uniongas
A Spectra Energy Company

June 1, 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 Submission

Dear Ms. Walli:

Please find attached Union's reply submission in 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
FINAL ARGUMENT

Overview

1. The Board issued Procedural Order No. 2 on May 21, 2009 allowing intervenors to submit additional argument with respect to the 2008 deferral account balances in the Short-Term and Other Balancing Service Deferral Account (No. "179-70") and the Long-Term Peak Storage Services Deferral Account (No. "179-72").

2. Additional argument was filed by London Property Management Association ("LPMA"), the School Energy Coalition ("SEC"), the City of Kitchener ("Kitchener"), the Canadian Manufacturers and Exporters ("CME") and the Federation of Rental-housing Providers of Ontario ("FRPO").

3. LPMA submitted that Union's reply argument and subsequent discussion in EB-2009-0101 provided sufficient explanations of the deferral balances in 179-70 and 179-72 and that the balances, as filed, are reasonable.

4. CME alleges that Union did not provide any explanation of the cost differences between Union's 2008 Financial Statements and the actual 2008 deferral balances filed

March 31, 2009. CME argues that the Board should approve the deferral balances as recorded the Financial Statements. Kitchener supported CME's argument.

5. FRPO has submitted that the Board's decision in EB-2008-0154 with respect to deferred tax is somehow related the capitalization of O&M costs and suggests that the O&M costs should continue to be regulated until the phase out of the ratepayer share is complete. SEC supported FRPO's argument.

6. Kitchener argues on the basis of some alleged mismatch between cost recovery and return on new investment, that there should be a "levelized rate of return," given that the sharing of the revenues from 179-72 will cease in 2011.

7. This is Union's reply to all of the above arguments.

Accounting Differences

8. CME argues that the 2008 deferral balances should be calculated based on Union's 2008 Financial Statements.

9. Union submits that it is appropriate to adjust deferral account balances submitted for disposition to reflect actual results where there is a difference between the estimate used to close accounts at year end for financial reporting and the actual results. This ensures disposition of more accurate results in the proper period. It has always been Union's practice in previous deferral disposition proceedings to seek approval based the actual deferral balances, not the balances reported in Union's Financial Statements. No question has ever been raised about this practice previously.

10. The practice of using assumptions and estimates in the preparation of financial statements is noted in Union's 2008 annual report (note 1) which says:
"The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities."

11. At year end, Union prepares accrual estimates in an attempt to provide the most accurate financial information for the Financial Statements. Inevitably, the accruals are never 100% correct when compared to the actual revenues and costs following year end. The 2008 Financial Statements and 2008 deferral balances are no different.

12. Union began preparation of its Financial Statements on January 1, 2009. For cost and rate base allocations related to the storage deferral accruals, Union used 2008 actual information for January to November and forecast information for December. The CME allegation that Union could "provide no information whatsoever" as to the cause of these variances is quite wrong. Mr. Ferguson testified at the Technical Conference that the estimates were prepared by his team within a few days of "the close" (i.e., December 31, 2008) and that any difference between the estimate and the actuals, which were also prepared by Mr. Ferguson and his team, were "timing differences".

13. There is no particular magic to the financial statement numbers, as Mr. Thompson brought out in the Technical Conference, p. 6:

> Mr. Thompson: Who made the estimate that appears in the financial statements?
>
> Mr. Ferguson: My team.

Mr. Thompson: So the auditors just accepted that?

Mr. Ferguson: That's correct.

Mr. Ferguson went on to testify that:
It's a matter of timing. The deferral calculation estimate would have been prepared on the first or second day of the close prior to all numbers being finalized.

14. Financial Statements are not considered finalized until such time as an audit opinion is issued. In the intervening period, the auditor assesses any potential further adjustments in terms of materiality. In Union's case, the external auditor opinion was issued on March 13, 2009. The adjustment to the storage deferral accruals based on actuals was immaterial for purposes of adjustment to the final Financial Statements.

15. Union's deferral disposition application was filed on March 31, 2009 using 2008 actual revenues and costs.

16. Union submits that it is normal accounting practice to "close the books" on estimates. This practice has been approved by the Board and accepted by intervenors in the past dispositions. Further, the explanation of deferral account variances between estimates at "the close" and actuals as of March 31, have never been a feature of deferral account disposition before, so it is hardly surprising that Mr. Ferguson did not have detailed information at his fingertips. If CME had actually wanted this information, it could have asked an interrogatory earlier in the proceedings or for an undertaking at the Technical Conference. CME did not do so.

17. Union requests the Board to approve the 2008 deferral balances in 179-70 and 179-72 as filed.

Capitalization of O&M Costs

18. FRPO and SEC argue that the O&M related to the deferral balances in 179-70 and 179-72 should continue to be capitalized as it was under regulated accounting. In support of this argument, they cite the Board's decisions in EB-2007-0598 and EB-2008-0154.

