EB-2007-0606
EB-2007-0615

IN THE MATTER OF the *Ontario Energy Board Act*, 1998, S.O. 1998, c. 15 (Sched. B);

AND IN THE MATTER OF an Application by Union Gas Limited for an Order or Orders approving a multi-year incentive rate mechanism to determine rates for the regulated distribution, transmission and storage of natural gas, effective January 1, 2008;

AND IN THE MATTER OF an Application by Enbridge Gas Distribution Inc. for an Order or Orders approving or fixing rates for the distribution, transmission and storage of natural gas, effective January 1, 2008;

AND IN THE MATTER OF a combined proceeding Board pursuant to section 21(1) of the *Ontario Energy Board Act, 1998*.

REPLY ARGUMENT OF UNION GAS LIMITED
RE: CUSTOMER ADDITIONS

1. This is Union's reply to the arguments of Green Energy Coalition ("GEC") and Pollution Probe ("PP") concerning the issue of customer additions.

2. Union remains of the view, as outlined in its argument in chief, that neither GEC nor PP have discharged their burden of demonstrating the need for special treatment of customer additions, or special penalties around customer addition levels, during incentive regulation (IR).

Exhibit C20.5

3. GEC argues, at pages 4-5 of its argument, that Union's Exhibit C20.5 should be taken "with a grain of salt". Exhibit C20.5 is Union's forecast of the financial impact of customer additions over the incentive regulation ("IR"). It shows a cumulative net sufficiency of $4.1 M in 2012 associated with customer additions during incentive regulation.

4. GEC argues that the 2008 numbers, in particular the operating expenses, are suspect because they are lower than the 2006 operating expenses. GEC therefore says the 2008 forecast should use the 2006 operating costs which they say results in a cumulative deficiency

during the IR. This, they go on to say is evidence that Union might have an incentive to reduce customer attachment activity for short term improvements in return.

5. Whatever other criticisms one might make of GEC's self serving manipulation of these numbers, the starting point of the argument, that the 2008 operating costs are lower than 2006, is simply wrong. What GEC has forgotten is that there are roughly 4,000 fewer customer attachments forecast for 2008 than was experienced in 2006 (26,346 in 2006 minus 22,479 in 2008). This is clear from C20.4 and C20.5 and was referred to in cross examination at p. 31, l. 24.

6. The 2008 forecast operating costs, on a per customer basis, are actually slightly higher than the 2006 operating costs ($118 in 2006 and $120 in 2008).

7. As Mr. Birmingham said in answer to one of PP's questions, the only real difference between the 2006 customer addition Tables in C20.4 and the 2008 Tables in C20.5 is that 2008 reflects the 2007 and the 2008 rate increases (reflected in higher net margin) and a drop in return on equity (9.62% in 2006 to 8.54% in 2008) (Transcript p. 31, l. 5 to p. 32, l.12; p. 33, l. 8-12). Mr. Birmingham also explained this to GEC in cross examination at p. 50, l. 10 to p. 51, l. 13.

8. There is, therefore, nothing suspect about the 2008 forecast in C20.5 or, in particular, the operating cost values. It makes no sense to use, as GEC has done, total 2006 operating costs (which reflect 26,346 customer additions) for the 2008 forecast, which is based on customer additions of only 22,479.

9. Union has already, in effect, used the "same" (actually slightly higher) operating costs for 2008 as it did for 2006, i.e., $120 per customer.

10. There is no reason, therefore, to take the cumulative net sufficiency of $4.1 M "with a grain a salt." Indeed, it is GEC's flawed manipulation of the numbers that is unjustified.

Annual Cost of Service "Rebasing"

11. The essence of both GEC and PP's argument revolves around the proposition that Union will be worse off under IR because it can not annually update rate base and, therefore,

cannot earn a return on new capital investment associated with annual customer additions until rebasing.

12. Union, however, has not had annual cost of service proceedings. Since 1998, Union has had only three cost of service applications, 1999, 2004 and 2007.

13. So it is completely wrong to say that IR, as such, is going to change Union's incentives to attach customers. Union's customer attachments have, in fact, remain fairly constant, between 34 to 36% of housing starts in all but one of the seven years from 2000 to 2006. Union attached about 200,000 customers during this period.

14. The proposition that under IR, Union will lose the benefit of annual increases to rate base and that this will impair customer attachments is, therefore, simply not born out by the facts.

Onus on GEC and PP

15. GEC places great weight on the so called "lag" in customer attachments in 2001 in arguing that this was a year during an IR regime. GEC also notes that Mr. Birmingham did not "volunteer any explanation".

16. It was not for Mr. Birmingham to volunteer explanations. This is GEC's proposal. GEC bears the burden of proof. If it wanted to argue that the drop in Union's attachments as a percentage of housing starts in 2001 was due to incentive regulation, it was GEC's burden to establish the evidentiary foundation for that argument. It has completely failed to do so. GEC's suggestion of a causal relationship is therefore pure speculation.

17. There are, in fact, any number of possible explanations for the 2001 anomaly, such as the fact that this was a year in which manufacturing in southwestern Ontario soured. It was also a year in which there was a steep increase in Union's commodity charges because of regulatory delays in clearing commodity deferral accounts. But GEC did not ask these questions and did not establish any "cause" for the change in percentage of attachments. GEC is left, therefore, to do no more than speculate.

18. At paragraph 8 of its argument, PP focuses on the profitability index of Union's portfolio rising from 1.29 in 2002 to 1.49 in 2003. On the basis of this numeric change, PP leaps to the conclusion that this is evidence of Union "rationing its capital" under incentive regulation. Again, this is pure speculation. PP too bears the onus of establishing evidence of the need for the measures it advocates. PP failed to do so. It does not now lie in PP's mouth to speculate that the cause of the change in profitability was a management decision to ration capital for short term returns in 2003.

19. More importantly, PP is, like GEC, manipulating numbers selectively to achieve its own selfish purposes. PP ignores the fact that, in 2003, Union's customer attachments as a percentage of housing starts was solidly in accordance with historical and subsequent experience, at 35%. PP also ignores the fact that 2003 represents, along with 2004, the high water mark of annual customer attachments in the seven year period from 2000 to 2006.

20. Accordingly, there is no evidence to support the proposition that Union will ration its capital or reduce customer attachments as a result of IR.

No Established Need for Penalties

21. Finally, GEC argues that if it is Union's intention not to alter customer attachment behavior during IR, then it should not object to penalties were it to do so. Fortunately, that is not how regulation works in the Province of Ontario. First, the OEB has already rejected penalties as a component of its service quality requirements. Second, for the extraordinary remedy of a penalty, there must be more than a speculation that certain behavior might or might not be affected by IR. Liberty is not suspended on speculation. Nor are penalties imposed or justified just because a party says it intends to act in the desired manner anyway. To the contrary, in the absence of a clearly demonstrated need for the draconian step of imposing penalties, they should not be established. There is not the slightest hint of any need for penalties on the facts of this case.

22. These are Union's submissions in reply to specific points raised in the GEC and PP arguments. Union otherwise relies on its argument in chief. At its core, it remains Union's position that the proposals of GEC and PP are solutions in search of a problem. They have failed

to justify a need to take the management of customer additions out of the IR formula or to impose penalties as an incentive to pursue attachment of new customers.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

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