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BY E-MAIL

April 15, 2011

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

Dear Ms. Walli:

**Re: Union Gas Limited – Request for Declaratory Relief
Board File No. EB-2010-0039
Board Staff Submission**

Please find attached Board staff's submission with respect to Union Gas Limited's request for declaratory relief.

Please forward the attached to Union Gas Limited and to all intervenors in the proceeding.

Sincerely,

Original Signed By

Hima Desai
Advisor

Encl.

EB-2010-0039 Union Gas Limited Request for Declaratory Relief

BOARD STAFF SUBMISSION

1. Introduction

On November 27, 2009, the Board released its Decision and Order in EB-2008-0411, granting Union Gas Limited ("Union") leave to sell the St. Clair Transmission Line to Dawn Gateway Pipeline Limited Partnership ("Dawn Gateway"). Leave to sell was granted on conditions, including a condition that ratepayers receive a credit for ratemaking purposes equal to the amount of the cumulative under-recovery from 2003 until the time of the transaction. Union was ordered to place this amount in a deferral account for disposition in a rates proceeding. Union was also ordered to file its calculation of the cumulative under-recovery from 2003 to the time of the first EB-2008-0411 Decision.

In a subsequent Decision and Order dated March 2, 2010 and under the same docket number, the Board found that the deemed sale price of the St. Clair Transmission Line ("St. Clair Line") for ratemaking purposes is \$13.7 million and that the deemed net gain on the sale of St. Clair Line is \$7.97 million. The March 2, 2010 Decision and Order also found that the cumulative under-recovery of the St. Clair Line for the period 2003 to March 1, 2010 was \$6.402 million and that the entire cumulative under-recovery amount should be credited to ratepayers as the ratepayers' share of the deemed net gain from the sale. The Board ordered that the \$6.402 million should be placed into a deferral account and also that Union create a second deferral account to capture the effect of removing the St. Clair Line from rates effective March 1, 2010. In a subsequent Decision and Order dated May 11, 2010 and also under the same docket number, the Board approved two draft accounting orders creating the deferral accounts ordered by the Board in the March 2, 2010 EB-2008-0411 Decision and Order.

Account 179-121 records the cumulative under-recovery of the St. Clair Transmission Line from 2003 until the time of the sale of the asset. Account 179-122 records the impact of removing the St. Clair Transmission Line (and related St. Clair River Crossing) from rates (including all rate base and OM&A consequences) effective March 1, 2010 until the Board adjusts Union's rates to reflect the asset sale.

Union filed an Application dated April 22, 2010 to address the disposition of 2009 deferral accounts and Market Transformation Incentive amounts, the 2009 earnings sharing amount

and the allocation of costs between Union's regulated and unregulated storage operations. The Board assigned docket number EB-2010-0039 to this Application.

On August 10, 2010, the Board approved the Settlement Agreement reached by parties in the EB-2010-0039 proceeding. With respect to the matter of the disposal of balances in account numbers 179-121 and 179-122, the parties agreed to postpone this issue until after November 1, 2010 when Union expected that Dawn Gateway and its shippers would have determined whether to proceed with the construction of the Dawn Gateway Pipeline and the purchase of the St. Clair Line from Union. In its Decision and Order, dated September 3, 2010, the Board determined that a two day oral hearing would be scheduled for December 6 and 7, 2010 to address the disposition of balances in deferral accounts 179-121 and 179-122.

On November 19, 2010, the Board received a Notice of Motion from Union seeking to adjourn the December 6 and 7, 2010 oral hearing until late February, 2011. Union indicated that Dawn Gateway was in the process of determining market interest in the proposed Dawn Gateway pipeline and that the delay sought by Union would provide time to determine whether there was sufficient interest in the pipeline for an in-service date of 2011. Canadian Manufacturers & Exporters ("CME") filed a Notice of Cross-Motion on November 29, 2010 seeking orders to clear forthwith to ratepayers the credit balances in accounts 179-121 and 179-122.

