



**EB-2013-0109**

**IN THE MATTER OF** the *Ontario Energy Board Act 1998*, S.O.1998, c.15, (Schedule B);

**AND IN THE MATTER OF** an Application by Union Gas Limited for an order or orders clearing certain non-commodity related deferral accounts and sharing utility earnings pursuant to a Board approved earnings sharing mechanism;

**AND IN THE MATTER OF** an Application by Union Gas Limited for an order approving a deferral account to capture variances between earnings sharing, deferral account and other balances approved for disposition and amounts actually refunded/recovered; and

**AND IN THE MATTER OF** a motion commenced by the Ontario Energy Board pursuant to section 19(4) of the *Ontario Energy Board Act, 1998* and Rule 43.01 of the Board's Rules of Practice and Procedure to review the Board's direction in its EB-2011-0210 Decision and Order requiring Union to annually prepare and file separate audited financial statements for that portion of its business that is subject to rate regulation.

**BEFORE:** Ken Quesnelle  
Presiding Member

Marika Hare  
Member

Ellen Fry  
Member

**DECISION AND ORDER**

**March 27, 2014**

## Introduction

Union Gas Limited (“Union”) filed an application dated May 9, 2013 with the Ontario Energy Board (the “Board”) under section 36 of the *Ontario Energy Board Act, 1998*, S.O. c.15, Schedule B, for an order of the Board amending or varying the rate or rates charged to customers as of October 1, 2013 in connection with the sharing of 2012 earnings under the incentive rate mechanism approved by the Board as well as final disposition of 2012 year-end deferral account and other balances (the “Application”).

The Application also requested approval of a deferral account to capture variances between earnings sharing, deferral account and other balances approved for disposition and amounts actually refunded/recovered (proposed Account No. 179-132).

The Application also included evidence which responded to the Board’s directive in EB-2011-0210 requiring Union to have an expert review its gas supply plan.

During the course of the proceeding, Union provided an updated cost estimate related to a previous Board directive in the EB-2011-0210 proceeding regarding the preparation of audited financial statements for Union’s regulated business. This update arose as a result of a significant increase in the cost estimate. The Board, on its own motion, determined that it would review the Board’s direction in its EB-2011-0210 Decision and Order requiring Union to annually prepare and file separate audited financial statements for that portion of its business that is subject to rate regulation (the “Motion”). The Board decided to hear the Motion within this proceeding.

## The Proceeding

The Board issued a Notice of Application dated June 6, 2013.

The Board granted the requests of the following parties for intervenor status in this proceeding:

- Association of Power Producers of Ontario (“APPrO”);
- Building Owners and Managers Association (“BOMA”);
- Canadian Manufacturers and Exporters (“CME”);
- Consumers Council of Canada (“CCC”);
- Enbridge Gas Distribution (“Enbridge”);
- Energy Probe Research Foundation (“Energy Probe”);
- Federation of Rental-housing Providers of Ontario (“FRPO”);
- Industrial Gas Users Association (“IGUA”);

- City of Kitchener (“Kitchener”);
- London Property Management Association (“LPMA”);
- Ontario Greenhouse Vegetable Growers (“OGVG”);
- School Energy Coalition (“SEC”);
- Shell Energy North America (Canada) Inc. (“Shell Energy”);
- Tenaska Marketing Canada (“Tenaska”);
- TransCanada Energy Ltd. (“TCE”);
- TransCanada Pipelines Ltd. (“TransCanada”), and
- Vulnerable Energy Consumers Coalition (“VECC”).

Due to the addition of the Board’s Motion to this proceeding, the Board issued a Notice of Motion on all intervenors of record in the EB-2011-0210 proceeding that were not already intervenors of record in this proceeding. The Board received no further requests for intervenor status as a result of the Notice of Motion.

A Settlement Conference was held on August 1, 2013. A letter was filed on August 7, 2013 on behalf of Union and the parties that participated in the Settlement Conference. The letter stated that a formal settlement on all issues was not reached. However, Union and the parties that participated in the Settlement Conference agreed that there are no matters in dispute with respect to the balances to be cleared and the allocation to ratepayers for the following deferral accounts:

- Short-Term Storage and Other Balancing Services (Account No. 179-70);
- Unbundled Services Unauthorized Storage Overrun (Account No. 179-103);
- Gas Distribution Access Rule Costs (Account No. 179-112);
- Late Payment Penalty Litigation (Account No. 179-113);
- Carbon Dioxide Offset Credits (Account No. 179-117);
- Average Use Per Customer (Account No. 179-118);
- International Financial Reporting Standards Conversion Costs (Account No. 179-120);
- Conservation Demand Management (Account No. 179-123);
- Harmonized Sales Tax (Account No. 179-124);
- Pension Charge on Transition to U.S. GAAP (Account No. 179-127); and
- Federal and Provincial Tax Changes.

The letter stated that with respect to the remaining matters raised by Union’s application, an oral hearing was requested to hear the following matters:

- Unabsorbed Demand Costs (Account No. 179-108);

- Upstream Transportation FT-RAM Optimization (Account No. 179-130) and associated impacts on the Earnings Sharing Calculation;
- Lost Revenue Adjustment Mechanism (Account No. 179-75);
- Demand Side Management Variance Account (Account No. 179-111);
- Shared Savings Mechanism Variance Account (Account No. 179-115);
- Demand Side Management Incentive Deferral Account (Account No. 179-126);
- Union's request for Deferral Clearing Variance Account (Account No. 179-132);
- Preparation of Audited Utility Financial Statements (Account No. 179-129);
- Exhibit A, Tab 3 (Allocation and Disposition of 2012 Deferral Account Balances; Federal and Provincial Tax Changes and 2012 Earnings Sharing Amounts);
- Exhibit A, Tab 4 (Incremental Transportation Contracting Analysis); and
- Exhibit B, Tab 5, Exhibit C, Tab 2 and Exhibit C, Tab 3 (Union's responses to the Board's EB-2011-0210 Gas Supply Plan Review and associated third party studies).

The Board held an oral hearing on October 22 – 24, 2013.

A record of all procedural matters in this proceeding is available on the Board's website.

The Board approves the disposition of the deferral accounts, as proposed by Union, for the accounts that were not the subject of disagreement by any parties. The contested issues are discussed below in this decision.

## **Gas Supply Plan**

### **Background**

The Board, in its EB-2011-0210 Decision, directed Union to file, prior to its next rates proceeding, an expert and independent review of its gas supply plan, its gas supply planning process, and gas supply planning methodology.<sup>1</sup>

Union filed two reports in this proceeding which responded to the above Board directive, one prepared by Sussex Economic Advisors ("Sussex") and the other by Concentric Energy Advisors ("Concentric").<sup>2</sup> These are referred to below as the "Sussex Report" and "Concentric Report".

### **Position of Parties**

---

<sup>1</sup> EB-2011-0210, Board Decision and Order at p. 40.

<sup>2</sup> Exhibit C, Tab 2 and Exhibit C, Tab 3.

Union stated that its gas supply plan is right-sized to meet firm system sales and bundled customer demands with a diverse, flexible and cost effective portfolio of firm services and assets. Union noted that its integrated supply planning process incorporates demand related items such as customer growth, normalized weather, design day requirements, customer consumption patterns and economic outlooks. Union stated that it plans, contracts for services, and manages assets to provide an efficient combination of upstream transportation, supply purchases, and storage assets to serve system sales and bundled direct purchase customers' annual, seasonal and design day gas delivery requirements. Union noted that it adheres to the gas supply guiding principles to ensure the assets procured on behalf of customers are robust, secure, diverse and reliable to meet firm customer demands. Union argued that the suggestion in its 2013 cost of service proceeding that it has contracted for excessive upstream gas transportation services in the gas supply plan to the detriment of the ratepayer is unfounded.<sup>3</sup>

Union noted that the Sussex Report verified and supported its position that its gas supply planning process, methodology, and plan reflects appropriate planning principles that are objectively applied and result in a gas supply plan that is right-sized.<sup>4</sup>

Sussex, after reviewing Union's gas supply plan, offered the following conclusions:

- Union's primary gas supply planning principles of reliability and cost are reasonable, similar to other Local Distribution Companies ("LDC"), and are reflected in the gas supply plan.
- Union's approach regarding design day demand forecasting (i.e., extreme cold weather conditions and a firm customer usage factor per degree day) is appropriate, similar to other LDCs, and reflected in the gas supply plan.
- The design day demand forecasting approach for Union North and Union South is consistent and aligned. Sussex noted that the Union North forecasted design day demand becomes a direct input into the gas supply design day plan, while the Union South forecasted design day demand is an input into the storage and transmission system plan; however, the process used to develop the Union North and Union South design day demand forecast is similar.
- Union's gas supply portfolio for Union North and Union South reflects the circumstances of each area; specifically, Union North is comprised of a non-

<sup>3</sup> EB-2013-0109, Exhibit B, Tab 3 at pp. 46-47.

<sup>4</sup> Ibid at p. 1.

contiguous service territory with the TransCanada Mainline providing the physical connections across the service territory. Conversely, Union South is a contiguous service territory with access to significant underground storage, transmission assets, as well as the Dawn Hub. Because of the differing circumstances, Union North relies on the TransCanada Mainline services to meet the gas supply planning principles; while Union South uses underground storage and access to various natural gas supply transportation paths to meet the gas supply planning principles. The resultant gas supply portfolios for Union North and Union South are reasonable and appropriately sized.

- Union's approach to decontracting / recontracting is comprised of data gathering, quantitative and qualitative analysis, and documentation. This approach is consistent with the contract evaluation approach used by other LDCs.
- The current approach utilized by Union to extract value from gas supply portfolio assets leverages the core competencies of the Gas Supply and Storage & Transmission groups, is consistent with other approaches used by LDCs (e.g., asset management arrangements), and is reasonable.<sup>5</sup>

Sussex also provided a number of recommendations in its report. The recommendations largely focused on increasing documentation (including the development of a Gas Supply Memorandum) and ensuring more formal review processes. A recommendation was also made that the coldest observed temperature should be used to develop the design day weather standard for Union South. When adopted this recommendation results in a design day weather standard for Union South of 43.1 degree days rather than the current value of 44 degree days. Sussex noted that implementing this recommendation would result in Union North and Union South having a consistent and similar approach regarding design day weather standards.<sup>6</sup> Union noted that it accepted all of Sussex's recommendations.<sup>7</sup>

The Concentric Report concluded that the cost allocation and rate design used by Union is reasonable, the structure and the natural gas supply deferral and variance accounts is appropriate and straightforward, and the structure and text of the natural gas supply deferral and variance accounts is consistent with regulatory principles and industry standards in general, and the Board's Decisions and Orders specifically.<sup>8</sup>

---

<sup>5</sup> EB-2013-0109, Exhibit C, Tab 2 at pp. 1-2.

