uniongas
A Spectra Energy Company

May 22, 2009

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 26th Floor
Toronto, ON
M4P 1E4

Re: Union Gas Disposition of 2008 Deferral Account and Other Balances (EB-2009-0052) – Union's Reply Argument

Dear Ms. Walli:

Please find enclosed two copies of Union's reply argument for the above noted proceeding.

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

Yours truly,

[original signed by]

Chris Ripley
Manager, Regulatory Applications

cc M. Penny (Torys)
EB-2009-0052 Intervenors

EB-2009-0052

ONTARIO ENERGY BOARD

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 amending or varying the rate or rates charged to customers as of July 1, 2009;

UNION GAS LIMITED
REPLY ARGUMENT

Overview

1. By Application dated March 31, 2009, Union applied to the Board for final disposition of Union's 2008 deferral and other account balances.

2. The Board issued Procedural Order No. 1 on April 22, 2009 providing for a written hearing, including written evidence, written interrogatories and written argument. Union's written prefiled evidence was delivered, with its application, to the Board on March 31, 2009. Union's written responses to interrogatories were delivered to the Board on May 8, 2009. A supplemental response to Exhibit B3.1 was filed on May 14, 2009.

3. Written argument was filed by the Ontario Energy Board Staff ("Board Staff"), London Property Management Association ("LPMA"), the Vulnerable Energy Consumers Coalition ("VECC"), the School Energy Coalition ("SEC"), the City of Kitchener ("Kitchener"), the Canadian Manufacturers and Exporters ("CME"), Energy Probe and the Federation of Rental-housing Providers of Ontario ("FRPO").

4. Board Staff invited Union to comment on the “threshold above which it would consider it prudent to align the timing of the DVA (deferral variance account) disposition and the special purpose amounts contemplated in the GEA”.

5. LPMA commented that in the interest of time, the Board should approve the deferral balances as filed, but LPMA was unable to the determine the reasonableness of the balances in two deferral accounts: the Short-Term Storage and Other Balancing Services (179-70) and the Long-Term Peak Storage Services (179-72). LPMA noted the Board should require Union to provide further details with respect to the balances in these two deferral accounts.

6. All other intervenors agreed with LPMA with respect to the balances in deferral accounts 179-70 and 179-72.

7. In addition, LPMA also argued that since Union does not true-up the difference between Board-approved deferral balances and actual recovery/disposition of deferral balances, that the Board should direct Union to track the difference between the Board-approved 2008 balances and the actual recovery / disposition in 2009.

8. This is Union’s reply to all of the above arguments.

The Green Energy Act

9. The Ontario legislature has passed the Green Energy Act (“GEA”) legislation which allows the Ministry of Energy to make assessments for expenses and expenditures related to conservation and renewable energy programs. Gas distributors will be

assessed some portion of total cost of those programs, and will collect that assessment and related costs from rate payers on the distributor's delivery services bill.

10. Union submits that the timing of the DVA disposition should not be aligned with the recovery of the GEA special purposes assessment, regardless of the magnitude of the special purpose charge assessment. The magnitude and timing of the special purpose assessment and related charge is unknown. In addition, the special purpose charges and deferral account recovery/refund are fundamentally different in nature. Deferral account balances arise from the provision of distribution transportation and storage services. The special purpose charges are not related to the distributor's provision of these services. Further, no analysis has been performed to determine whether or not the alignment of the special purpose charges with the deferral account disposition will be offsetting. The assumption seems to be that because Union's total proposed deferral balance is a credit of $22.5 million it will offset the special purposes charges at the rate class level. At this time it is not known what the amount, timing or cost allocation methodology will be for these potential special purpose assessments. Aligning the recovery of the special purpose charges with the deferral account disposition may mitigate rate impacts for some rate classes but it could exacerbate the impact for other rate classes. Accordingly, there is no rationale for aligning the timing of the special purpose charge recovery with the deferral account balance disposition.

11. Union submits that unlike the special purpose assessments, the deferral balances are known, and following Board approval, should be disposed of in a timely manner. It would be inappropriate to hold the disposition of known deferral balances in the absence of known special purpose charges.

12. Further, to maintain customer charge transparency, it is Union's view that the deferral account disposition and GEA special purpose charge recovery must be displayed separately on customer's bills. The customer bill must also include contact information so that customers are able to make inquiries as to the nature of the special purpose charges. As it is Union's view that the GEA charges should be shown separately on the bills there is no mitigating rationale to align the deferral disposition timing with the GEA recovery.

Short-Term Storage and Other Balancing Services – Imputed Margin

13. Intervenors noted concerns about a perceived substantial increase in costs compared to a lower increase in total revenue in the Short-Term Storage and Other Balancing Services ("179-70") deferral account. The 2008 actual revenues represent a 30% increase over Board-approved revenues and the 2008 actual costs represent a 300% increase over Board-approved costs.

