uniongas
A Spectra Energy Company

April 30, 2009

Ontario Energy Board
2300 Yonge Street
Suite 2700
Toronto, Ontario
M4P 1E4

Attention: Ms. Kirsten Walli, Board Secretary

Re: EB-2008-0106
Union's Argument in Chief

Dear Ms. Walli:

Please find attached Union's Argument in Chief in the above noted proceeding.

Should you have any questions please contact me at (519) 436-5476.

Yours truly,

[original signed by]

Chris Ripley
Manager, Regulatory Applications

cc: EB-2008-0106 Intervenors
Crawford Smith (Torys)

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Union Gas Limited

EB-2008-0106

ONTARIO ENERGY BOARD

IN THE MATTER OF a proceeding initiated by the Ontario Energy Board to determine methodologies for commodity pricing, load balancing and cost allocation for natural gas distributors;

ARGUMENT IN CHIEF OF UNION GAS LIMITED

A. Overview

1. In March 2005, following a series of consultation sessions with ratepayers, gas marketers and utilities, the Ontario Energy Board (the "Board") issued its Natural Gas Forum report (the "NGF Report").

2. In the NGF Report, the Board concluded that utilities should continue to provide a regulated gas supply option. In reaching this conclusion, the Board cited the potential merits of the utilities aligning the price setting mechanism for this option. The Board further indicated that the Quarterly Rate Adjustment Mechanism ("QRAM") should be formulaic, consistent and reflect an appropriate trade-off between market prices and price stability.

3. In May 2008, the Board, on its own motion, commenced a proceeding (EB-2008-0106) to consider the methodologies used by utilities in respect of gas commodity pricing, load balancing, and cost allocation between the supply and delivery functions in relation to regulated gas supply. Following an Issues Day on July 31, 2008, the Board confirmed

these, along with Billing Terminology and Implementation, as the issues in this proceeding.

4. Union filed written evidence addressing all of the above issues. As reflected in that evidence, Union's existing methodologies are consistent with the conclusions reached by the Board in the NGF Report. The QRAM processes used by Union and Enbridge Gas Distribution Inc. are, in large part, already standardized (Exhibit E2, Appendix A). These processes are mechanical and have received a wide degree of acceptance from stakeholders. Most importantly, they achieve a reasonable balance between price sensitivity and rate stability. For this reason, Union is proposing in this proceeding only the following changes: (1) to eliminate the Intra-Period Weighted Average Cost of Gas ("WACOG") deferral account, and (2) to revise its QRAM filing requirements and timeline.

5. With respect to the other issues in the proceeding – load balancing, cost allocation and billing terminology – Union is not proposing any changes to its existing methodologies.

B. Quarterly Rate Adjustment Mechanism

6. As described above, in the NGF Report, the Board concluded that the appropriate pricing structure for the regulated gas supply option should reflect the following objectives:

(a) a balance between an accurate price signal and price stability for customers;

(b) transparency that results from QRAM prices that reflect market prices; and

(c) reference prices and Purchase Gas Variance Account ("PGVA") calculations and disposition methodologies that are formulaic and consistent (NGF Report, pp. 68-70, Exhibit E2, p. 6).

7. In the same report, the Board communicated two key concerns that it wished to address in a subsequent hearing, specifically:

(a) Is a 12-month price outlook appropriate as the basis for pricing the regulated gas supply option?

(b) Is the frequency of the price adjustment appropriate? (NGF Report, p. 69, Exhibit E2, p. 6)

8. Further, the Board stated that to achieve the objective of market price transparency the utilities should consider similar methodologies for calculating the QRAM price (NGF Report, p. 69, Exhibit E2, p. 6).

Union's Current QRAM Methodology

9. Union's current QRAM methodology was designed to be automatic, formulaic and mechanical. Each quarter Union gathers specific market data and performs routine calculations to derive a forward looking market price of gas and to prospectively recover/refund gas supply related deferral balances. Upon approval by the Board, rates are adjusted quarterly to reflect the current market conditions, regardless of how small or large the adjustment may be (Exhibit E2, p. 7).

Calculation of Gas Supply Reference Price

10. Union's quarterly gas supply reference price represents an average cost for gas at Empress (the Alberta Border Reference Price) for the next 12 months. Union determines this price by applying a forward Empress basis differential to the future 12-month NYMEX market prices, applying a foreign exchange rate and weighting these monthly prices by the volume Union plans to buy in each of the 12 months. The result is an average cost per gigajoule in Canadian dollars that represents the forward market price at Empress. The reference price is, therefore, essentially a rolling 12-month price that is updated quarterly. This 12-month average price is intended to smooth seasonal prices or cost anomalies that may be present in any of the individual months, so that customers see a more stable rate on their bills. Quarterly updates to this rate are intended to ensure that the reference price adequately reflects any changing market dynamics (Exhibits E2, p. 8 and K1.2).