On December 3, 2010 the Board heard submissions on the Motion and rendered an oral Decision. The Board granted Union's request for an adjournment to a date set in consultation with Board staff and intervenors. The Board required Union to file any additional evidence or new evidence with respect to this matter at least 30 days prior to the date ultimately set to address the disposition of balances in the deferral accounts.

2. The Request

By letter dated February 4, 2011, Union filed evidence in support of a request for declaratory relief that the amounts in deferral accounts 179-121 and 179-122 not be disposed of until the sale of the St. Clair Line has closed or the project is cancelled.

3. The Issues

By way of Procedural Order No.4, the Board set the date of April 6, 2011 to hear Union's request for declaratory relief. The Board determined that the issues to be considered at the oral hearing were:

- 1) Is the disposition of deferral accounts 179-121 and 179-122 dependent on the completion of the transaction between Union Gas Limited and Dawn Gateway Limited Partnership?
- 2) If the answer to the first issue is yes, what if any action is required by the Board at this time?
- 3) If the answer to the first issue is no,
 - a) As of what effective date should deferral accounts 179-121 and 179-122 be disposed?
 - b) What are the amounts in the accounts as of that date?
 - c) What is an appropriate methodology to apportion the amounts across customer rate classes?
 - d) Does the St. Clair Transmission Line remain in Union Gas Limited's rate base?

4. Background

On November 27, 2009, the Board released its Decision in EB-2008-0411, granting Union leave to sell the St. Clair Transmission Line to Dawn Gateway Pipeline Limited Partnership ("Dawn Gateway"). Leave to sell was granted on 3 conditions¹ :

- (a) The sale price for ratemaking purposes shall be the fair market value which is defined as the replacement cost of the line.
- (b) The ratepayers will receive a credit for ratemaking purposes equal to the amount of the cumulative under-recovery from 2003 until the time of the transaction which amount shall be placed in a deferral account for disposition in a rates proceeding.
- (c) Union shall file with the Board, with a copy to all intervenors, its calculation of the cumulative under-recovery from 2003 to the current time and its estimate as of the closing date of the transaction. Union at its discretion may file its estimate of the replacement cost of the line.

Two subsequent Decisions and Orders (dated March 2, 2010 and May 11, 2010) dealt with, among other things, the methodology for calculating the amounts described above, the

¹ Ontario Energy Board, Decision and Order, EB-2008-0411, November 27, 2009, page 37.

creation of deferral accounts 179-121 and 179-122 (both also under docket EB-2008-0411) and the requirement that the net book value and associated expenses of the St. Clair Line be removed from Union's rate base and rates as of March 1, 2010.

4.1 Account 179-121 – Cumulative Under-Recovery of the St. Clair Line

Account 179-121 was established to record the cumulative under-recovery of the St. Clair Transmission Line from 2003 until the time of the sale of the asset. Union noted that as of December 31, 2010 the credit balance in Account 179-121 is \$6.447 million².

The Board established this account to compensate ratepayers for harm resulting from the sale of the St. Clair Line. In the EB-2008-0411 Decision, the Board indicated that "the Board has the power to allocate a portion of the proceeds based on fair market value to ratepayers where the transaction will harm ratepayers"³.

The accounting entry of account 179-121 is described as follows⁴:

"To record, as a credit in deferral account No. 179-121, the cost of removal for the St. Clair Transmission Line ordered by the Board in EB-2008-0411 to be equal to the amount of cumulative under-recovery of Union's St. Clair Pipeline, from 2003 until the time of the sale of the asset, to be refunded to ratepayers".

4.2 Account 179-122 – Impact of Removing the St. Clair Line from Rates

Account 179-122 was established to record the impact of removing the St. Clair Transmission Line (and related St. Clair River Crossing) from rates (including all rate base and OM&A consequences) effective March 1, 2010 until the Board adjusts Union's rates to reflect the asset sale⁵. Union noted that as of December 31, 2010 the credit balance in account 179-122 was \$1.028 million⁶.