14. The Board-approved revenues and costs for 179-70 were determined in EB-2005-0520 (Union's 2007 Cost of Service proceeding). Initially, the revenues and costs for 179-70 were calculated based on 2 PJ of peak storage resulting in forecasted revenues of $1.794 million and forecasted costs of $0.847 million. As noted in Union's supplemental response to Exhibit B3.1, the Board-approved settlement agreement in EB-2005-0520 imputed $12.000 million of margin into 179-70. The settlement agreement did not specify the total revenues or any costs associated with the $12.000 million imputed margin.

15. In EB-2007-0606 (Union's Incentive Regulation and 2008 rate order proceeding) Union filed a rate order working paper (Schedule 16) identifying the S&T revenues and costs included in rates. At line 4 of Schedule 16, it can be seen that Union added the $12.000 million imputed amount to the Total Revenue (column a) but did not change or modify the Allocated Cost (column b) as it remained at $0.847 million. As a result, Union's forecasted revenues were increased by 670% but the costs were not increased at all.

16. Accordingly, Union submits that the comparison between the Board-approved costs for 179-70 and the 2008 actual costs is not appropriate due to the intervening $12.000 million of imputed margin. Achieving $12.000 million of additional revenue cannot be accomplished without additional costs.

17. In order to do a proper comparison of Board-approved revenues with associated costs to 2008 actual revenues it would be necessary to remove the $12.000 million of imputed margin from the Board-approved revenue. Removing the $12.000 million imputed revenue results in Board-approved revenue of $5.961 million. The 2008 actual revenues of $23.327 million represent a 300% increase over $5.961 million. This is exactly proportional to the increase in costs between Board-approved costs and actual costs which also was an approximate 300% increase.

18. To achieve $12.000 million in additional margin it was clear that Union would be required to sell additional short-term transactional services which would result in increased demand and commodity costs. However, as noted above, the EB-2005-0520 settlement agreement and the 2008 rate setting process did not forecast any cost

increases in 179-70 which would be required to achieve an additional $12.000 million in margin.

Short-Term Storage and Other Balancing Services – Demand and Commodity Costs

19. Union's response to Exhibit B3.1 (Attachment 2) provided a comparison between Board-approved costs and 2008 actual costs broken down into two primary elements: Demand and Commodity costs. Union's supplemental response to Exhibit B3.1 provided further detail by identifying the cost components within the Demand and Commodity costs. Demand costs include operating and maintenance ("O&M"), depreciation, property & capital tax, interest, income taxes, deferred tax drawdown and return. Commodity costs include unaccounted for gas ("UFG") and compressor fuel.

20. The Board-approved demand costs in 179-70 were $0.600 million compared to $2.261 million for 2008 actual costs and the Board-approved commodity costs were $1.532 million compared to $6.208 million for 2008 actual costs.

21. Intervenors argued that the perceived significant cost increases between Board-approved and the 2008 actual costs, as identified at Exhibit B3.1 (Attachment 2), raises concerns.

22. As noted above, the Board-approved costs related to short-term storage included in rates only reflected the costs for 2 PJ of forecast short-term peak storage and does not include any costs related to the $12.000 million of imputed margin. Transactional services sold in 2008 to attain the $12.000 in margin resulted in proportionately higher costs in 179-70 compared to Board-approved costs.

23. In EB-2005-0551, the Board directed Union to reserve 100 PJ of storage space for infranchise customers. In the event Union's infranchise growth does not require the entire 100 PJ, Union would sell the difference between the 100 PJ reserve and the amount required by infranchise customers at market prices.

24. Union determined it required 92 PJ of storage to meet infranchise customer demands in 2008. The remaining 8 PJ was sold as short-term storage with the revenues and costs being captured in 179-70. The costs related to the sale of 8 PJ of short-term peak storage exceed the Board-approved costs which reflected the original forecast of selling 2 PJ of short-term peak storage (i.e. prior to the $12.000 million of imputed revenue).

25. Kitchener, in their argument at paragraph 10, states that "the costs of these temporarily surplus utility assets (the 8 PJ) are already included in rates and recovered from infranchise customers". This is not true. The cost allocations in Union's infranchise delivery rates are based on EB-2005-0520 which included 92 PJ of storage for infranchise needs. Said another way, Union's 2007 infranchise delivery rates included an allocation of costs for 92 PJ of storage, not costs in respect of the 8 PJs of storage space that was surplus to Union's immediate infranchise needs.

26. The Board's EB-2005-0551 decision was issued on November 7, 2006. Union did not incorporate the total costs related to the 100 PJ infranchise storage reserve, noted above, into infranchise delivery rates. As noted above, Union's 2007 infranchise delivery rates only included 92 PJ of storage related costs.

27. Union's 2008 rates were derived using the 2007 Board-approved rates plus the impacts of incentive regulation (EB-2007-0606).

28. The Board-approved commodity costs in 179-70 were based on 2 PJ of activity. As noted above, the actual activity in 2008 significantly exceeded 2 PJ resulting in higher demand and commodity costs when compared to the Board-approved costs.

29. Union submits that the deferral balance in 179-70 is calculated correctly, is reasonable and, therefore, requests the Board to approve the deferral account balance as filed. The variances between the Board-approved costs (related to 2 PJ of forecast short-term storage sales) and the 2008 actual costs (reflecting 8 PJ of actual short-term storage sales) is reasonable and is consistent with the agreed upon imputed margin increase.