<sup>6</sup> Ibid at pp. 3-5.

<sup>7</sup> EB-2013-0109, Exhibit B, Tab 5 at pp. 5-7.

<sup>8</sup> EB-2013-0109, Exhibit C, Tab 3 at p. 13.

Board staff submitted that Union adequately responded to the Board's direction, as set out in its EB-2011-0210 Decision and Order. Board staff noted that it has no issues with Union's gas supply planning process, its planning methodology or the resulting gas supply plan.<sup>9</sup>

CCC submitted that Union complied with the Board's gas supply plan directive and noted that it is encouraged by Union's commitment to present, on an ongoing basis, its gas supply plan for review by interested stakeholders throughout the IRM term.<sup>10</sup>

FRPO noted that Union divided the work required to address the Board's directive into three tasks.<sup>11</sup> FRPO submitted that the resulting division of labour left gaps that should have been studied (e.g. deferral account implications of the actual transactions that underpin operations meeting market demand).

FRPO noted that Union has asserted that its gas supply plan is appropriately or right-sized throughout evidence and testimony. FRPO submitted that once the gas supply plan is established, the utility systematically sells the rights to the firm transport without ensuring the resulting contractual commitment is underpinned by firm transport. FRPO noted that it is concerned that the study was limited only to the gas supply plan. FRPO noted that it had anticipated that the review would allow an expert to consider how the plan was implemented or operationalized. As a result, FRPO has unanswered questions which it will reserve for a future time.

FRPO requested that the Board direct Union to provide additional evidence on Unabsorbed Demand Cost ("UDC") mitigation versus transportation optimization. FRPO also requested that the Board direct Union to enhance its proposed Gas Supply Memorandum with a breakdown of TransCanada contracts and their respective utilization.<sup>12</sup>

FRPO's submissions on the gas supply plan were adopted by LPMA.<sup>13</sup>

CME stated that it defers to the submissions of Board staff and others in regard to the gas supply plan.<sup>14</sup> No other parties provided comments on the gas supply plan.

---

<sup>9</sup> EB-2013-0109, Board Staff Submission at p. 6.

<sup>10</sup> EB-2013-0109, CCC Submission at p. 5.

<sup>11</sup> Sussex was retained to review Union's Gas Supply Planning Principles & Process (Task 1) and Peak Day Practice (Task 2). While, Concentric was retained to review Union's Cost Allocation / Rate Design and Deferral Accounting Practices (Task 3).

<sup>12</sup> EB-2013-0109, FRPO Submission at pp. 7-10.

<sup>13</sup> EB-2013-0109, LPMA Submission at p. 7.

In its reply submission, Union noted that FRPO was critical of its responses to the Board's gas supply directive. Union submitted that despite FRPO's position, it has not set out any recommended changes to Union's gas supply plan, its planning process or the gas supply planning methodology.

Union concluded its reply submission by reiterating its position that it responded appropriately to the Board's directive. Union also submitted that the Board should deny FRPO's request for further information in relation to UDC and its request to include additional information in the Gas Supply Memorandum.<sup>15</sup>

## **Board Findings**

The Board finds that Union responded appropriately to the EB-2011-0210 directive to file an independent review of its gas supply plan. The evidence filed by Union in regard to its gas supply plan provides the context in which the Board made its findings regarding the treatment of the FT-RAM related revenues.

The Board notes that no parties have provided any recommended changes to the plan.

The Board expects that Union will implement all of the recommendations set out in the Sussex Report.

With respect to FRPO's request for further information in relation to UDC mitigation, the Board finds that no additional information is required at this time. At the time that Union's gas supply plan is next reviewed, FRPO can seek information related to UDC mitigation. In regard to FRPO's request for enhancements to the Gas Supply Memorandum, the Board will not require any enhancements at this time. The Board will have an opportunity to review the first filing of that memorandum and determine at that time whether any enhancements are necessary going forward.

## **Treatment of FT-RAM related Revenues**

### **Background**

In the Board's Decision and Order on Preliminary Issue in the EB-2012-0087 proceeding (Union's 2011 ESM proceeding), the Board found that Union's 2011 FT-

---

<sup>14</sup> EB-2013-0109, CME Submission at p. 20.

<sup>15</sup> EB-2013-0109, Union Reply Submission at pp. 15-16.

RAM related optimization revenues should be classified as gas cost reductions as opposed to utility earnings.<sup>16</sup>

In the current proceeding, Union proposed that revenues generated from FT-RAM related upstream transportation optimization be classified as utility earnings (subject to sharing through the ESM). Under Union's proposal, the FT-RAM optimization deferral account would have no balance and the amount to be shared with ratepayers would be \$15.73M.

### Position of Parties

In its evidence, Union set out the following reasons for treating the 2012 FT-RAM optimization revenues as utility earnings:

1. A key premise of the Board's EB-2012-0087 Decision with respect to the treatment of net FT-RAM revenue is that Union's gas supply plan was driven, in part, by optimization opportunities. Union noted that it provided evidence to highlight that its gas supply plan is right-sized and it does not consider opportunities for optimization when developing its plan.
2. The upstream transportation assets underpinning Union's gas supply plan are contracted based on a set of gas supply principles that are consistent with those used in other jurisdictions in Canada and the United States. Union stated that its gas supply plan does not have excess upstream capacity that can be used to facilitate transportation exchange services.
3. Notwithstanding the Board's EB-2012-0087 Decision, treating net FT-RAM revenue as a gas cost offset (Y-Factor) is inconsistent with: (1) the historical treatment of upstream transportation exchange revenue; (2) the terms of Union's gas supply deferral accounts which were disposed of in 2012 by final orders of the Board in QRAM proceedings and which orders cannot be changed retroactively; and (3) represents a significant departure from the EB-2007-0606 and EB-2009-0101 Settlement Agreements for Union's IRM Framework for 2008-2012 approved by the Board.
4. The Board's EB-2012-0055 Decision (Enbridge Gas Distribution's 2011 ESM Proceeding) finding that temporarily surplus upstream assets may be used to support transportation exchange is consistent with how Union generates transportation exchange revenue.

---

<sup>16</sup> EB-2012-0087, Board Decision and Order on Preliminary Issue at p. 24.

5. Base exchanges and FT-RAM exchanges are transportation services sold to customers pursuant to a Board Approved rate schedule. Union stated that the noted transactions are fundamentally the same in that they use upstream transportation assets that are temporarily surplus, only differing as a result of the value provided by TCPL's FT-RAM service.
6. Union's proposed treatment of net FT-RAM revenue will ensure that a robust and active secondary market for transportation services will continue to exist and provide ongoing benefits to Ontario.<sup>17</sup>

Union noted that it applied the following criteria to determine if an FT-RAM transaction should be regarded as Transactional Service revenue subject to earnings sharing:

1. Temporarily Surplus - The exchange activity was served by some quantity of the upstream transportation capacity, and/or a portion of its path distance that was not required on a temporary basis to meet market area demands. Temporarily surplus capacity varies depending on weather and market demands.
2. Unplanned - The activity was unplanned in the sense that it was not included in the gas supply plan.
3. Sold as service - The exchange activity was a service provided to third parties. Union is not permitted to bundle the sale of gas and transportation, meaning that the only way to extract value is through transportation exchange transactions involving temporary surplus capacity to third parties.<sup>18</sup>

Union argued that all upstream transportation assets in the gas supply plan serve the purpose of meeting design day market demands and annual customer requirements. Union stated that any surplus that is available to support transportation exchange service activity (whether daily, monthly or seasonal) is only available on a temporary basis. The temporary surplus arises as a result of factors outside of Union's control, such as weather and consumption levels. Union stated that the surplus is not available on a planned basis.<sup>19</sup>

Union noted that the Board, in this proceeding, has the benefit of comprehensive pre-filed evidence (which was not available in the 2011 ESM proceeding). Union noted that

---

<sup>17</sup> EB-2013-0109, Exhibit B, Tab 1 at pp. 5-6.

<sup>18</sup> EB-2013-0109, Union Argument-in-Chief at pp. 12-13.

<sup>19</sup> Ibid.

its evidence sets out, in detail, the context and nature of Union's upstream transportation optimization activities.<sup>20</sup>

Board staff submitted that the issue in the current case is fundamentally the same as the issue that was before the Board in Union's 2011 ESM proceeding. Board staff submitted 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. Board staff noted that the Board is not bound by the 2011 ESM decision.

Board staff stated that in the current proceeding, Union provided better, more thorough and complete evidence explaining its FT-RAM related activities than it did in 2011. Board staff noted that there were also some changes to the activities undertaken by Union in 2012 as compared to 2011. Board staff submitted that the combination of this more comprehensive evidence and the changes to Union's activities, could be a reasonable basis for the Board to make a decision in the current case which is different from the decision it made on the same issue in 2011.

The Board's decision in Union's 2011 ESM proceeding essentially set out 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 submitted 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 submitted 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 generating optimization activities are not part of the gas supply planning process, the transaction is properly considered unplanned.

---

<sup>20</sup> EB-2013-0109, Union Argument-in-Chief at p. 4.

Board staff submitted that these two criteria are appropriate for considering whether revenues from FT-RAM related transactions should be treated as utility earnings or as gas cost reductions.

Board staff submitted that, with the exception of the March combined Assignment / Exchange transaction (which included an assignment of Empress to EDA capacity), Union's 2012 FT-RAM related transactions occurred on an unplanned basis and relied on temporarily surplus transportation capacity. Therefore, Board staff submitted that the revenues generated from Union's FT-RAM related transactions (with the exception of the \$700,000 generated from the March transaction) are properly considered Transactional Service revenues and should be recorded as utility earnings subject to earnings sharing in accordance with Union's IRM Framework.

In regard to the March combined Assignment / Exchange transaction (which included an assignment of Empress to EDA capacity), Board staff submitted that at the time of sale, Union could not have known whether there would be surplus assets available to support the transaction (as the design day could occur in March). Therefore, Board staff submitted that this transaction, which Union stated generated \$700,000 in revenues, does not rely on temporarily surplus assets. Board staff submitted that the revenues associated with this transaction do not fall within the criteria set out by the Board for determining whether a transaction is properly considered a Transactional Service. Therefore, Board staff submitted that the \$700,000 associated with this transaction should be properly classified as a gas cost reduction and should be shared 90:10 in favour of ratepayers through Account 179-130 (the Upstream Transportation FT-RAM Optimization Deferral Account).<sup>21</sup>

Union, in its reply submission, stated that the design day has never occurred in March and therefore the reduction to the net FT-RAM related revenues proposed by Board staff is unwarranted.<sup>22</sup>

APPrO submitted that the FT-RAM related revenues should be treated as utility earnings as proposed by Union. APPrO submitted that the transportation conditions that were purported to be present (as set out by the Board in EB-2012-0087) do not exist. APPrO noted that Union filed evidence from Sussex that indicates: "The resultant gas supply portfolios for Union North and Union South are reasonable and appropriately sized." APPrO stated that this conclusion by Sussex indicates that Union's supply portfolio is reasonable.