Union noted that that as of December 2009, the St. Clair Line was removed from rate base and reclassified as assets held for sale. This stopped further depreciation on the asset. Reclassifying the asset as "held for sale" reduced the utility rate base by \$0.2 million in 2009 and by \$5.2 million in 2010⁷ for the purposes of earnings sharing⁸.

² EB-2010-0039, Pre-filed Evidence, Exhibit E1.1

³ Ontario Energy Board, Decision and Order, EB-2008-0411, November 27, 2009, page 23, paragraph 102.

⁴ Ontario Energy Board, Decision and Order, EB-2008-0411, May 11, 2010, Appendix A.

⁵ Ontario Energy Board, Decision and Order, EB-2008-0411, May 11, 2010, Appendix B.

⁶ EB-2010-0039, Pre-filed Evidence, Exhibit E1.4.

⁷ EB-2010-0039, Pre-filed Evidence, Exhibit E1.7.

5. Board Staff Submissions

Issue 1: Is the Disposition of the deferral accounts dependent on the completion of the transaction between Union and Dawn Gateway?

Board staff submits that the disposition of deferral accounts 179-121 and 179-122 is dependent on the completion of the transaction between Union and Dawn Gateway, i.e., the sale of the St. Clair Line.

In regards to Account 179-121, the account was specifically established to compensate ratepayers from harm related to the sale of the St. Clair Line.

Board staff's submission on this issue is supported by a number of findings in the Board's EB-2008-0411 Decision and Order dated November 27, 2009.

In particular, at paragraph 92, the Board concluded "that the transaction does result in harm to ratepayers." The Board went on to discuss how the harm can be mitigated at paragraph 93:

The Board further finds, however, that this harm can be mitigated through an appropriate allocation to ratepayers upon completion of the transaction based on a fair market value for the asset.

The Board then went on to discuss the remedy for the harm to ratepayers. The Board found that it has the power to modify the transaction price for rate setting purposes and then allocate a portion of the proceeds based on fair market value to ratepayers where the transaction will harm ratepayers.

At paragraph 122 of the November 27, 2009 Decision and Order, the Board concluded that to address the harm of the transaction, ratepayers should be allocated an amount equivalent to the cumulative under-recovery of the asset since 2003 from the proceeds of a sale based on fair market value as determined by the Board to be the replacement cost.

The Board indicates at paragraph 123 that it "...will approve the transaction conditional on the ratepayers being allocated a portion of the deemed net gain equivalent to the cumulative under-recovery as of the date of the transaction."

⁸ EB-2010-0039, Transcript, pages 136-137.

Board staff submits that while the Board did deem the net gain, it did not deem that the transaction had taken place. In deeming the net gain⁹ the Board neither expressly nor implicitly indicates that it is also deeming the transaction to have occurred as of a particular date. In fact, later in paragraph 123, in discussing the nature of the evidence required to be filed by Union to substantiate the cumulative under-recovery of the assets, the Board says:

The Board will then fix the amount to be allocated to ratepayers to compensate for the harm arising from the transaction. This ***amount will only vary depending upon the timing of the actual transaction.*** The determination of the relevant amount will be made as part of this proceeding so as to provide certainty to the parties. ***A deferral account will be established to capture the amount of the allocation as of the date of the transaction.***¹⁰ [Emphasis added.]

By indicating that the amount allocated to ratepayers will vary depending on the timing of the actual transaction and that a deferral account is required to capture the allocation as of the date of the transaction, the Board, in Board staff's submission, is acknowledging that the date of the transaction is unknown and, by implication, that it may not occur.