Long-Term Peak Storage Services

30. Union's response to Exhibit B3.1 (Attachment 1) provided a comparison between the Long-Term Peak Storage Services ("179-72") Board-approved costs and 2008 actual costs broken down in to 3 primary elements: Demand, Commodity and Asset Related. Union's supplemental response to Exhibit 3.1 provided further detail by identifying the cost components within the Demand, Commodity and Asset Related costs. Demand costs include O&M, depreciation and property & capital tax. Commodity costs include UFG and compressor fuel, net of customer supplied fuel. Asset Related costs include interest, income taxes and return for unregulated assets.

31. The Board-approved demand costs in 179-72 were $19.382 million compared to $15.686 million for 2008 actual demand costs. The Board-approved commodity costs were $0.955 million compared to $1.696 million for 2008 actual commodity costs. The Board-approved Asset Related costs were $0.316 million compared to $18.233 million for 2008 actual Asset Related costs.

32. Intervenors argued that the perceived significant cost increases between Board-approved and the 2008 actual costs in the Demand, Commodity and Asset Related costs, as identified at Exhibit 3.1 Attachment 1, raise concerns, specifically citing a 5800% increase in Asset Related costs.

33. In total, the 2008 actual revenue of $87.093 million is a 107% increase over the Board-approved revenue of $42.058 million and the 2008 actual costs of $35.615 million are a 72% increase over the Board-Approved costs of $21.405 million. The intervenors have focused on the Asset Related cost increase of 5800% to question Union's calculation of the deferral balance in 179-72 yet the total costs are substantially less than 5800%. In fact, the 2008 revenue increase of 107% exceeds the 2008 cost increase of 72%. This increase in net margin compared to the Board-approved margin provides an additional benefit to be shared with ratepayers.

34. The 2008 actual demand costs of $15.686 million are lower than the Board-approved demand costs of $19.382 million. The primary reason for the apparent decrease in demand costs is the accounting treatment of 2008 actual costs compared to the Board-approved costs in EB-2005-0520. The 2007 Board-approved costs include O&M, depreciation, property & capital tax, return and income taxes. As indicated above, the 2008 actual costs include O&M, depreciation and property & capital tax. The 2008 actual costs included in Demand did not include costs related to return and income taxes. These costs were included in Asset Related costs.

35. In EB-2009-0101 Union provided an attachment (Exhibit B Tab 3 Schedule 2 Attachment 3) that better aligns the 2008 actual costs with the 2007 Board-approved

costs. As can be seen on the attachment, the 2008 actual demand costs increased by approximately 72% compared to a revenue increase of 107%.

36. The 2008 actual commodity costs of $1.696 are higher than the Board-approved commodity costs of $0.955 million. As noted above, the 2008 long-term revenue increased by 107% over the Board-approved revenue. The revenue increase is a result of more long-term storage contracts and increased activity. An increase in long-term storage contracts and activity results in more gas being injected and withdrawn resulting in an increase in commodity costs.

37. The 2008 actual asset related costs of $18.233 million are higher than the Board-approved asset related costs of $0.316 million. These two numbers, however, are not comparable. The 2007 Board-approved forecast included costs related to dehydration system integrity. As noted above, the 2008 actual costs under the category of Asset Related include interest, income taxes and return for all unregulated assets used to provide exfranchise storage services. Interest, income taxes and return are included in "Demand Costs" in the 2007 Board-approved costs.

38. Union submits that the deferral balance in 179-72 was calculated correctly, is reasonable, and therefore requests the Board to approve the deferral account balance as filed. The 2008 actual costs are higher than 2007 Board-approved costs as a result of increased activity above forecast and Union's investment in storage in Ontario. Union's at-risk investment in storage is a direct result of the Board's decision in EB-2005-0551. In 2008 rate payers received a benefit from these investments.

2008 Deferral Account Recovery / Refund Tracking

39. LPMA suggested "the Board should direct Union to provide the Board and intervenors with information on the amount of the difference between the actual disposition of the 2008 balances and the approved amount when it files its application for the disposition of the 2009 balances in 2010".

40. Union currently tracks the variance between the Board-approved deferral balances and the actual recovery / refund of the deferral balances. In 2007, Union over-refunded $0.107 million to rate payers compared to the approved 2006 deferral account balances. In 2008, Union over-refunded $0.342 million to rate payers compared to the approved 2007 deferral balances.

41. Given the magnitude of the deferral balances, Union considers the variances between the approved amounts and the actual recovered / refunded amounts to be nominal. Therefore, Union has not sought a true-up of the past variances.

Conclusion

42. In conclusion, for the reasons set out above Union requests an order of the Board approving the 2008 deferral and other balances as outlined in Exhibit A, Tab 1 Schedule 1 and Schedules 2, 3 and 4. Union also seeks an order of the Board approving the method of allocation of these amounts as outlined in Exhibit A, Tab 2, Schedules 1 to 3.