19. Union submits that it is appropriate to deduct all of the actual costs attributable to market priced storage services in the determination of net storage revenues for deferral including the increase in operating and maintenance expenses due to the change in accounting as a result of the change in regulation of storage.

20. Consistent with other rate regulated companies in Ontario, Union capitalizes indirect and general administrative overhead costs associated with utility capital projects. This is a standard rate regulated entity accounting practice.

21. In EB-2005-0551 the Board determined Union's storage operations to be unregulated. As a result, Union's unregulated storage capital projects follow the accounting principle found at section 3861, paragraph 20 of the CICA Handbook which states:

> "The costs of an item of property, plant and equipment includes direct construction or development costs (such as material and labour) and overhead costs directly associated attributable to the construction or development activity".

22. In accordance with section 3861, Union no longer capitalizes indirect general and administrative costs associated with unregulated capital projects. These costs include salaries, wages and benefits for non-directly attributable functions such as Human Resources, Legal and Accounting.

23. Intervenors' reliance on EB-2007-0598 and EB-2008-0154 is completely misplaced. The issue of changes in accounting due to the change in the regulation of storage was addressed in both EB-2007-0598 and in EB-2008-0154 in a manner which totally supports precisely what Union has done in this case. On page 7 of the decision in EB-2008-0154 the Board indicated that

> "Union can include ongoing costs associated with the unregulated storage business to calculate net revenues with the exception of deferred taxes for the period 1997-2006, the liability of which was at issue in the 2006 Deferral Account Decision and for which the Board denied recovery. The 2006 Deferral Account Decision makes no finding as to the appropriate recognition of taxes in the determination of net revenues from storage transactions for the period 2007 and beyond; the decision deals specifically and exclusively with the 1997-2006 deferred tax expense. And, as indicated above, the issue of deferred taxes was not raised at all in the 2007 proceeding, and therefore the 2007 Deferral Account Decision also does not address the treatment of taxes for purposes of determining "net revenues" from ex-franchise storage services. The 2007 Deferral Account Decision accepted the $2.196 million that was included in Union's application but directed Union to recalculate the 2007 balance in account 179-72 in accordance with the Board's finding, for later disposition. There is nothing in that decision to prevent Union from including current and deferred tax expenses related directly to the 2007 revenues as a cost for purposes of determining net revenues."

24. The Board's decisions in EB-2007-0598 and in EB-2008-0154 dealt with deferred taxes. As was made clear in the latter decision, it was only the past liabilities (1997-2006) associated with deferred taxes that were deemed to be unrecoverable. The reduced capitalization of the O&M costs at issue here is an ongoing cost and is not at all comparable to the Board's decision on historical deferred taxes.

25. Changes in accounting, as they relate to the treatment of O&M costs in 179-70 and 179-72, are ongoing costs which Union must account for under the CICA Handbook

rules. Union submits that it has followed the prescribed accounting rules and calculated the deferral account balances correctly.

Levelized Rate of Return

26. Kitchener argues that Union's long-term storage return costs in 2009, 2010 and 2011 should be reduced as a result of the impact of ratebase additions that will be depreciated over a period of time in excess of the time period during which there will be sharing of net storage margin. Specifically, Kitchener argues that there may be recovery of costs early in the life of the new storage developments relative the return, and that the returns should be "levelized" to provide a constant return over the economic life of the assets.

27. Union finds this argument difficult to understand. As Mr. Poredos testified at the Technical Conference:

> "The one thing I should remind everyone is that the investment was made and there is no risk to customers. They are sharing on the margin which they have taken no risk on at all. So it's a bit of an issue."

What Mr. Poredos was saying is that there is no down side to customers, only upside, on the issue of new storage development. This is because none of the new storage development costs are embedded in rates. If Union fails to achieve revenue targets, customers pay nothing in rates for the cost associated with these investments. The only way in which the cost of new storage development comes into the equation at all is through the calculation of net margin. In this regard, there can be only credits to customers in respect of new storage development, not debits.

As the passage quote from EB-2008-0154 above makes clear, the net margin for sharing is to be determined on the basis of actual costs. There is no merit to the suggestion that the cost of new storage should be manipulated in the sharing calculations so as to produce a "levelized return."

28. Union has never levelized return in any past cost of service proceedings. Union has always calculated the sharing of incremented revenue, not of incremental costs. There is no precedent or evidentiary basis for making such a change to "levelizing" the return. The concept of "levelizing" return would be a deviation from all previous presentations of cost Union has ever done.

29. Kitchener's position is also opportunistic, in that Kitchener proposes to levelize the costs but proposes to continue to use actual revenue from the sale of storage services at market prices in 2008. It is unfair and illogical to used "levelized" costs but actual incremental revenue.

30. Accordingly, Union submits that the well established methodology for calculating net revenue in these deferral accounts is the correct, well established approach and that it should continue to be utilized in this case.

Conclusion

31. In conclusion, for the reasons set out in Union's argument in chief, reply and 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.