by GW Utilities with respect to the control

and management of Consumers' Gas.

#### 4.1 Consumers' Gas as a Conservation Utility

As a conservation utility Consumers' Gas would aggressively promote energy efficiency by providing (selling, financing, renting and installing) its customers with energy efficient equipment (e.g., super-efficient furnaces, hot water heaters, dryers, stoves, windows and doors). The aggressive promotion of energy efficiency by Consumers' would provide significant environmental and economic benefits.

First, from an environmental perspective, it would reduce its customers' contribution to global warming. (The combustion of natural gas produces carbon-dioxide which is a major greenhouse gas.)

Second, from an economic perspective, it has the potential to significantly reduce its customers' total energy bills. This potential will be especially large if the price of natural gas rises dramatically. A significant increase in natural gas prices could occur in the 1990s as a result of a rise in the U.S. demand for Canadian gas or the introduction of a carbon tax (designed to reduce our carbon-dioxide emissions by reducing our fossil fuel consumption).

Furthermore, the transformation of Consumers' Gas into a conservation utility would be consistent with federal and provincial energy policy. To be specific, in August 1989, the Federal-Provincial-Territorial Conference of Ministers of Energy urged Canada's natural gas utilities to aggressively promote energy efficiency. In addition, Ontario's Minister of Energy, the Honourable Lyn McLeod, has stated that she supports "a greater role for the Ontario natural gas utilities in promoting efforts to conserve energy and to reduce the global-warming effects of gas use."

#### **4.2 Affiliate Transactions**

An undertaking prohibiting Consumers' Gas from purchasing gas from its subsidiaries or affiliates would be in the public interest for two reasons.

First, in the absence of such an undertaking the aggressive promotion of energy efficiency might not be in the financial self-interest of Consumers' Gas and/or British Gas. For example, if Consumers' promotes energy efficiency it will sell less gas and hence may purchase less gas from its subsidiaries affiliates.

Second, there is compelling evidence to suggest that in the recent past Consumers' has purchased gas from its non-regulated gas producing division for re-sale to its customers at above market prices. There is a real possibility that, if affiliate transactions

are not prohibited, Consumers' will in the future purchase gas from its affiliates or subsidiaries at above market prices. To the extent that this occurs, Consumers' customers will pay the price.

#### **4.3 Acceptance of the Undertakings Given by GW Utilities to the Lieutenant Governor in Council with respect to the Control and Management of Consumers' Gas**

In 1987 the Lieutenant Governor in Council (the Ontario Cabinet) approved the takeover of Consumers' Gas by GW Utilities after receiving a number of undertakings from GW Utilities and Consumers' Gas with respect to the control and management of Consumers' Gas. The undertakings addressed a number of issues including: 1) Consumers' public share float; 2) the independence of Consumers' Board of Directors; 3) Consumers' auditors; 4) the location of Consumers' head office; 5) restrictions on GW Utilities right to sell shares of Consumers' Gas to third parties; 6) affiliate transactions; 7) the financial integrity of Consumers'; 8) takeover acquisition and reorganization costs; and 9) diversification by Consumers' into activities that are not regulated by the Ontario Energy Board.

To ensure the continued protection of the public interest, approval of the takeover should also be contingent on British Gas accepting undertakings with respect to the control and management of Consumers' that are substantially similar to those accepted by GW Utilities in 1987.