---

<sup>21</sup> EB-2013-0109, Board Staff Submission at pp. 10-13.

<sup>22</sup> EB-2013-0109, Union Reply Submission at p. 2.

APPrO also noted that the FT-RAM activities do not rely only on upstream transportation contracts. APPrO noted that in order to generate some of the FT-RAM exchanges, Union also relied on other transportation assets to execute the exchanges. These other assets included the use of the Dawn-Parkway system. APPrO noted that the Dawn-Parkway system is paid for by customers in addition to system sales and bundled direct purchase customers in the North.<sup>23</sup>

BOMA submitted that Union has not provided any new evidence that justifies the Board treating the 2012 FT-RAM revenues differently than the 2011 revenues. BOMA noted that the Board, in three recent decisions in the last 12 months, determined that the amounts at issue in this proceeding should be treated as gas cost reductions.<sup>24</sup>

BOMA submitted that the fact that the Board has made three decisions in the last twelve months which stated that the amounts in question should be treated as gas cost reductions, coupled with Union's admission that the type of optimization transactions it was doing in 2012, were the same as those they did in 2011 and the fact that Union declined to seek a Board rehearing of the EB-2012-0087 decision places a very high onus on the applicant in this case.

BOMA stated that the status of Union's gas supply plan (whether it was right-sized) did not enter into the Board's reasons in any material way in its EB-2012-0087 decision.

BOMA submitted that it would support a 10% incentive to Union to induce Union to continue to carry out its optimization activities. BOMA noted that a 10% incentive is consistent with the incentives provided in previous Board decisions (EB-2012-0087 and EB-2011-0210, and the NGEIR decision<sup>25</sup> whereby the Board allowed Union to receive 10% of the net revenues associated with short-term storage and balancing activities).

In its reply submission, Union stated that BOMA's submission essentially argues for a result that is consistent with the EB-2012-0087 proceeding while not taking into consideration the facts on the record.

Union submitted that it disagrees with BOMA's statements with respect to the prior proceedings. BOMA's assertion that the Board was not concerned in EB-2012-0087 with the status of Union's gas supply plan and whether it was appropriately sized is contradicted by the Board's own words. Union noted that the Board held that, "...the portion of utility gas supply assets that is available to support transactional service

---

<sup>23</sup> EB-2013-0109, APPrO Submission at pp. 2-6.

<sup>24</sup> BOMA cited the Board's Decisions in EB-2011-0210, EB-2012-0087 and EB-2012-0055.

<sup>25</sup> EB-2005-0551, Decision with Reasons, November 7, 2006.

activities is only the portion of those assets that is temporarily surplus to the gas supply plan as a result of factors beyond Union's control."<sup>26</sup>

CME set out two issues that, in its view, the Board should address:

1. Whether under the IRM agreement, the amounts realized in 2012 from the FT-RAM related activities is appropriately classified and allocated as gas cost reductions?
2. What is the appropriate incentive to be paid to Union's shareholder for having produced the FT-RAM related revenues?

CME goes on to provide a description of the types of FT-RAM related activities undertaken by Union in 2012. CME submitted that the outcome of these activities is that they produce savings compared to the embedded costs of transportation being recovered by Union through rates.

CME stated that an essential component of the FT-RAM related optimization transactions is the use of a method to move Union's utility gas to its system from points upstream which differs from the method for moving that utility gas which is embedded in rates. CME characterized this essential component of the FT-RAM related transactions as "transportation switching". CME submitted that transportation switching is the key factor in determining whether FT-RAM related optimization amounts should be classified as upstream gas transportation cost reductions or as utility revenues. If transportation switching must take place in order for optimization benefits to be utilized, then the upstream gas transportation cost reduction classification for the savings realized should prevail.

CME submitted that FT-RAM related optimization transactions are not the same as base exchanges. CME noted that base exchanges are a service that Union sells to a third-party using transportation capacity that is temporarily under-utilized because of weather or reduced demand. CME stated that no decision must be made to change the method for moving utility gas to Union's system from points upstream before the benefits of a base exchange can be realized. In contrast, CME submitted that an FT-RAM related exchange requires the utility to use a method other than the firm transport service embedded in the gas supply plan to move utility gas. CME stated that it is this change in transportation method which gives rise to the classification of the FT-RAM

---

<sup>26</sup> EB-2013-0109, Union Reply Submission at pp. 10-11.

related revenues as gas cost reductions. CCC makes a similar argument in its submission.<sup>27</sup>

CME noted that, despite its submissions, the Board could find that 2012 FT-RAM related amounts should be classified as utility revenues. CME stated that, even if the Board treats the revenues as utility earnings, it still must determine an appropriate incentive. CME stated that there is no principled basis for the incentive to be based on the earnings sharing mechanism. CME submitted that the principled basis for determining the appropriate incentive to be paid to Union's shareholder for engaging in such activities involves, amongst other things, a consideration of the Board's precedent decisions determining the appropriate percentage level for compensating Union's shareholder for optimization activities. CME noted that the EB-2012-0087 Decision considered potential incentive levels. The incentive payments cited in that decision ranged from 10% to 25%. CME noted that Union's expert (on the gas supply plan) stated that, in his experience, 10% is a very common incentive payment for these types of activities. CME submitted that the range of reasonableness for Union's incentive payment is between 10% and 25% of the savings.

CME also submitted that, if the Board adopts a utility revenues classification for the FT-RAM related revenues, Union's proposal to allocate the amounts to rate classes who pay no upstream transportation costs in their rates is inappropriate.<sup>28</sup>

In its reply submission, Union stated that CME's argument is based on the result of the EB-2012-0087 Decision and not the rationale for that decision. Union submitted that CME's argument reflects a complete departure from the Board's reasoning in EB-2012-0087 and EB-2012-0055. In both decisions, the Board indicated that the key distinction when determining if proceeds from optimization activity were to be treated as revenue versus a gas cost reduction was whether the underlying transportation assets were temporarily surplus to system sale and bundled direct purchase customer needs.

Union noted that CME proposes that the Board should make its decision based on whether Union made a "decision" to use a different method to deliver gas from that specified in the gas supply plan. The argument goes on to say that the decision to make such a change is a matter within Union's control and therefore the revenues should be treated as a gas cost offset. CME purports to define this criterion as "transportation switching."

---

<sup>27</sup> EB-2013-0109, CCC Submission at p. 3.

<sup>28</sup> EB-2013-0109, CME Submission at pp. 2-20.

Union submitted that CME's criterion is inconsistent with the criteria already established by the Board. Union submitted that CME's definitional characterizations should be disregarded. Union stated that the decision to depart from the gas supply plan is clearly a decision made by Union and one that is within its control. All decisions with respect to utility operations are within Union's control. Further, the very essence of exchanges transactions is that they represent, at least in part, a decision by Union to depart from the gas supply plan because the assets are temporarily surplus.

Union stated that the fact that Union has chosen to depart from the gas supply plan does not, however, change the fact that the transactions at issue were: (1) served by some quantity of the upstream transportation capacity that was not required on a temporary basis to meet market area needs; (2) unplanned in the sense that the transaction was not included in the gas supply plan (nor, as Sussex confirmed, should it have been); and (3) sold as a service.

Union noted that CME bolsters its argument by trying to draw a distinction between FT-RAM related exchanges and "base exchanges". Union submitted that the evidence directly contradicts CME's assertion in relation to base exchanges. Union noted that Exhibit B, Tab 2, Section 9 describes a base exchange. On the basis of that evidence, Union submitted that it is clear that base exchanges and FT-RAM related exchanges are the same and that both involve a departure from the gas supply plan.

Union noted that CME suggests that the "range of reasonableness" for the incentive is between 10% and 25%. Union submitted that this aspect of CME's argument fundamentally disregards the terms of the IRM Settlement Agreements. Union stated that the only relevant question – because this case concerns 2012 revenues – is what were the terms of Union's Board-approved IRM Framework for the period 2008-2012. Union submitted that, on this question, there is no dispute. Union submitted that all exchange revenues are to be treated as utility revenues subject to earnings sharing.<sup>29</sup>

LPMA submitted that in a FT-RAM transaction, the gas purchased by Union at Empress is still required to service its system gas customers. Union could continue to use the transportation contracts to transport the purchased gas to its customers. However, when available, Union uses the FT-RAM credits to facilitate the movement of the gas purchased for its customers to the location where that gas is needed. LPMA submitted that these transactions do not rely on temporarily surplus assets. LPMA submitted that the assets would only be surplus if it did not have gas, needed by its customers, to transport.

---

<sup>29</sup> EB-2013-0109, Union Reply Submission at pp. 5-10.

LPMA submitted that if Union is able to deliver gas to Ontario for consumption by system gas customers using utility assets that are paid for in their entirety by those same system gas customers at less than the forecast based on the gas supply plan, then the reduction in costs should be passed through to those customers. LPMA submitted that the Board should direct that all of the net FT-RAM revenues be passed on to ratepayers, with no incentive percentage accruing to Union.

LPMA also submitted that the allocation of the FT-RAM related optimization amounts should be the same regardless of whether the Board determines that these amounts are cost reductions that should flow through gas costs or revenues that are shared through the earnings sharing mechanism.

LPMA noted that if the Board approves Union's proposal and treats the FT-RAM optimization amounts as revenues rather than gas cost reductions, then Union proposes to allocate the resulting earnings sharing amount of \$15.730 million to rate classes based on the allocation of the 2007 Board approved return on equity (this is equivalent to an allocation based on rate base). LPMA submitted that the allocation of the earnings sharing based on rate base is not appropriate for 2012. While it is true that the allocation of earnings sharing in previous years has been based on rate base, the situation in 2012 is significantly different. In particular, there would be no earnings sharing for 2012 whatsoever in the absence of the FT-RAM optimizations revenues.

