uniongas
A Spectra Energy Company

August 26, 2011

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

Re: EB-2011-0038 - Union Gas Limited - 2010 Earnings Sharing & Disposition of Deferral Account and Other Balances – Reply Evidence

Dear Ms. Walli:

Please find enclosed two copies of Union Gas Limited's reply to the evidence of Mr. John Rosenkranz filed on behalf of Canadian Manufacturers & Exporters, Federation of Rental-housing Providers of Ontario and the City of Kitchener on July 6, 2011.

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

Yours truly,

[Original signed by]

Chris Ripley
Manager, Regulatory Applications

cc: Crawford Smith (Torys)
EB-2011-0038 Intervenors

Reply Evidence of Union Gas Limited – EB-2011-0038

This evidence is in reply to the Report of John Rosenkranz (the "Rosenkranz Report") filed on behalf of Canadian Manufacturers & Exporters, Federation of Rental-housing Providers of Ontario and City of Kitchener on July 6, 2011, in respect to Union's proposed cost allocation methodology and calculation of margins on short-term and long-term storage services for the storage service deferral accounts.

The Rosenkranz Report is based on a series of assumptions regarding Union's operations, service offerings, as well as certain reporting data. A number of these assumptions are incorrect and result in errors for the purposes of allocating costs between Union's regulated and unregulated businesses. This evidence is organized as follows:

1. Space Deemed Unavailable
2. Storage Optimization
3. Cross Charge
4. Storage and Transportation Access Rule Reporting
5. Downstream Pipeline Balancing Service
6. Compression Horsepower
7. Non-Utility Storage Allocator

1. Space Deemed Unavailable

The Rosenkranz Report assumes that Union has made an inappropriate adjustment to its available storage space *viz*. to include space deemed unavailable. The report states that storage deemed unavailable is treated as available storage space, which inflates the share of plant costs allocated to utility storage services (p. 4).

The assumption that Union has made an inappropriate adjustment to its available storage space is incorrect. Union has correctly applied the 2007 Board-approved storage space allocator (the STORAGEXCESS allocator), adjusted for the reservation of 100.0 PJ for in-franchise growth, to separate the costs of its regulated and unregulated businesses.

<u>2007 Board-approved Allocators</u>

At the time of Union's 2007 rate case (EB-2005-0520), Union's official storage working capacity was 154.0 PJ. Accordingly, in Union's Board-approved 2007 cost allocation study, the STORAGEXCESS allocator used to allocate the components of revenue requirement associated with storage space, excluding system integrity, reflected storage space demands of 154.0 PJ.

Based on Union's official working capacity of 154.0 PJ, the methodology described above resulted in an allocation of 84.0 PJ of storage space to in-franchise customers and 70.0 PJ to ex-franchise customers. The in-franchise allocation of 84.0 PJ included 1.5 PJ of space deemed unavailable, which Union did not expect to be permanently unavailable space requiring a reduction in Union's official storage working capacity.

Union's cost allocation methodologies, including the allocation of storage space-related costs to rate classes, was approved by the Board in EB-2005-0520. In the NGEIR Decision (EB-

2005-0551), the Board determined (p. 74) that Union's 2007 cost allocation study was sufficient to separate the costs of its regulated and unregulated businesses. In accordance with that Decision, Union has applied the Board-approved 2007 cost allocation study methodologies, adjusted for the reservation of 100.0 PJ for in-franchise growth, to separate the costs of its regulated and unregulated businesses.

Annual Costs of Space Deemed Unavailable

Contrary to the Rosenkranz Report, the annual costs associated with 1.5 PJ of space deemed unavailable are borne by Union's unregulated storage operations, rather than its regulated business.

Union's Board-approved 2007 cost allocation study allocated 93.3 PJ of storage space to in-franchise customers. This figure was comprised of 84.0 PJ for working capacity requirements (including 1.5 PJ of space deemed unavailable), plus approximately 9.3 PJ of system integrity space.

In the NGEIR proceeding, Union calculated its total in-franchise storage space requirements to be 92.1 PJ. This figure was comprised of 82.4 PJ for working capacity requirements (excluding 1.5 PJ of space deemed unavailable), plus 9.7 PJ for system integrity purposes.