Board staff is of the view that all of this language and the general thrust of the Board's findings in this first of the EB-2008-0411 Decisions and Orders leads to the conclusion that the Board was addressing the harm to ratepayers arising out of the transaction and in order to do that, created a proxy (a portion of the deemed net gain equivalent to the cumulative under-recovery of the assets since 2003) but it did so fully aware of the fact that the transaction date was unknown and could not be known at the time.

In Board's staff's view, the Board's findings clearly stipulate that the actual transaction date is relevant to the calculation of the cumulative under-recovery amount. Board staff submits that if there is no transaction, there is no harm to address.

Board staff also notes that in its November 2009 Decision and Order, the Board indicated that leave to sell the St. Clair Line to Dawn Gateway would expire on December 31, 2013.¹¹ The Board went on to say:

If the transaction has not been completed by that date, a new application for leave to sell will be required in order for the transaction to proceed.¹²

⁹ Ontario Energy Board, Decision and Order, EB-2008-0411, March 2, 2010, paragraph 13.

¹⁰ Ontario Energy Board, Decision and Order, EB-2008-0411, November 27, 2009, page 31, paragraph 123.

¹¹ Ontario Energy Board, Decision and Order, EB-2008-0411, November 27, 2009, page 37, No.2.

¹² Ibid, page 37.

The Board clearly contemplated that the transaction may take a considerable amount of time to finalize, that it may not occur until after 2013 and further that it may not occur at all.

The Board therefore explicitly acknowledged the possibility that the transaction was not a certainty and in Board staff's submission, the Board did not intend for ratepayers to get the benefit of a deemed net gain on a transaction unless that transaction occurred.

In the second EB-2008-0411 Decision and Order dated March 2, 2010, the Board did set a March 1, 2010 transaction date, however, that date was clearly stated to be "...for purposes of determining the cumulative under-recovery..."¹³ Board staff is of the view that the original language in the November 27, 2009 EB-2008-0411 Decision and Order is paramount, since it was the Decision and Order granting leave to sell and setting out the financial principles related to ratepayer compensation associated with the sale. The March and May Decisions and Orders were, in Board staff's view, essentially the implementation of the November Decision and Order in terms of setting the methodology of calculating the estimated replacement cost of the line. When the Board refers in paragraph 52 of the March Decision and Order to the "deemed transaction date,"¹⁴ Board staff submits that the date was required for the purpose of calculating the cumulative under-recovery which was in turn used to address the harm to ratepayers upon the sale of the St. Clair Line. Without a sale, there would be no harm and no need to mitigate the harm by allocating a portion of the deemed net gain of the transaction. Further, by creating the second deferral account, account 179-122, in order to capture the impact of removing the St. Clair Line (and related St. Clair River Crossing) from rates effective March 1, 2010 until the Board adjusts Union's rates to reflect the asset sale, the Board was acknowledging that the March 1, 2010 date was simply for purposes of setting the end date of deferral account 179-121 and the start date for deferral account 179-122. In other words, deferral account 179-122 was intended to continue to capture the impact of removing the St. Clair Line from rates until the sale transaction occurred.

At the hearing Union confirmed that the St. Clair Line has not been sold because shippers interested in Dawn Gateway transportation service had adopted a wait-and-see attitude as a result of natural gas market changes,¹⁵ (i.e., the emergence of shale gas in the US North East). Board staff submits that if there is no sale of the St. Clair Line there is no harm to ratepayers at this time and that the balance in Account 179-121 should be held over (and continue to accrue interest) until Union confirms that either the sale has occurred or that the

¹³ Ontario Energy Board, Decision and Order, EB-2008-0411, March 2, 2010, paragraph 46.

¹⁴ Ontario Energy Board, Decision and Order, EB-2008-0411, March 2, 2010, paragraph 52.