LPMA noted that the impact of Union's proposal is that customers that do not pay for upstream transportation - because they do not utilize any upstream transportation assets (i.e. TCPL contracts that were used to generate FT-RAM credits) - benefit from the optimization of these assets by Union. LPMA submitted that this is not appropriate. LPMA submitted that the benefits achieved through the optimization of these upstream assets should be allocated only to those customers that pay for those assets.<sup>30</sup>

In its reply submission, Union noted that LPMA's main argument is that the FT-RAM transactions do not rely on temporarily surplus assets as the assets utilized in the transaction are still required to transport the purchased gas. Union submitted that LPMA's argument confuses the issue of temporarily surplus assets and UDC. Union stated that, in the UDC scenario, Union does not need the gas to serve its market areas. In order to address having too much supply, Union stops buying the commodity and assigns the upstream pipe to a third-party. Any revenue from the assigned capacity is credited to ratepayers to offset UDC costs. Union noted that, in the temporarily surplus scenario, Union continues to require the gas commodity and continues to

---

<sup>30</sup> EB-2013-0109, LPMA Submission at pp. 1-6.

purchase the gas from the same location; temporarily surplus capacity is available because the entire portion of the transportation path is not required.

Union also stated that it does not agree with LPMA's proposed alternative allocation of utility earnings. Union stated that, under the terms of the IRM Framework, all revenues are treated as utility earnings. The method for distributing the ESM amount has always been based on the allocation of 2007 Board-approved return on equity. Union stated that there is no reason to depart from that methodology.<sup>31</sup>

CCC submitted that, in consideration of this issue, it is important for the Board to go back to the fundamentals of IRM. CCC submitted that Union, during the IRM term, was expected to look for efficiencies in the way in which it ran its business. To the extent that it could find efficiencies like reductions in capital expenditures and operating and maintenance costs, those would be shared through the ESM. If efficiencies are created through the implementation of better gas supply planning those efficiencies should be translated as gas cost savings, and allocated to the benefit of those customers that paid for the assets imbedded in the plan. CCC submitted that gas costs are clearly a pass-through item, as dictated by the original IRM Settlement Agreement. Accordingly, CCC argued that the Board should treat all FT-RAM generated revenue in 2012 as gas cost savings.<sup>32</sup> SEC made similar arguments to CCC.<sup>33</sup>

In its reply submission, Union stated that CCC's argument that the FT-RAM related transactions (described as efficiencies by CCC in its submission) are created through the implementation of better gas supply planning is not accurate. Union stated the FT-RAM related exchange transactions at issue are not the product of better gas supply planning. As Sussex confirmed "better planning" does not have regard to optimization.<sup>34</sup>

FRPO submitted that the FT-RAM related revenues should be treated in the same manner as set out by the Board in the EB-2012-0087 proceeding.

FRPO noted that Union has attempted to frame the concept of temporarily surplus capacity as a foundation for its classification of the FT-RAM related revenues. FRPO noted that Union's gas supply plan is designed to get gas to where it is needed seasonally and to ensure its peak day market needs are met. The gas goes to meet market demand or goes to storage to meet subsequent market demand. FRPO submitted that Union's framing of the issue misses the point that getting the gas to where it is required at a prudently incurred cost is part of the undertakings of a utility

---

<sup>31</sup> EB-2013-0109, Union Reply Submission at pp. 12-15.

<sup>32</sup> EB-2013-0109, CCC Submission at pp. 2-4.

<sup>33</sup> EB-2013-0109, SEC Submission at pp. 30-31.

<sup>34</sup> EB-2013-0109, Union Reply Submission at p. 12.

that is given rights to a monopoly franchise. FRPO noted that Union has found ways of lowering the cost of annual contracts by managing the transportation of gas in its role as a prudent utility. FRPO submitted that to the extent that Union then uses those assets in a different way to get the gas to the required destination it is a logical extension that the lowered cost should accrue to those who pay for the service.

FRPO noted that, as part of the regulatory construct, Union is kept whole for under-recovered transportation costs. FRPO stated that if Union incurs UDC charges, because transportation capacity is underutilized, those costs are passed through to ratepayers. FRPO noted that Union mentioned that the 2012 UDC costs incurred and the exchange revenues that were generated were both as a result of warmer than normal weather. FRPO questioned how Union had the foresight to see opportunities to assign transport or create exchanges in the market while not recognizing the opportunity to mitigate excess transportation costs for ratepayers. On this issue, FRPO concluded by submitting that recovering 100% of UDC costs from ratepayers while accruing the benefits of transportation optimization for shareholders, above a threshold, is not fair to ratepayers.<sup>35</sup> OGVG noted that it generally supports FRPO's submission. OGVG submitted that Union's FT-RAM related activity has not changed in any material way as to justify a change in how the Board views the revenue generated from FT-RAM related transactions.<sup>36</sup>

In its reply submission, Union stated that, like LPMA, FRPO appears to confuse the issues of optimization activity and UDC. Union noted that FRPO argues that Union has an obligation to pass-through to ratepayers the benefits of all optimization activities, including FT-RAM related exchange activity on the basis that Union has that obligation as a prudently-run utility. Union submitted that this cannot be correct. If it were true then the terms of the IRM Settlement Agreements would be meaningless. Union noted that based on this theory Union would have agreed to reduce the revenue requirement in rates by increasing the Storage & Transportation ("S&T") margin embedded in rates in exchange for giving away any incentive at all to engage in that very activity. Union stated that no rational utility would make that bargain and it did not make that deal.<sup>37</sup>

Energy Probe submitted that transportation exchange revenue should be treated on the basis of the established regulatory principle of cost causality. Energy Probe noted that the majority of transportation exchange revenue is generated from upstream assets paid for by sales customers (and bundled direct purchase customers in Union North). Energy Probe noted that it accepts that Union should get an incentive for the

---

<sup>35</sup> EB-2013-0109, FRPO Submission at pp. 1-6.

<sup>36</sup> EB-2013-0109, OGVG Submission at pp. 1-3.

<sup>37</sup> EB-2013-0109, Union Reply Submission at p. 14.

optimization of assets. Energy Probe submitted that the net revenues (which it defined as gross revenues minus costs minus the incentive payment) should not be included in utility revenue but refunded directly to the ratepayers that pay for the underlying assets in rates. Energy Probe submitted that the Board should order the establishment of a 2012 Upstream Optimization Deferral Account (Account No. 179-130). This follows the appropriate cost causality principles that who pays for the underlying assets receives the benefits (and is also fair to Union and ratepayers). Energy Probe also provided some potential alternative treatments for the optimization revenues, if the Board does not agree with its submission set out above.<sup>38</sup>

In its reply submission, Union noted that Energy Probe argued that the issue of the proper treatment of FT-RAM related revenues and base exchange revenues should be determined on the basis of what it describes as “cost causality.” Union noted that Energy Probe argued that because the majority of transportation exchange revenues are generated from upstream assets paid for by system sales and direct and bundled direct purchase customers in the North they should receive substantially all of the benefit of the revenues associated with the FT-RAM related exchange transactions. Union submitted that cost causality is a cost allocation principle; it is not concerned with the classification of the revenues at issue. Union stated that, at best, Energy Probe’s argument reflects a view as to which rate classes should receive the benefit of the net FT-RAM revenues after earnings sharing.<sup>39</sup>

VECC submitted that Union has not provided any evidence in the current proceeding that would lead the Board to approve Union’s proposed treatment of the FT-RAM related revenues. VECC submitted that when an applicant challenges the Board’s recent determinations with respect to an issue, there is an onus on the applicant to provide real and substantial new evidence to the regulator in support of its challenge. VECC argued that Union has not met this onus. VECC submitted that Union has not persuasively demonstrated any new facts or other evidence in this proceeding, which would result in overturning the Board’s recent findings on this issue. As such, VECC submitted that the net FT-RAM revenues for 2012 should be removed from utility earnings and be classified as gas cost reductions.<sup>40</sup>

In its reply submission, Union noted that VECC asserted that the transactions undertaken by Union in 2011 were the same as those undertaken in 2012. Union submitted that this statement is wrong. Union noted that it did not enter into any annual assignments in 2012. In addition, Union’s winter exchange activity in 2012 focused on

---

<sup>38</sup> EB-2013-0109, Energy Probe Submission at pp. 6-13.

<sup>39</sup> EB-2013-0109, Union Reply Submission at p. 13.

<sup>40</sup> EB-2013-0109, VECC Submission at pp. 2-3.

the Union CDA and not the Union EDA contract. Union stated that even if it were correct that Union, at a high level, engaged in the same “types” of FT-RAM transactions that is not relevant. Union noted that what is relevant are the circumstances surrounding the various transactions, when were they were undertaken and whether the assets used were temporarily surplus or not.<sup>41</sup>

Also in its reply submission, Union restated that it is proposing to treat the net FT-RAM revenue as utility revenue subject to earnings sharing. Union noted that the reasons for Union’s proposed treatment are described in its Argument-in-Chief. Union stated that, fundamentally, Union’s position is based on the evidence adduced in this proceeding as applied to recent guidance from the Board, the historical treatment of exchange related revenues and the terms of the IRM Settlement Agreements.<sup>42</sup>

### **Board Findings**

The Board finds that, with the exception of the March transaction discussed below, Union’s proposed treatment of the FT-RAM related revenues is appropriate.

The Board notes that this proceeding is not a review of its Decision on the 2011 FT-RAM related issues in EB-2012-0087.

In its submission, Board staff stated: “...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 bound by the 2011 ESM decision.”<sup>43</sup> The Board agrees with this submission. The Board’s responsibility in this proceeding is to determine the appropriate treatment of 2012 FT-RAM related revenues based on the Board’s consideration of the evidence and argument in this proceeding. The Board’s Decision on the 2011 FT-RAM issue set out two criteria to use as pre-conditions in determining whether the revenues generated from a given optimization transaction are properly considered Transactional Service revenues (during the IRM term). The two criteria set out by the Board are: (a) the transaction must rely on temporarily surplus assets; and (b) the transaction must be unplanned. The Board believes that these two criteria continue to be appropriate for making determinations in regard to the treatment of optimization revenues.

The Board finds that both the gas supply plan evidence and the optimization evidence, provided by Union in the current case, support Union’s position that the 2012 FT-RAM

---

<sup>41</sup> EB-2013-0109, Union Reply Submission at p. 14.

<sup>42</sup> Ibid at p. 2.

<sup>43</sup> EB-2013-0109, Board Staff Submission at p. 10.

related transactions meet the criteria set out by the Board in its decision on the 2011 FT-RAM issue. The Board therefore finds that, with the exception noted below, Union's proposed treatment of the 2012 FT-RAM related revenues as utility earnings is appropriate in the context of Union's IRM Framework.

