



uniongas

A Spectra Energy Company

January 15, 2010

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, Ontario M4P 1E4

Dear Ms. Walli:

**Re: EB-2008-0411 – Calculation of Under-Recovery
Union's Reply Submission**

Please find attached Union's Reply in the above-noted proceeding. A confidential Schedule has been filed under separate cover and couriered to the Board and to the Intervenor who executed the Declaration and Undertaking.

Yours truly,

[Original signed by]

Chris Ripley
Manager, Regulatory Applications

c.c.: EB-2008-0411 Intervenor
Sharon Wong, Blakes

Attach.

CR/la

Introduction

This is the Reply of Union Gas Limited (“Union”) to the submissions filed by Board Staff, Canadian Manufacturer & Exporters (“CME”) and Federation of Rental-Housing Providers of Ontario (“FRPO”) regarding the calculation of the cumulative under-recovery from 2003 to the current time and Union’s estimate as of the closing date of the transaction.

1. Date of Transaction

If the sale of the St. Clair Pipeline actually occurs, Union estimates that the closing date of the sale to Dawn Gateway Pipeline Limited Partnership (“DGLP”) would most likely be on or about March 1, 2010.

DGLP filed an Application for Leave to Construct the Bickford Dawn Line and for approval of the regulatory framework for the Dawn Gateway Pipeline on December 23, 2009. In that Application, DGLP stated that there is a limited time window in which the project would likely proceed, and DGLP asked the Board to issue a decision by Friday February 26, 2010. Although the date for a decision requested by DGLP is sooner than would normally be expected, since it is unlikely that the transaction will proceed if DGLP does not receive approval in the requested time frame, the estimated closing date of March 1, 2010 is the most realistic date. Therefore, it is this date that should be used for any regulatory calculations associated with the sale of the St. Clair Pipeline.

2. Interest

The Board's decision did not direct Union to include interest in the calculation of the cumulative under-recovery. It was appropriate for the Board to exclude interest prior to the establishment of the deferral account as there is no principled reason why such interest should be included.

There is no basis at all for CME's speculation that Union would be seeking interest if circumstances were reversed. Mr. Thompson on behalf of CME could provide no example of Union requesting interest be included in a deferral account prior to the establishment of a deferral account approved by the Board. The normal treatment for a deferral account is that interest does not accrue until it has been approved by the Board.

The investment in the St. Clair Pipeline was made in 1988 with the approval of the Board, and no one alleges that the investment was imprudent or the facilities were not used or useful. Union only earned an approved rate of return on the approved utility investment. Union's evidence in the 1988 proceeding for leave to construct the St. Clair Pipeline indicated that the incremental construction costs of the St. Clair Pipeline would be more than recouped in savings on gas costs in less than 2 years after construction. No party has disputed this. From the time of construction to the time of the eventual sale of the regulated utility asset (assuming a sale occurs), Union will have only received a fair return on an investment that benefited ratepayers and was made in the public interest. In these circumstances, there is no reason why the Board's Decision should be implemented retroactively by requiring Union to pay interest on returns it

1 earned in the past since 2003. To include past interest would amount to retroactive ratemaking,
2 an approach that has been consistently rejected by the Board.

3
4 According to paragraph 92 of the Board's Decision, the cumulative under-recovery amount is
5 intended to compensate for the harm that the ratepayers may suffer in the future if the sale of the
6 St. Clair Pipeline takes place. The ratepayers have suffered no compensable harm in the past.
7 According to the Board's Decision, the harm to ratepayers takes place in the future, after the St.
8 Clair Pipeline is sold, because of the "inability of ratepayers to recoup the cumulative past
9 subsidy since 2003 through future revenues" which Union might have earned if it retained
10 ownership of the St. Clair Pipeline. Because the harm that is being compensated for is meant to
11 address a future impact after the time of the sale, there is no basis for applying interest prior to
12 the sale.

14 **3. St. Clair River Crossing**

15 In paragraphs 122 and 123 of the Board's November 27, 2009 Decision and Order therein (the
16 "Decision"), the Board directed Union to calculate an amount equivalent to the cumulative
17 under-recovery "**of the asset**". The asset is the St. Clair Pipeline itself, and does not include the
18 St. Clair River Crossing which is owned by St. Clair Pipelines LP. Accordingly, Union submits
19 that the cumulative under-recovery amount related to the St. Clair Pipeline should be limited to
20 the revenues and costs directly attributable to the St. Clair Pipeline itself, and should exclude the
21 cost of the St. Clair River Crossing which is not part of the asset.

1 In addition, as noted above, the St. Clair River Crossing was constructed to provide security and
2 diversity of supply to Ontario, a role that it has played since construction and will continue to
3 play regardless of the ownership of the St. Clair Pipeline.

4
5 **4. Other Considerations - Cost of Building Replacement Line**

6 In paragraph 121 of the Decision, the Board estimated that the total deemed net gain on the sale
7 by Union would be approximately \$8 to \$13 million based on the Board's estimate that the cost
8 of the most economical replacement line would be in the range of \$13 to \$18 million.¹

9
10 In paragraph 122 of the Decision, the Board estimated that the amount of the deemed net gain to
11 be allocated to the ratepayers would be approximately \$5 million which the Board further
12 estimated to be in the range of 35% to 65% of the total deemed net gain of \$8 to \$13 million.

13
14 Union estimates that the actual cost of the most economical alternative to the purchase of the St.
15 Clair Pipeline is approximately \$11.4 million which is less than the Board's initial estimates.