11. To set the gas supply commodity charge, Union adds TCPL compressor fuel specific to each delivery area, and the gas supply administration charge to the Alberta Border reference price (Exhibit E2, p. 26).

The PGVA

12. The difference between Union's forecasted and actual gas procurement costs and the price set through the QRAM process is captured through two PGVA accounts (Exhibit E2, p. 10). Separate PGVA deferral accounts are maintained for the North and South operational areas.

13. In the North, Union serves its sales service customers using supplies transported by TCPL. Accordingly, in the North actual Empress gas costs are deferred against the Alberta Border reference price each month and the cost variances accumulate in the North PGVA account for disposition to the sales service customers at the next QRAM period. In the North, because Union provides transportation services to both sales service and direct purchase ("DP") customers, transportation deferred costs are not included in the North PGVA (Exhibit E2, p. 9).

14. The South PGVA captures variances in both gas supply commodity and upstream transportation costs for sales service customers only. This is appropriate because Union does not provide the gas supply commodity or upstream transportation to DP customers in the South. Accordingly the South PGVA is limited to sales service activity and is recovered/refunded from only sales service customers. The calculation of the South PGVA is detailed in Union's evidence at Exhibit E2, p. 9.

15. With respect to the recovery of PGVA balances, each quarter Union identifies the debits/credits that have accumulated in both PGVA accounts during the previous quarter and calculates commodity price adjustments (also referred to as rate riders) that recover/refund accumulated deferral account balances prospectively over the next 12 months. Union also includes in the rate rider any variances between the actual and forecast amounts recovered/refunded from the previous quarter as a result of actual consumption varying from planned consumption over the quarter (Exhibit E2, p. 10).

The Existing QRAM Methodology is Appropriate

16. It is Union's view that the existing QRAM methodology provides customers with the appropriate balance between market price sensitivity and price stability. Price stability is achieved through Union's QRAM methodology because forecast costs are averaged over the forward 12 months and any past cost variances are also recovered/refunded over the forward 12 months. Changing the gas supply commodity charge quarterly is sufficiently responsive to changing market conditions (Exhibit E2, pp. 11-12). As the Board stated in the NGF Report, "the current pricing process, whereby the price is set every three months on the basis of a 12-month price forecast, represents a balance between market price signals and price stability" (NGF Report, p. 68).

17. In its evidence, Union tested its existing QRAM methodology against other possible price-setting forecast and disposition periods. In particular, Union considered monthly and quarterly rate setting frequencies over monthly, quarterly and yearly disposition periods. The alternatives do not offer improvements in both price stability and market price sensitivity. In the one case (Scenario 1) where somewhat less stable, but more accurate rates would result, these could only be achieved through increased cost, increased administrative burden, and customer confusion associated with moving to monthly filing (Exhibits E2, pp. 13-21 and K1.3, Transcript, April 6, pp. 25-27).

C. Union's Proposals

Proposal #1: Eliminate the Intra-Period WACOG Deferral Account

18. Reference price changes driven by Union's QRAM process do not currently cause Union to update its revenue requirement and, as a result, its distribution rates. Union's delivery

rates include the costs associated with gas in inventory, compressor fuel and unaccounted for gas ("UFG"). These delivery-related cost of gas items are not currently updated through the QRAM process. Instead, the price variance between the cost of gas included in Board approved rates and the WACOG determined in the QRAM is captured in the Intra-Period WACOG deferral account. The Intra-Period WACOG deferral account is not disposed of as part of the QRAM process. Currently, this account is disposed of annually (Exhibit E2, pp. 12 and 32).

19. In order to further align Union's practices with Enbridge's, Union proposes to:

    (a) change its current practice of recovering price variances in delivery related cost of gas items annually through the Intra-Period WACOG deferral account in favour of a quarterly resetting of distribution rates to update these costs with the QRAM reference price; and

    (b) eliminate the Intra-Period WACOG deferral account after a final disposition of the account balance (Exhibit E2, p. 32).

20. While Union acknowledges that changing delivery rates on a quarterly basis will require Union to file additional supporting schedules, Union believes these will not materially impact the complexity of its filing. The proposal will also reduce the potential for significant out of period adjustments (Exhibit E2, p. 33).