The Board, however, does not believe that the March combined assignment / exchange transaction which included an assignment of Empress to EDA capacity, meets the criterion of relying only on temporarily surplus assets. As submitted by Board staff, at the time of sale, Union could not have known whether there would be surplus assets available to support the transaction. The Board therefore finds that the revenues associated with this transaction are properly classified as a gas cost reduction and should be shared 90:10 in favour of ratepayers through Account 179-130 (the Upstream Transportation FT-RAM Optimization Deferral Account). The Board directs Union to file an update to the earnings sharing calculation and the balance in Account 179-130 to reflect this finding in its Draft Rate Order.

The Board notes that a number of parties raised new concepts and principles which they suggested the Board should apply in evaluating the FT-RAM related transactions. For example, CME stated:

In our view, transportation switching is the key factor in determining whether FT-RAM Related optimization amounts should be classified as "upstream gas transportation cost reductions" or as "utility revenues". If "transportation switching" must take place in order for optimization benefits to be utilized, then the "upstream gas transportation cost reduction" classification for the savings realized should prevail.<sup>44</sup>

The Board has included detailed summaries of the various parties' submissions with respect to evaluating criteria of FT-RAM related transactions. The Board is of the view that the criteria set out by the Board in EB-2012-0087 continue to be appropriate criteria by which the treatment of revenues generated from optimization activities are to be evaluated. The Board provided its views in EB-2102-0087 as guidance for future activities by Union. Union has supported its activities that are subject to scrutiny in this application with arguments that its activities align with the Board's previous findings. Without dismissing any particular element of the proposals the Board has received, the Board is not convinced that any of the proposed evaluation methodologies are of sufficient merit to override the Board's guidance and the reliance Union has placed on it.

---

<sup>44</sup> EB-2013-0109, CME Submission at p. 12.

With respect to the arguments put forth by some parties that the 2012 earnings sharing amount should be allocated differently than in previous years, the Board does not agree. The 2012 earnings are driven by a number of factors, not only the FT-RAM revenues. The Board therefore finds that the earnings sharing amount should be allocated in a manner consistent with the Board approved methodology.

The Board directs Union to file the appropriate updates in its Draft Rate Order to reflect the Board's findings.

### **Deferral Clearing Variance Account (Account No. 179-132)**

#### **Background**

Union requested the establishment of a Deferral Clearing Variance Account effective April 1, 2013, to capture variances between earnings sharing, deferral account and other balances approved for disposition and amounts actually refunded or recovered from ratepayers. Union previously filed an application on April 22, 2013 requesting approval of this deferral account noting that supporting evidence would be filed in the current proceeding.

Union noted that during the 2008 Deferral Disposition proceeding (EB-2009-0052), the Board had requested Union investigate the possibility of implementing a true-up mechanism to capture any volumetric variance related to the disposition of deferral accounts. Union determined in a response to an interrogatory in the 2009 Deferral Disposition proceeding (EB-2010-0039, Exhibit B2.01), that the average variance of deferral disposition from 2005 through 2007 was approximately \$25,000 per year, which did not represent a material amount that would warrant a true-up mechanism.

Union noted that during the 2011 Deferral Disposition proceeding (EB-2012-0087) Union was asked to revisit the need for a true-up mechanism by updating the information supplied in the 2009 Deferral Disposition proceeding to include the years 2008 and 2009. Union found that the average impact from 2005 to 2009 of not trueing-up the disposition of deferral account balances was approximately \$3,000 per year. Consistent with its position during the 2009 proceeding, Union determined that no true-up mechanism was required.

In 2013, upon completion of the disposition of 2010 deferral account balances, Union determined that due to variances from forecasted volumes, approximately \$1.3 million

had been refunded to ratepayers in excess of the final deferral balances approved for disposition in EB-2011-0038.<sup>45</sup>

Because this amount was material, Union proposed the establishment of a Deferral Clearing Variance Account. It proposed that this deferral account would apply to 2011, 2012, and subsequent year deferral and variance account dispositions.<sup>46</sup>

### Position of Parties

Union provided the major drivers for the large variance between actual and forecast volumes used for the disposition of 2010 deferral account balances.<sup>47</sup>

Union noted that deferral and variance accounts record the difference between actual and forecast results. Union noted that the accounts eliminate forecast error, to ensure that actual results are dealt with as directed by the Board. Union submitted that, as a matter of principle, it would be inconsistent with the principle underlying the establishment of such accounts if Union, or ratepayers, were to gain or lose on the disposition of the actual amount recorded in an account.

Board staff supported the establishment of the new deferral account as it will eliminate forecast error risk and ensure that all parties are held harmless as a result of the disposition process. Board staff also noted that Union's proposal is consistent with the approach used by Enbridge and electricity distributors in Ontario.<sup>48</sup>

LPMA, CME and CCC supported the proposed new deferral clearing variance account in principle, but opposed it for 2011 and 2012 on the basis that it was not contemplated as part of the IRM Framework Settlement Agreements. They further argued that under those agreements, Union assumed volume risk. SEC and Energy Probe argued that Union did not propose, as part of its IRM plan, an account to mitigate the volume risk associated with the clearance of deferral and variance accounts, and to do so now would change the parameters of the original plan, and therefore, should be rejected by the Board.

LPMA submitted that if the Board determines that it is appropriate to approve the deferral clearing variance account for 2011 and 2012 disposition balances, then Union should also be directed to include in the account any amounts that cannot be processed (credits or debits) as one-time adjustments related to contract customers that are no

---

<sup>45</sup> EB-2013-0109, Exhibit A, Tab 1 at pp. 39-40.

<sup>46</sup> EB-2013-0109, Exhibit D2.1.

<sup>47</sup> EB-2013-0109, Exhibit A, Tab 1, p. 41.

<sup>48</sup> EB-2013-0109, Board Staff Submission at p. 15.

longer on the system. LPMA noted that Union proposed that these amounts would not be included in the requested account. LPMA stated that if the goal of the new account is to hold both the utility and ratepayers whole, then any amount not refunded to or collected from contract customers should not accrue to Union, but also be included in the requested account.<sup>49</sup>

CME submitted that, in the alternative, if a deferral clearing variance account is to be approved, then the Board may consider limiting the scope of the account to over-refunds associated with the FT-RAM related optimization deferral account.<sup>50</sup>

No other parties made submissions on this issue.

Union noted that LPMA, CME and CCC all support the new deferral clearing variance account in principle, but oppose it for 2011 and 2012 on the basis that it was not contemplated as part of the IRM Settlement Agreements. They further argue that under those agreements, Union assumed volume risk.

Union argued that it did not decide to take on volume risk on deferral account balances through the IRM plan, as the very purpose of deferral accounts is to eliminate risk by keeping both parties whole. Union noted that it anticipated that any remaining variances at the end of the planned disposition period in question would be immaterial, consistent with what past history would support. Further, Union stated that it did not take on the risk that balances would be materially affected by a return of customers from direct purchase to systems sales but that is what drove, in part, the large over-refund. Union stated that this was not an error on Union's part. Union stated that it cannot anticipate how many customers will return to system supply. Union also stated that it did not take on the risk that the Board would establish the Upstream Transportation FT-RAM Optimization Deferral Account part way through the IRM term.

## Board Findings

The Board finds that Union's proposal to establish the Deferral Clearing Variance Account (Account No. 179-132) is not appropriate.

The Board agrees with the submissions of intervenors which stated that the proposed account was not contemplated as part of the IRM Framework. Union did not request the establishment of an account to mitigate the volume risk associated with the clearance of deferral and variance accounts as part of its IRM plan. Therefore, the Board is of the view that the establishment of such an account, at this point in the IRM

<sup>49</sup> EB-2013-0109, LPMA Submission at pp. 6-7.

<sup>50</sup> EB-2013-0109, CME Submission at pp. 21-22.

term, would change the parameters of the original plan significantly and Union has not satisfied the Board that exceptional circumstances have arisen that would justify such a significant change. Therefore, the Board will not order the establishment of the proposed Deferral Clearing Variance Account.

## **Preparation of Audited Utility Financial Statements**

### **Background**

In the EB-2011-0210 proceeding, the Board directed Union to prepare and file separate Audited Financial Statements (“AFSs”) for the portion of its business that is subject to rate regulation.<sup>51</sup> In that proceeding, Union estimated the cost of preparing AFSs to be approximately \$400,000.

In the current Application, Union filed an Addendum to inform the Board that a more current estimate indicates that the costs of preparing AFSs for the regulated business was projected to increase from \$400,000 to \$1.3 million. In the Addendum, Union explained that this is a one-time cost comprised mainly of system related modifications. Union further noted that there would be an ongoing cost of \$80,000 for preparing the financial statements on an annual basis and indicated that it did not expect any material variation to this estimate.<sup>52</sup>

As noted previously, the Board, as a result of the significant increase in the cost estimate to prepare audited financial statements for the regulated businesses of Union, on its own motion, initiated a review of the Board’s direction.

### **Position of Parties**

Union submitted that as it indicated in EB-2011-0210, the parties that advocated for separate audited financial statements failed to identify any information not already disclosed by Union in the EB-2011-0210 proceeding or by Union in response to the Board's Reporting and Record Keeping Requirements that would be available as a result of the audited statements. Union submitted that it is unclear what incremental information will be available to the Board and to intervenors as a result of the directive.

Union noted that, as required by its IRM Settlement Agreements, it files with the Board an earnings sharing calculation supported by schedules that report utility earnings in which non-utility earnings are removed from corporate earnings. Union submitted that

---

<sup>51</sup> EB-2011-0210, Decision and Order at p. 128.

<sup>52</sup> EB-2013-0109, Evidence Addendum dated July 26, 2013.

this information addresses the requirements of the Board and parties in respect of the financial results related to utility operations.

Board staff agreed with Union that the information that would be provided in the AFSs does not add to the information filed in a rebasing rate application or information reported in the Reporting and Record Keeping Requirements (“RRR”). Board staff submitted that at issue is the rigour exercised and level of confidence provided in information that is used to establish the appropriate allocation between the rate regulated and non-rate regulated storage businesses. Board staff also submitted that allocation is particularly important because approximately 24% of Union’s Earnings before Interest and Tax (“EBIT”) for 2012 comes from Union’s unregulated business.

Board staff submitted that filing AFSs for the regulated portion of the business would allow the Board to better assess revenue requirement and earnings sharing in rate applications and monitor performance during the IRM period. Further, the provision of information in a separate AFS for the regulated business will lead to greater transparency and improved efficiency in rate applications.