16 The most economic alternative to the purchase of the St. Clair Pipeline would not be to build a
17 replacement for the St. Clair Pipeline. If Dawn Gateway did not have the use of the St. Clair
18 Pipeline, the most economic alternative would be to build a new pipeline directly from the St.
19 Clair River to Dawn on a direct path, rather than the proposed indirect route which utilizes the
20 existing St. Clair Pipeline and the proposed new Bickford to Dawn line.

¹ To arrive at the deemed net gain, the Board apparently subtracted the Net Book Value of the St. Clair Pipeline from the cost of the most economical replacement line.

1 Accordingly, the cost of the most economic alternative to the use of the St. Clair Pipeline is
2 equal to the difference between the cost of a direct pipeline from the St. Clair River to Dawn and
3 the cost of the proposed Bickford to Dawn Pipeline.

4
5 At the hearing, Union filed Confidential Undertaking X 1.1 which contained a general estimate
6 of pipeline construction costs to build Bickford to Dawn as of June 30, 2009. Union is filing a
7 confidential Schedule with this Reply regarding the estimated the costs of constructing the most
8 economical alternative to the St. Clair Pipeline. This Schedule contains the most up to date
9 evidence regarding pipeline construction costs.

10
11 With the cost of the most economic alternative estimated at \$11.4 million, the deemed net gain
12 on the sale using the method set out in the Board's decision is \$6.2 million (being \$11.4 million
13 less the NBV of \$5.2 million). In its December 23, 2009 submission, Union estimated the
14 cumulative under-recovery to be \$3.951 million, which would represent approximately 64% of
15 the deemed net gain from the sale and which is at the upper end of the 35% to 65% range
16 identified by the Board in its decision.

17
18 Board Staff, CME and FRPO are requesting changes to the method for calculating the
19 cumulative under-recovery which would result in the amount of the allocation to ratepayers
20 increasing to somewhere in the range of \$6.577 million plus interest (Board Staff submission, p.
21 3) to \$8.1 million (FRPO submission, Appendix A). If the Board set the allocation at the levels
22 requested by Board Staff, CME and FRPO it would allocate more than 100% of the deemed gain

1 to the ratepayers, making this route more expensive than DGLP's alternative. Union submits
2 that there is no precedent for allocating more than the deemed gain to the ratepayers.

3
4 The Board estimated that only about 35% to 65% of the deemed gain would be allocated to
5 ratepayers, and invited Union to submit evidence if the deemed net gain was not in fact going to
6 be well in excess of the cumulative under-recovery to the ratepayers (Decision, para. 123).

7 Based on these statements, Union believes that the Board did not intend to allocate the entire
8 deemed gain to the ratepayers, and certainly did not intend to allocate more than the deemed gain
9 to the ratepayers.

10
11 In the Board's Interpretive Guidance to the Affiliate Relationships Code for Gas Utilities, issued
12 on December 9, 2004, the Board advised that in the normal course gains from the disposition of a
13 utility asset to an affiliate would be shared 50/50 between ratepayers and utility shareholders:

14 The final disposition of a capital gain or loss on the sale of utility assets to an
15 affiliate will be dealt with at the subsequent rate hearing. In order to provide
16 stakeholders guidance, the Board will generally expect that any capital gains or
17 losses on the transfer of utility assets to an affiliate should be shared 50/50
18 between ratepayers and utility shareholders. Panels on rates cases will determine
19 if there are exceptional circumstances justifying different treatment.

20 (at p. 2 of the Interpretive Guidance)

21 Although DGLP and Union are not affiliates subject to the Affiliate Relationships Code, Union
22 submits that, at a minimum, the Board should apply these same principles in this case with
23 respect to the sharing of the gains from a sale and that there are no exceptional circumstances
24 which justify allocating all of the deemed net gain to the ratepayers. In fact, the circumstances

1 suggest that the allocation should be closer to the normal allocation of 50% because the
2 allocation is intended to compensate ratepayers for the loss of the possibility to recoup some of
3 the under-recovery in the future if Union were to retain ownership of the St. Clair Pipeline, but
4 there is no certainty that the ratepayers would recoup all (or even any) of the under-recovery in
5 the future if the sale does not occur.

6 7 **5. Implications for 2009 Earnings Sharing**

8 CME and FRPO have taken issue with Union's intention to include the amount of the cumulative
9 under-recovery in Union's 2009 regulated earnings for the purposes of earnings sharing. Union
10 believes that the amount allocated to ratepayers should be treated as a reduction to its regulated
11 utility earnings, however Union agrees with FRPO and CME that the matters should be
12 determined at its next rate case where the Board will have the benefit of full submissions from all
13 interested parties.

14 15 **Conclusion**

16 Union therefore requests that the Board accept the estimated amount of the cumulative under-
17 recovery of \$3.951 million as calculated by Union in its December 23, 2009 submission. The
18 alternative cost of replacing the St. Clair Pipeline is approximately \$11.4 million which is \$6.2
19 million in excess of the net book value of \$5.2 million. Union's cumulative under-recovery
20 calculation of \$3.951 million represents 64% of the \$6.2 million and is consistent with the 35%
21 to 65% range identified by the Board in its decision and aligns with prior Board decisions related
22 to the sharing of gains on the disposition of utility assets. Union further requests that the Board

- 1 approve the draft accounting order relating to the establishment of the deferral account as set out
- 2 in Appendix A to Union's December 23, 2009 submission.