Proposal #2: Reduced QRAM Process Timeline

21. The existing QRAM process is mechanical. Nevertheless, on review, the timeline associated with this process can be streamlined further, so as to provide a more timely

market price. In particular, Union proposes to reduce the filing time associated with the filing of its commodity and rate calculations and to eliminate the period for intervenor comments on any hearing structure. More specifically, Union plans to simplify and reduce the number of schedules it files as part of a QRAM application. As stated on page 36 of its evidence, since 2005 Union has only received a total of three interrogatories in 12 QRAM proceedings. By doing so, Union will be able to file QRAM applications with the Board using a 21-day NYMEX strip that closes approximately 14 days later than the current process. Union believes that moving the close of the 21-day strip closer to the QRAM effective date makes it more reflective of current market conditions.

D. Load Balancing and Cost Allocation

22. Union's existing load balancing and relevant cost allocation methodologies are described in Union's pre-filed evidence at Sections B and C.

23. With respect to load balancing, it is Union's position that its North and South balancing mechanisms reflect the unique operational characteristics of these areas and are appropriate. Union's load balancing methodologies have been widely accepted by rate payers and gas marketers. Cross-examination on this issue at the proceeding was minimal. In the result, Union is proposing no changes to its existing methodologies (Exhibit E2, pp. 3-4, 52, 56-57).

24. Similarly, Union is proposing no changes to its cost allocation methodology as it relates to the allocation of costs associated with the administration of the regulated supply and DP supply options. As the evidence demonstrates, the cost structure of the regulated gas

supply service does not impede the competitiveness of DP activity (Exhibit E2, pp. 58-69).

E. Billing Terminology

25. In Union's view, there is no compelling reason to require the utilities to incur the cost of further harmonizing their already substantially similar bills.

26. The majority of Union's customers rate its bill as highly effective. The bill was the product of a major redesign which took place less than three years ago at considerable cost. Given the absence of any evidence that customers require or even desire further harmonization or that they compare Union's bill to Enbridge's, Union is not proposing any changes to its bill presentment (Exhibit E2, pp. 69-70).

F. Union's Proposals

Implementation – Elimination of the Intra-Period WACOG Deferral Account

27. Implementation issues are addressed in Section E of Union's pre-filed evidence. As described in that section, Union does not anticipate any material cost impacts for Union or ratepayers as a result of the two proposals in this proceeding. In the event that costs are incurred, these will be allocated in a manner consistent with the existing Board approved cost allocation methodology (Exhibit E2, pp. 71-72).

28. With respect to timing Union's evidence is that assuming its proposal to eliminate the Intra-Period WACOG deferral account is accepted, depending on the date of the Board's decision, Union would adjust delivery rates in the first QRAM immediately following the

Board's decision. Any balance accumulated in the Intra-Period WACOG deferral account prior to delivery rates being adjusted will be disposed of as part of the annual deferral account disposition proceeding (Exhibit E2, pp. 71-72).

Implementation – Revision to QRAM Filing and Timing Requirements

29. With respect to Union's proposal to revise the QRAM filing requirements and shorten the QRAM process timeline, Union supports the development of standard filing requirements consisting of summary schedules which are common to Enbridge and Union. As described in Exhibit IR 8.10, Union believes that the Board should determine, following this decision, which schedules it would like to see in a common filing. Union proposes that the distributors file, within 60 days of the Board's decision, the proposed schedules and information to be used in the QRAM process. Key stakeholders would then be entitled to make submissions to the Board commenting on the distributor's proposed QRAM filings.

Implementation - MRAM

30. As a final matter, Union was asked by CME to provide all incremental costs associated with moving from a QRAM to a MRAM. While Union intends to respond in reply to any specific proposals put forward by the Gas Marketer Group, the answer to CME's question (Undertaking J1.1) is that in total Union estimates the cost of moving to an MRAM to be $2.45 million in increased O&M costs and $0.4 million in one time capital costs. The O&M costs consist of four main components (regulatory, bill printing, customer care and an increase in short-term borrowing costs).

31. In Union's view, there is no appreciable benefit to an MRAM over the existing QRAM process and, as such, these additional costs should not be imposed on ratepayers (or Union). In the event the Board's decision orders Union to transition to an MRAM, Union would require six months to develop a transition plan and implement the decision.

G. Conclusion

32. Union's only proposed changes are the elimination of the Intra-Period WACOG deferral account and the revision to the QRAM filing and timing requirements. These changes are expected to not only enhance Union's current QRAM process but achieve even greater alignment with Enbridge. As identified in its evidence, due to operational realities and potential cost concerns, Union did not propose any changes to its current approach to load balancing, cost allocation and billing terminology. Although Union does not anticipate any material cost impacts for Union and/or its ratepayers as a result of its proposed changes, in the event there are implementation costs, Union will seek recovery and allocate the costs to ratepayers in a manner consistent with Board approved cost allocation methods.

All of which is respectfully submitted:

Crawford G. Smith
Counsel for Union Gas Limited