However, Board staff submitted that, if the Board is concerned with the level of the revised cost estimate provided by Union to prepare the AFSs, other options exist that would enhance the robustness of the financial information currently presented by Union. Board staff noted that these options include an assurance provided by an independent professional advisor regarding the required financial information or segmented note disclosure within Union’s consolidated financial statements.<sup>53</sup>

FRPO supported Board staff’s position. FRPO also submitted that the Board should consider the current investment that ratepayers make in Union’s financial statements. FRPO submitted that Union’s non-rate regulated storage business ought to bear some of the financial reporting cost as part of their privilege to earn the Board’s confidence in the financial reporting of the combined utility.<sup>54</sup>

Energy Probe submitted that the current method of Union making non-utility cost/revenue eliminations lacks the independent oversight to provide certainty for ratepayers that historic utility costs are correct as the basis for forward year costs and rate setting.<sup>55</sup>

---

<sup>53</sup> EB-2013-0109, Board Staff Submission at pp. 14-15.

<sup>54</sup> EB-2013-0109, FRPO Submission at p. 11.

<sup>55</sup> EB-2013-0109, Energy Probe Submission at p. 17.

CME submitted that the Board and Board staff are the ones best able to determine whether the additional costs that Union expects to incur are reasonable, and if they are, whether the benefits the Board expects to receive from these separate audited financial statements are likely to exceed the costs of preparation.<sup>56</sup> CCC filed similar comments as CME.<sup>57</sup>

LPMA submitted that the Board should relieve Union of the directive to prepare separate AFSs. LPMA submitted that it does not see the need for these audited financial statements for the regulated business. LPMA noted that Union already prepares an earning sharing calculation that is based on the regulated utility earnings. Non-utility activity is taken out of the corporate earnings. LPMA stated that, because the earnings sharing calculation requires a regulated utility return on equity, the adjustments made by Union in this calculation are extensive. LPMA submitted that there is not any incremental value in requiring audited financial statements for the regulated business relative to the cost. LPMA submitted that intervenors and the Board are as qualified as any auditor in determining what adjustments are appropriate in the calculation of financial information for the regulated entity.<sup>58</sup> SEC agreed with the submissions of LPMA.<sup>59</sup>

No other parties commented on this issue.

In its reply submission, Union stated that it believes that the information that is currently provided addresses the requirements of the Board and parties in respect of the financial results of the utility operations. Union submitted that it should be relieved of the directive.<sup>60</sup>

## Board Findings

The Board notes that the cost estimate of implementing the Board direction has increased significantly. In the EB-2011-0210 proceeding, Union estimated that the cost of preparing the separate AFSs to be approximately \$400,000. In the current proceeding, Union provided evidence advising the Board that the revised cost estimate of preparing the AFSs for the regulated business is a one-time cost of approximately \$1.3 million (and an ongoing cost of approximately \$80,000 each year).

---

<sup>56</sup> EB-2013-0109, CME Submission at p. 23.

<sup>57</sup> EB-2013-0109, CCC Submission at p. 7.

<sup>58</sup> EB-2013-0109, LPMA Submission at pp. 8-9.

<sup>59</sup> EB-2013-0109, SEC Submission at p. 31.

The Board finds that, based on the new cost estimate, the potential value received from the separate AFSs does not justify the expected costs. Therefore, the Board relieves Union of the requirement to prepare separate AFSs for its regulated business.

The Board requires Union to record the amount already spent on implementing the Board's directive in the deferral account that was established in the EB-2011-0210 proceeding. The amount recorded in that account will be subject to review at the time that amount is brought before the Board for disposition.

## **Disposition of DSM related Deferral Accounts**

### **Background**

The balances recorded in Union's various Demand Side Management ("DSM") related accounts are set out in Exhibit A, Tab 1 of Union's application. Union filed its 2012 DSM Annual Report, Audit Report, and Audit Committee Summary Report with the Board on October 30, 2013. Subsequently, Union filed an update to its application on November 4, 2013 to reflect the 2012 audited results in the balances of the relevant DSM deferral accounts. The updates resulted in a decrease in the Lost Revenue Adjustment Mechanism ("LRAM") deferral account balance (Account No. 179-75) of \$69,000 and a decrease in the DSM Incentive deferral account balance (Account No. 179-126) of \$388,000.

Union proposed that the updated DSM related deferral account balances, which reflect the audited 2012 results, be disposed of in this proceeding.

The Shared Savings Mechanism ("SSM") Variance Account (Account No. 179-115) has a zero balance related to the 2011 audit true-up for DSM activity in 2011. For 2012 there is no balance in the account as in EB-2011-0025 the Board approved a new DSM Incentive Deferral Account (Account No. 179-126), which reflects 2012 activity. Accordingly, Union is seeking approval, in this proceeding, to close the SSM Variance Account.

### **Position of Parties**

Union stated that both the 2011 and 2012 DSM deferral account balances reflect Union's audited results and a consensus between Union and the members of its Evaluation and Audit Committee (the "EAC").

Union noted that SEC was the only party to conduct any cross-examination on its DSM activities. Union noted that the focus of SEC's examination was Union's 2011 custom project portfolio. Union stated that the nature of Union's custom projects did not change in 2011 in comparison to previous years.

Union noted that its claimed 2011 DSM savings for custom projects underwent several reviews:

- 1) The projects and savings were reviewed internally by engineers employed by Union.
- 2) A sample of projects was selected by a third party, Navigant Consulting, following the sampling protocol established in 2008 in consultation with Union and Enbridge's EACs. The sample was designed to achieve a 90:15 statistical confidence level. There were 25 projects sampled for the commercial/industrial custom program, and 13 sampled for the large distribution contract custom program.
- 3) The selected projects were then verified by Michaels Energy ("Michaels") for commercial/industrial custom projects and by Diamond Engineering ("Diamond") for large distribution contract custom projects. Both Michaels and Diamond reviewed their findings internally within their own organizations, and had the results reviewed by an Ontario Professional Engineer.
- 4) Cascade Energy ("Cascade"), a subcontractor of the 2011 auditor EcoNorthwest, then independently reviewed the Michaels and Diamond reports and calculations. As part of this review, Cascade interviewed each of the verification consultants to clarify the results of the verification work and seek answers to any questions that arose during Cascades' review.
- 5) Prior to the finalization of the audited results, Union's EAC reviewed executive summaries of the Michaels and Diamond reports, along with the Audit Report by EcoNorthwest, which reflected Cascades' findings.
- 6) The verified savings and audit recommendations are reflected in the final 2011 audited DSM figures.

Union submitted that SEC's questions were directed at whether, absent the involvement of Union's DSM group, the customer would have undertaken the particular custom project on its own initiative. Although SEC framed its questions as relating to the proper

"base case", Union submitted that in substance, SEC's questions related to the approach to "free ridership". Union submitted that the Board considered this issue in EB-2006-0021 (the first generic DSM proceeding) when it approved the framework applicable to Union's 2011 DSM activity. There, the Board specifically considered whether "free riders for custom projects [should] be determined on a portfolio average or on a project basis." The Board approved a portfolio average approach for determining free ridership for custom projects. Union stated that consistent with the Board's decision, Union applies a free ridership rate of 54% to the custom projects portfolio. As a result, Union's DSM results reflect only 46% of the savings associated with custom projects. Union noted that it has used this free ridership rate since 2009, with support from its DSM consultative and its various EACs.<sup>61</sup>

SEC made comprehensive submissions regarding the balances included in the DSM related deferral accounts. SEC stated that its concerns largely relate to the 2011 large industrial custom projects. Specifically, SEC noted that is concerned with the assumptions used by Union and its verification contractors (and accepted by Union's auditor) to calculate the results achieved for those projects.

In its submission, SEC provided an in-depth discussion of the DSM principles and concepts (free ridership, baseline, effective useful life, persistence, and advancement) that it submitted are relevant to its concerns. SEC also provided a discussion of the roles and responsibilities of the parties involved in the review of Union's DSM results. SEC also made submissions on Union's application of the relevant principles / concepts to specific 2011 custom projects in its calculation of the DSM results.

Overall, SEC submitted that Union appears to be expanding the concept of free ridership to remove most of the need for causal connection between Union's DSM programs and the conservation measures implemented by customers. SEC stated that Union's view appears to be that it should get credit for savings even if it did not cause the savings and even if in some cases the savings did not actually happen. SEC stated that using the blanket 54% free ridership rate applied to all custom projects means that causal relations between programs and results are not relevant. SEC submitted that Union's position can be seen in two ways:

- a) Union believes that it should get credit for all conservation activities by industrial / commercial customers even if Union knew, or ought to have known that the conservation activities would have happened anyway.

---

<sup>61</sup> EB-2013-0109, Union Argument-in-Chief at pp. 21-23.

- b) Union believes that the calculation of savings that actually take place as a result of Union's DSM programs should not consider what the customer would have otherwise done, instead should be limited to reviewing the maximum technically possible savings arising out of the measures implemented by the customer.

SEC submitted that the problem with (a) is one of known free ridership. SEC submitted that there are numerous examples in the project specific evidence where any reasonable person – including Union – would believe that Union had no actual impact on the actions of the customer. SEC submitted that Union believes that situations like these are covered by the 54% overall free ridership rate, but it disagreed with Union's position. SEC submitted that the free ridership rate is intended to capture situations in which Union pays incentives in good faith, but in fact the customer is taking advantage of the program and receiving an incentive for something it would have done anyway. SEC submitted that it is not intended to allow Union to focus its efforts on paying ratepayer money to customers with foreknowledge that they are not achieving any incremental efficiency benefit.

SEC submitted that the problem with (b) is one of calculation of savings. SEC submitted that the basic principle which should be applied is comparing the gas usage that occurs with Union conservation measures in place against the gas usage had Union's program not been there. SEC submitted that, instead, Union calculates savings based on the technical savings arising from the conservation measures relative to the status quo. SEC submitted that Union and its verification auditors are supposed to answer the question: "How do the results compare to what otherwise would have happened?" Instead, they answer the question: "How much technical savings arise from the conservation measures relative to the existing status quo?" SEC submitted that Union claims that any other aspects of the calculation are subsumed in the concept of free ridership. SEC disagreed with this position.

SEC submitted that, overall, the evidence shows a pattern of material errors in the assumptions, approaches, and calculations used to produce the results claimed for custom projects, particularly in the large industrial custom projects. SEC submitted that the Board should order Union to conduct, preferably in conjunction with its stakeholders, an independent review of the ways in which custom projects are marketed to customers, and evaluated on completion. SEC stated that the review should include, but not be limited to, an assessment of whether participation is being promoted on a routine basis to known free riders, and whether realistic base cases are being developed to assess the impact of the projects.