¹⁵ EB-2010-0039, Transcript pages 12-13.

sale is being cancelled. In its pre-filed evidence, Union indicated that “Shippers have until November 2011 to make a decision whether or not they will support construction of the Dawn Gateway Pipeline for November 2012 in-service”¹⁶. If Shippers take no action by November 2011, the “Amended Precedent Agreements will terminate with no further obligations or liabilities for Shippers or Dawn Gateway”¹⁷. Board staff is of the view that if Shippers allow the Amended Precedent Agreements to expire this November, then the balance in Account 179-121 should be returned to Union and the account should be closed.

With respect to Account 179-122, the balance of \$1.028 million has been accumulated on the basis that the St. Clair Line was “notionally” taken out of rate base in December, 2009.

Board staff notes that although the St. Clair Line has been taken out of rate base and reclassified as an “asset held for sale”,¹⁸ it is still being utilized by Union and its shippers.

At the hearing, Union clarified that it is not receiving a return on this “asset held for sale”. Ms. Elliott indicated that the actual rate base is used to calculate Union’s return on equity.¹⁹

The St. Clair Line is still being used by Union and its shippers but continues to be under-utilized. The average amount of gas shipped on the St. Clair Line in 2010 was 29,994 GJ/day while the daily capacity for the St. Clair Line is 214,000 GJ/day which represents a utilization factor of approximately 14%.²⁰

Issue 2: What action is required by the Board at this time?

Union noted that if the Board decides not to dispose of Accounts 179-121 and 179-122, it will seek to return the St. Clair line to rate base at its book value of \$5.2 million (which is the same amount that was taken out of rate base to reflect the removal of the St. Clair Line). Board staff submits that the balance in Account 179-122 should continue to accumulate until a sale occurs or the project is cancelled. If the project is cancelled on a final basis, Board staff submits that the account should be closed and the balance returned to Union.

Board staff submits that the Board should take a holistic view of the contemplated transaction and the regulatory construct imposed upon it. Union came to the Board for a

¹⁶ EB-2010-0039, Pre-filed Evidence, Exhibit C, page 13

¹⁷ EB-2010-0039, Pre-filed Evidence, Exhibit C, pages 11-12

¹⁸ EB-2010-0039, Pre-filed Evidence, Exhibit E1.7.

¹⁹ EB-2010-0039, Transcript pages 126-127 and pages 136-137.

²⁰ EB-2010-0039, Pre-filed Evidence, Exhibit E1.5.

leave to sell a portion of its pipeline. It was in the context of an application for leave to sell that Accounts 179-121 and 179-122 were established. More specifically these deferral accounts were intended to protect ratepayers from – or more appropriately to mitigate - the harm resulting from the sale of the St. Clair Line.

The sale has not occurred at this time and therefore disposition of the accounts does not align with the purpose for which the accounts were created as indicated by the language of the Board in its findings in the first November 27, 2009 EB-2008-0411 Decision.

If the sale does occur, the credit balances in the accounts should be disposed of to ratepayers at that time. If the sale does not occur, the accounts should be closed, the balances returned to Union and the asset “returned” to rate base.

Issue 3: If the answer to the first issue is no,

- a) As of what effective date should deferral accounts 179-121 and 179-122 be disposed?**
- b) What are the amounts in the accounts as of that date?**
- c) What is an appropriate methodology to apportion the amounts across customer rate classes?**
- d) Does the St. Clair Transmission Line remain in Union Gas Limited’s rate base**

If the Board does not agree with Board staff’s submission that the disposition of the deferral accounts is dependent on the sale of the St. Clair Line, then the Board may wish to refer to responses to Board staff’s interrogatories Exhibit E1.1, E1.3, E1.4 and E1.7 which set out the amounts in Accounts 179-121 and 179-122 and the methodology to apportion these amounts across customer rates classes. Also, in the event that the Board decides to dispose of the deferral account balances, Board staff believes that the cumulative balances in Accounts 179-121 and 179-122 should be disposed of as of the date of the Board’s decision. The actual mechanics of the disposition could be dealt with as part of the regulatory proceeding related to the disposition of Union’s 2010 deferral account balances.

- All of which is respectfully submitted -