## 5.0 ENDNOTES

1. Investment Canada Act, section 21.
2. "No clear benefits in utility takeover", Toronto Star, (March 9, 1990), p. A26.
3. "Reichmanns get \$1 billion offer for Consumers", Toronto Star, (March 8, 1990), pp. A1, A28.
4. "No clear benefits in utility takeover", Toronto Star, (March 9, 1990), p. A26.
5. "Investors wary of bid for Consumers", Globe and Mail, (March 8, 1990), pp. B1, B4.
6. See The Ontario Energy Board Act sections 13 and 19.
7. O.E.B., E.B.R.L.G. 28 Report Of The Board, Volume 1, p. 9/23.
8. O.E.B., E.B.R.L.G. 30 Report Of The Board, pp. 61, 62.
9. "Undertakings of GW Utilities Limited, 706377 Ontario Limited (To Be Named GW Subco Limited), HWR Holdings Inc., 685515 Ontario Inc. And The Consumers' Gas Company Ltd. TO: The Lieutenant Governor in Council for the Province of Ontario" (March 4, 1987), p. 12.
10. As the Board noted in its 1986 Report with respect to the takeover of Consumers' Gas by GW Utilities:  
    "...the Board realizes that business opportunities exist for a parent corporation to so arrange its affairs that inter-company transactions could lead to advantages to the parent and disadvantages to the subsidiary utility and its customers."  
Ontario Energy Board, E.B.R.L.G. 30 Report Of The Board, p. 47.
11. In December 1989 the Board ruled that Union Gas was not required to produce its long term gas supply contracts with Shell and Gulf. This ruling was made despite the submission by Counsel to Board Staff that a refusal to order the production of these contracts would "handcuff" Board Staff and that:  
    "The fact is that this is a regulatory tribunal. We are set up because Union Gas in its franchise area is a monopoly. And unless we look at the price that Union pays for all its services, we can't be sure that Union is not paying too much and charging customers too much. That is, after all, why we are here."  
Ontario Energy Board, E.B.R.O. 462, Transcript Vol. 5, pp. 639-643, 656-658; Vol. 6, pp. 798,799.
12. Ontario Energy Board Docket No. E.B.R.O. 410-III/414-II, Submissions on Behalf of Counsel to Board Staff, (November 27, 1987), pp. 90-95 and Decision With Reasons, (January 22, 1988), pp. 57-60.
13. O.E.B., E.B.R.L.G. 30 Report Of The Board, p. 24.

14. "Undertakings of GW Utilities", p. 4.
15. According to a brochure for British Gas' International Consultancy Service (ICS) the "ICS exists to make available to other countries, companies or organizations on a commercial basis, the expertise and advanced technology of the British Gas Corporation."
16. "Undertakings of GW Utilities", pp. 8, 9.
17. According to Dr. Sherwin and Ms. McShane, Consumers' cost of capital experts, a change in ownership will not affect Consumers' cost of equity capital:  
"The change in ownership does not affect the return requirement, which should always be based on the business and financial risks of the "stand alone" enterprise, and the alternative investment opportunities available in the market."  
Ontario Energy Board Docket No. 464, Exhibit 17.1A, p. 12.
18. Ontario Energy Board, E.B.R.L.G. 34 Report Of The Board, p. 101. See also Ontario Energy Board, E.B.R.L.G. 28 Report of the Board, Vol. 1, p. 6/13.
19. O.E.B., E.B.R.L.G. 34 Report Of The Board, (January 31, 1990), p. 67.
20. Federal-Provincial-Territorial Conference of Ministers of Energy, Communique, (Toronto: August 28, 1989), p.2.
21. Letter from the Honourable Lyn McLeod to Jack Gibbons, February 23, 1990.
22. Consumers' Gas 1989 Annual Report, p. 25.
23. Florentin Krause and Joseph Eto, Least Cost Utility Planning Handbook for Public Utility Commissioners, Vol. 2, The Demand Side: Conceptual and Methodological Issues, (Washington, D.C.: NARUC; 1988), p. II-8.
24. Ontario Energy Board E.B.R.O. 462, Exhibit J7, Schedule 1, p.3.
25. In the language of an economist, this result is due to the fact that Consumers' marginal cost of increasing or decreasing gas sales or deliveries is less than the Board-approved gas sales and delivery rates (i.e., Consumers' average costs).
26. The link between Consumers' profits and throughput volumes can be severed by establishing a Distribution Margin Deferral Account. See Jack Gibbons, Sustainable Development: Its Implications for Union Gas, (Toronto: Canadian Institute for Environmental Law & Policy; 1989), pp. 20-25.
27. "Undertakings of GW Utilities Limited".