In regard to the 2011 SSM Variance Account, SEC submitted that the evidence indicates that the total TRC claimed for the 13 projects reviewed by Diamond was just over \$61 million. SEC submitted that based on its analysis (as outlined above) that figure should be reduced by at least half. SEC recommended that the Board reduce the amount of the 2011 SSM Variance Account by the impact of 50% of the TRC arising out of the large industrial (Rates T1 / 100) custom projects. SEC stated that it is not seeking a reduction in the SSM for commercial custom projects, or smaller industrial custom projects. SEC submitted that the evidence of Michaels shows some of the same problems as were apparent in the large industrial projects, but the pattern of calculation and assumption errors is not as obvious. SEC submitted that it is possible that the errors in that area are less pervasive.

In regard to the 2011 LRAM Variance Account, SEC noted that the reduction of the large industrial TRC would also reduce the volumes used for the calculation of the LRAM with respect to 2011 results. SEC noted that this means that both the 2011 LRAM, and the 2012 LRAM, would be affected. However, SEC submitted that only the 2011 LRAM has to be adjusted in this proceeding (as it made separate submissions regarding the 2012 amounts, which are discussed below in this decision).

In regard to the 2011 DSM Variance Account, SEC noted that spending only qualifies for DSM Variance Account recovery if the utility meets or exceeds its target for the year. SEC noted that if the adjustments that it proposed to the TRC were to result in Union not meeting its target for 2011 then DSM Variance Account recovery would no longer be available.

SEC noted that Union seeks to clear its 2012 DSM accounts on a provisional basis, without audit support, as has been its practice under the previous DSM framework.<sup>62</sup> SEC submitted that this is no longer consistent with Board policy. SEC submitted that Union's previous practice of clearing the DSM accounts provisionally, on an unaudited basis, in one year, followed by a true-up in a subsequent year, has now been superseded by a new Board policy. SEC stated that Union has not provided any evidence to support the need or appropriateness of the provisional clearance approach in 2012, sufficient to displace the new Board policy specifically applicable to 2012 and subsequent years. Therefore, SEC submitted that clearance of the 2012 accounts should not be approved by the Board in this proceeding, as Union has not filed the Audit

---

<sup>62</sup> Union filed its 2012 DSM Annual Report, Audit Report, and Audit Committee Summary Report with the Board on October 30, 2013. Union filed an update to its application on November 4, 2013 to reflect the 2012 audited results in the balances of the relevant DSM deferral accounts. Union proposed that the updated deferral account balances, which reflect the audited 2012 DSM results, be disposed of in this proceeding.

Report and other supporting material required by the policy.<sup>63</sup> FRPO and OGVG supported SEC's submissions on the DSM related issues.<sup>64 65</sup>

LPMA generally supported SEC's submissions. LPMA submitted that, on a going forward basis, the Board should require Union, its contractors and its auditors to obtain the expected replacement date of equipment in the absence of incentives from Union to advance the replacement. LPMA noted that savings would then only be calculated over this period, not the entire life of the new equipment. Similarly, LPMA submitted that Union should be required to present evidence that the custom project incentives did indeed have an impact on customer behaviour. If Union cannot demonstrate that in the absence of incentives the customer would not have done anything, then Union should not be able to claim any savings.

With respect to the clearance of the 2012 DSM related account balances, LPMA submitted that it continues to support the current practice of clearing the DSM accounts on a provisional basis, followed in the next year with a true-up based on audited information. LPMA stated that the amount recovered from customers related to the DSM activities is often in the \$8 to \$10 million range. LPMA noted that waiting to recover these amounts in the following year only adds the carrying costs to the amounts to be recovered from ratepayers.<sup>66</sup>

APPPrO generally supported the submissions of SEC. APPPrO stated that it is unclear whether the 54% free ridership rate that Union has used since 2009 is current and whether or not it includes all of the free riders referred to by SEC. APPPrO submitted that this percentage may need to be updated to reflect Union's current customers' investment in energy efficiency measures.

In regard to the LRAM Variance Account, APPPrO submitted that it has some concerns with the rate used to derive the revenue impact for rate classes M4 and Rate 20. APPPrO noted that rates classes M4, Rate 20, and T1 each have 2 commodity charges. Once a customer consumes an amount above a specified initial amount (block 1), the balance of the volumes attracts a lower commodity fee (block 2). APPPrO noted that for rate classes M4 and Rate 20, Union only uses the first block in determining the lost revenues, rather than some weighted average of the blocks. Union's rationale for only using the first block is that the majority of the volumes lost are in the first block. APPPrO submitted that while this may be true, it overstates the lost revenues from the DSM program.

---

<sup>63</sup> EB-2013-0109, SEC Submission at pp. 2-29.

<sup>64</sup> EB-2013-0109, FRPO Submission at p. 10.

<sup>65</sup> EB-2013-0109, OGVG Submission at p. 3.

<sup>66</sup> EB-2013-0109, LPMA Submission at pp. 9-10.

APPrO noted that there are not many customers in M4 and Rate 20 rate classes and DSM programs are administered on an individual customer basis. APPrO stated that rather than assume all losses are in the first consumption block, it would be more appropriate to use the actual customer consumption reduction information determined from the DSM program and then apply the appropriate commodity rates from each block when determining LRAM revenues.<sup>67</sup>

BOMA stated that Union has clearly followed all of the DSM guidelines in terms of planning, delivering, verifying and auditing its DSM results. BOMA submitted that by the time Union reaches the final audit stage, consideration of individual projects must defer to analysis of the portfolio as a whole. BOMA stated that sampling procedures for verification and adjustments related to free riders and persistence are all concepts that are applied at the portfolio level. BOMA also submitted that the membership of Union's EACs should be improved.<sup>68</sup>

GEC, which is not an intervenor in the proceeding, also filed comments on the DSM issue. GEC noted that as a result of the new rules in place for audits of 2012 DSM results, all evaluation reports should routinely be made available to the audit committee.<sup>69</sup>

In its reply submission, Union stated that SEC has made multiple assertions about Union's custom project portfolio for which there is no basis in the evidence.

Union submitted that custom projects are unique and complex in nature and cannot be simplified in the manner set out in SEC's argument. Each project is assessed on a case-by-case basis. The nature of custom projects is such that the issues of base case, expected useful life ("EUL"), and persistence cannot be examined in isolation. Their interrelationship can only be effectively considered by modeling project inputs to determine the appropriate level of savings. Union noted that this work is completed by Union's technical experts and verified internally by professional engineers.

Union referred to the appropriate treatment of free ridership as discussed by the Board in the Decision with Reasons for the DSM Generic Proceeding (EB-2006-0021). Union stated that its sector-specific custom free ridership rates were approved in the 2011 DSM Plan proceeding (EB-2010-0055) and adjusted to a single free rider rate of 54% in the 2009 audit (as a result of an audit recommendation), which was agreed to be applied on a custom portfolio basis. Union noted that this rate has been applied for SSM

---

<sup>67</sup> EB-2013-0109, APPrO Submission at pp. 6-9.

<sup>68</sup> EB-2013-0109, BOMA Submission at pp. 10-14.

<sup>69</sup> EB-2013-0109, GEC Submission at p.1.

in 2010 onwards with support from Union's EAC. Union noted that the 54% represents the Board-approved rate for the 2011 program year. Therefore, Union submitted that this is the appropriate rate to apply for 2011 SSM.

Union submitted that it does not target its program towards projects it knows would provide equivalent savings absent DSM support. However, Union is aware that a portion of the custom portfolio's deemed savings supported through Union's customer incentives and technical expertise would have occurred absent the program. Union stated that this is captured in the 54% free rider rate applied to the custom portfolio. Union noted that the 54% custom free ridership is based on a comprehensive study conducted by Summit Blue Consulting.

Union submitted that contrary to SEC's claim, there is a causal relationship between Union's programs and the results. Union submitted that it has a key role in influencing customers' decisions when it comes to the implementation of custom projects. This is in large part due to the ongoing efforts from Union account representatives and engineers to provide expertise to customers in helping to understand ways in which to make efficiency improvements. Union stated that industrial projects by their nature are complex and customer/process specific. Union helps customers assess their energy efficiency effectiveness.

Union noted that SEC stated that "Union and its CPSV contractors have treated the useful life of custom project measures as being the technical life, and have ignored the concepts of persistence and advancement". Union submitted that this is inaccurate. Union does not limit its assessment of EUL to technical life. Union assesses the life for which the savings are planned to persist on a custom basis for each project.

Union submitted that for each project, base case, EUL and persistence were reviewed by Union's technical experts and verified internally by professional engineers. The projects were then further reviewed and verified independently.

Union submitted that it would not be appropriate for the Board to make the adjustments to the SSM and LRAM proposed by SEC. The simplified approach put forward by SEC in no way accurately accounts for the rigorous assessment required to appropriately identify the savings from complex custom projects.

Union stated that SEC selectively chose what it deems to be shortfalls in Union's review of certain projects as a reason to make adjustments to the audited 2011 DSM results. Union submitted that the assumptions underlying the projects in question were

appropriate and reviewed by experts, and the portfolio free ridership rate was appropriately applied.

Union noted that it filed its 2012 Audit documents with the Board on October 30, 2013 and reflected the updated balances in an evidence update dated November 4, 2013. Union argued that it is appropriate to dispose of the 2012 audited DSM balances in this proceeding because:

- 1) the 2012 Audit Committee has accepted the balances in the subject DSM deferral accounts and supports an order from the Board disposing of the amounts through to rates;
- 2) waiting to recover these amounts in the following year only adds the carrying cost to the amounts to be recovered from ratepayers; and
- 3) recovery now ensures that costs are recovered from customers as close as possible to the time period in which customers participated in the DSM programs.

In regard to APPrO's suggestion that Union's method for deriving the LRAM revenue impact for rate classes M4 and Rate 20 is inappropriate, Union disagreed. Union noted that the rates Union uses for LRAM, in the case of multi-block rates, reflect the single rate block most representative of the DSM-related volume reductions. In the case of Rate M4 and Rate 20, this is the first rate block. Union stated that its practice is consistent across all rates classes, applies to both contract and general service rates, has been the long-standing Union practice approved by the Board in many cases, and is the most reasonable proxy of the revenues lost given Union does not track or report DSM-related volume reductions at the rate block level.

In addition to its comments on LRAM, Union noted that APPrO questions whether the free ridership rate of 54% should be updated. Union stated that the Technical Evaluation Committee ("TEC") is in the process of considering the scope of a new free ridership study.

Union submitted that SEC's suggestion that an additional independent review be conducted in relation to custom projects is not necessary as the scope of the utilities' TEC includes the review of evaluation research priorities and individual studies. Union stated that, through the TEC process, Union together with its stakeholders, will confirm whether a review of the evaluation and verification of its custom portfolio is a priority.<sup>70</sup>

---

<sup>70</sup> EB-2013-0109, Union Reply Submission at pp. 17-25.

## Board Findings

The Board finds that the 2011 TRC amount related to Union's 2011 large industrial custom DSM projects (Rates T1 / 100) should be reduced by 25% for the reasons set out below. .

The Board notes that the requirements to be followed by Union in approving and validating its 2011 DSM projects are contained in the Generic DSM Proceeding (EB-2006-0021) and Union's 2011 DSM plan proceeding (EB-2010-0055) (collectively the "2011 DSM Requirements").

SEC argued that in calculating the savings resulting from a DSM project, the question should be "How do the results compare to what otherwise would have happened?" The Board agrees. The Board notes that the 2011 DSM Requirements contemplate that Union will apply assumptions in assessing the DSM savings for projects. However, there is a clear expectation that the assumptions used will be grounded in the reality of each specific project:

"... Assumptions with respect to measure life should reflect actual expected measure life." (Issue 12.3)

"Only the part of the project that the Utility influenced is to be counted for SSM or LRAM purposes." (Issue 12.5)<sup>71</sup>

Accordingly, assessing the benefits of DSM projects involves considering what would have happened if the DSM project had not occurred (baseline); the effective useful life of the DSM measure (repairs, new equipment, etc.); and the period in which the DSM measure will actually be in operation, which may or may not be as long as the effective useful life (persistence).

The Board notes that the process to approve and validate custom projects was more rigorous than for other types of projects. Union's witnesses stressed the need to assess the savings for custom projects on a case-by case-basis:

Ms. Lynch: Custom projects are opportunities where the savings are unique to the application in – whether it be the building or the design process, so the savings associated need to be assessed on an individual basis.<sup>72</sup>

---

<sup>71</sup> EB-2006-0021, Decision with Reasons at pp. 46-47.

<sup>72</sup> EB-2013-0109, Oral Hearing Transcripts, Volume 3 at p. 10.

Mr. Shepherd: ...But for custom projects like a large industrial facility, you'd have to calculate the savings based on the actual activity that the customer undertook and engineering estimates of the lifetime impacts of those activities, right?

There's no predetermined number?

Ms. Kulperger: It's on a case-by-case basis. Correct.<sup>73</sup>

SEC cross-examined a panel of witnesses concerning the large industrial custom projects included as part of the statistically significant sample verified by Diamond. In its cross-examination, SEC focused on whether the large industrial custom projects were assessed appropriately.

The Board is of the view that the written project descriptions for some of the large industrial custom projects, and the testimony of the Diamond witness, reasonably lead to the conclusion that in assessing the TRC and hence in calculating the DSM savings, Union did not exercise the requisite due diligence in considering base case, effective useful life and/or persistence. In responding to questions about these factors, the witness from Diamond raised the possibility that there might be factors not apparent in the written project descriptions that justified Union's assessment. However, after considering carefully the testimony of the Diamond witness, the project particulars and the testimony of the Union witnesses concerning Union's TRC assessment process, the Board is not convinced that Union applied the requisite due diligence in assessing these factors for some of the large industrial custom projects.

As indicated above, case-by-case scrutiny was particularly important for custom projects. Given the magnitude of savings claimed for the large industrial custom projects, this scrutiny is particularly important. The Board notes that custom projects, by their nature, require a certain level of engagement between Union and prospective custom project incentive recipients. This engagement presents an opportunity to apply basic critical analysis of the value of providing an incentive.

The Board considers it reasonable to expect that at least a minimal level of scrutiny of the value of incentive investments would occur even though there is a free ridership rate applied to the portfolio overall. The investment in DSM should not occur when it is apparent that the implementation of a proposed project is not being influenced by the DSM incentive contribution. In other words, investments should not knowingly be made in free riders. The Board does not consider Union's approach to its large industrial custom DSM projects to be sufficient in this respect. Given the application of an overall

---

<sup>73</sup> Ibid at p. 48.

portfolio free rider rate the Board does not consider it reasonable to expect that any more than a readily applied basic level of scrutiny. However, it is apparent to the Board that this basic level of scrutiny is not part of Union's program management, as highlighted by a number of examples raised by SEC in its cross-examination on specific projects and in its submission.<sup>74</sup>

The Board also sees shortcomings in Union's practice in setting appropriate baselines and assessing appropriate levels of persistence for some of its large industrial custom DSM projects. Union's practice of applying baseline life expectancies based on the status quo with no consideration of what will likely occur in the particular situation without the DSM incentive has not been sufficiently supported. Union has not demonstrated how this approach results in reasonable indications of the incremental energy saving value of the DSM incentive investments.

For example, SEC, in its argument, highlighted a large industrial custom project that involved resetting the controls for a large number of air handling units. SEC noted that this project involved implementing a behavioral change (as opposed to a hardware upgrade). SEC argued that the CPSV contractor did not put sufficient thought into how to measure the savings against the base case. The Board agrees.

For this project, savings were estimated to accrue over a 20-year period. This assumes that without the DSM incentive the customer would not implement this type of improvement for 20 years. SEC disagreed, arguing that without a DSM incentive, a customer such as this one, with sophisticated building automation systems, and extensive studies of air flows, should be expected to make this kind of behavioural change within a shorter time frame than 20 years. The Board agrees with this logic. In addition, SEC argued that calculating savings based on the behavioural change being in effect for the 20-year period assumes that the airflow settings would not be changed at any point over that 20-year period. SEC also argues that this assumes the automation systems would not be replaced for 20 years, even though the building automation systems, when the control setting was changed in the DSM project, were already considered "not new". The Board is of the view that Union's assumptions concerning this project are clearly flawed and that savings arising from the DSM project would not have persisted over a 20-year period.

Accordingly, the Board agrees with SEC that a reduction of Union's TRC amount for large industrial custom projects is appropriate. However, the Board does not believe SEC's proposal to reduce the 2011 TRC amount arising from the large industrial custom projects by 50% provides sufficient consideration of the existence of the portfolio free

---

<sup>74</sup> EB-2013-0109, SEC Submission at pp. 19-21.

ridership rate of 54%. The Board does not consider it possible to make an adjustment to the TRC for these projects with any kind of precision, given that this would involve an attempt to re-assess the likely effect each project by applying scrutiny retroactively. However, the Board's findings in this regard have been well informed by Union's forthright explanations of its approach to the management of this program.

On the balance and consideration of the aforementioned, the Board considers it appropriate to disallow 25% of the 2011 TRC amount attributable to the large industrial custom projects (Rates T1 / 100). As a result, the Board expects that the 2011 SSM amount and 2011 (and possibly 2012) LRAM amount will need to be reduced.

The Board orders Union to file the necessary calculations, and make the appropriate revisions to the relevant accounts, to give effect to its decision as part of the Draft Rate Order process.

In regard to the 2012 DSM accounts, the Board considers it appropriate to dispose of the audited balances in these accounts as part of this proceeding (with a potential revision to the 2012 LRAM amount arising from the Board's findings above, if necessary). The Board typically utilizes the most current information available to it when making its findings. Considering, in this proceeding, the audited balances in the 2012 DSM accounts are available, the Board believes that it is appropriate to dispose of those balances at this time. The Board notes that the use of the audited 2012 DSM balances does not predetermine the eventual final amount that will be approved after the 2012 DSM results are reviewed as part of Union's 2013 ESM and Deferral Account disposition proceeding. The Board would like to make it clear that all parties will have the opportunity to make arguments on the 2012 DSM savings claimed by Union (and the resulting SSM and LRAM claims) as part of Union's 2013 ESM and Deferral Account disposition proceeding.

SEC submitted that the Board should order Union to conduct an independent review of the ways in which custom projects are marketed to customers and evaluated upon completion. The Board finds that a review of this nature is unwarranted at this time. The current framework applicable to Union's DSM activities concludes at the end of 2014. A new DSM framework for the gas distributors, applicable for 2015 (and onwards), has yet to be developed. The Board finds that any consideration of Union's marketing and evaluation of its custom projects would be best performed in conjunction with the development of a going forward framework. With regard to the DSM related claims for the years prior to the launch of a new DSM framework, the Board notes that the findings set out above will be available to inform future proceedings.

Also, the Board notes that a number of parties made other recommendations for the Board to consider. These recommendations include:

- LPMA's request that the Board require Union to obtain the expected replacement date of equipment in the absence of incentives from Union to advance the replacement date;
- APPrO's request to change the way that Union calculates the LRAM revenue impact for rate classes M4 and Rate 20; and
- BOMA's recommendation that the membership of Union's audit committee should be improved.

While the Board sees some merit in the above recommendations, the Board finds that it will make no changes to the DSM framework at this juncture as these issues can be raised by parties at the time that the next DSM framework is being considered by the Board.

The Board finds that the SSM Variance Account can be closed after the amounts arising from this decision have been disposed of to ratepayers.

### **Implementation**

The Board directs Union to file a Draft Rate Order which reflects the Board's findings in this Decision. The Board will provide Board staff and intervenors an opportunity to comment on the Draft Rate Order. Union will also be given the opportunity to respond to the comments of Board staff and intervenors.

Once the Draft Rate Order has been filed and all parties have had the opportunity to comment on it, the Board will issue a subsequent Decision and Rate Order. The Board is unsure when the resulting rate impact of this Decision can practically be implemented. The Board asks Union, in its Draft Rate Order, to make a proposal regarding when the rate impact arising from this Decision can be implemented. The Board is of the view that the dispositions related to this decision should occur as soon as possible.

The Board notes that the process for cost claims will also be set out in the subsequent Decision and Rate Order.

**THE BOARD ORDERS THAT:**

1. Union shall file a Draft Rate Order reflecting the Board's findings in this Decision on, or before, April 10, 2014.
2. Board staff and intervenors who wish to file comments on the Draft Rate Order shall do so no later than April 22, 2014.
3. Union shall file responses to the comments of Board staff and intervenors no later than April 29, 2014.

All filings to the Board must quote file number **EB-2013-0109**, be made through the Board's web portal at <https://www.pes.ontarioenergyboard.ca/eservice>, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Please use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at [www.ontarioenergyboard.ca](http://www.ontarioenergyboard.ca). If the web portal is not available you may email your document to the [BoardSec@ontarioenergyboard.ca](mailto:BoardSec@ontarioenergyboard.ca). Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file seven paper copies. If you have submitted through the Board's web portal an e-mail is not required.

**ISSUED** at Toronto, March 27, 2014

**ONTARIO ENERGY BOARD**

*Original Signed By*

Kirsten Walli  
Board Secretary