In its NGEIR Decision, the Board ruled that Union should reserve 100.0 PJ of storage space for future in-franchise needs. As in-franchise customer requirements are 92.1 PJ, Union sells

7.9 PJ (the difference between 100.0 PJ and 92.1 PJ) on a short-term basis and allocates the costs associated with this excess utility storage space to its unregulated storage operations.

The 1.5 PJ of space deemed unavailable is in excess of the 92.1 PJ required to serve in-franchise customers and is included in the 7.9 PJ of excess utility storage space. Accordingly, the annual costs associated with the 1.5 PJ of space deemed unavailable are borne by Union's unregulated storage operations. In-franchise customers pay for the costs associated with 92.1 PJ of space, commensurate with forecasted 2007 in-franchise storage requirements of the NGEIR Decision.

2. Storage Optimization

The Rosenkranz Report states that "the storage numbers Union uses for ratemaking purposes significantly understate the amount of long-term non-utility storage services that Union is actually able to sell" (p. 4). The Rosenkranz Report proposes that the storage space sold through optimization should be used in the determination of allocation factors.

The Rosenkranz Report's proposal to include the storage optimization space in the "storage numbers" used for allocating utility and non-utility costs is inappropriate.

In order to understand how Union provides storage services, it is important to distinguish between two sources for storage space underpinning the provision of those services:

- Physical storage is actual storage space which is sold to both utility and non-utility customers. It attracts fixed costs which are allocated between both utility and non-utility customers. The split of physical storage space sold to in-franchise (utility) and ex-franchise (non-utility) customers is reported at Exhibit B3.4. If there was no optimization activity, physical storage would represent the maximum amount of storage available for use.

- Optimization space is storage sold to non-utility, ex-franchise customers. There is no physical storage space, and consequently no fixed costs associated with physical assets that can be attributed to this storage space.

To allocate physical storage, firm storage requirements are used to divide the physical storage space (and costs) between utility and non-utility. This allocation was completed based on the contracted capacity at a point in time, using the 2007 Cost Study. The purpose of this allocation is to ensure all fixed costs associated with physical storage space are captured.

At the time of the allocation in 2007, there was no optimization space. However, had there been optimization space at that time, Union's methodology would remain unchanged. There would still be no allocation of the storage space or costs from the optimization storage, since optimization space does not attract costs. This ensures that no unregulated storage space, costs, revenues or risks are directed to the utility and its customers, which is entirely consistent with the reasoning in the in the NGEIR proceeding.

The Rosenkranz Report has suggested a methodology which introduces non-utility optimization space into the allocation of costs between utility and non-utility storage. If optimization space is to be included in this allocation, then so must the associated optimization revenues, costs and risks. This is an unnecessarily complex approach, and it is inappropriate to include purely non-utility revenues, costs, risks and space in an allocation exercise between utility and non-utility, when they can be streamed directly to the non-utility business as Union does now.

In addition, the costs associated with Union's physical storage space are already allocated between its regulated and unregulated businesses. Union's unregulated storage business is already paying for its portion of Union's physical space. Including Union's optimization of unregulated long-term space in the allocation of space-related costs between its regulated and unregulated businesses effectively double-counts the costs of that space.

3. <u>Cross Charge</u>

The Rosenkranz Report claims that Union has erred by shifting $1.662 million of fixed costs associated with selling the 7.9 PJ of excess utility storage space from long-term storage to short-term storage for the purposes of calculating storage margins for sharing with ratepayers (p. 1).

Union has not erred in treating all the costs associated with selling 7.9 PJ of excess utility storage space as short-term costs. It is appropriate for Union to include both the revenues and costs associated with the 7.9 PJ in the short-term storage deferral account for purposes of calculating margins for sharing with ratepayers.

In Union's 2007 rate case forecast, 2.0 PJ, of short-term C1 storage sales were forecast. This forecast resulted in $0.599 million in costs being allocated to the C1 storage rate class to support the short-term sales. Subsequently, in its NGEIR Decision, the Board ruled that Union should reserve 100.0 PJ of storage space for future in-franchise needs. As noted above, given forecasted in-franchise storage requirements of 92.1 PJ and the reservation of 100.0 PJ for in-franchise customers, 7.9 PJ of excess utility storage space became available for sale on a short-term basis (as compared to the 2.0 PJ previous forecast).

In accordance with the NGEIR Decision, Union sells the excess utility storage space of 7.9 PJ on a short-term basis only. In comparison to the $0.599 million in costs associated with 2.0 PJ of forecasted short-term storage sales, the costs associated with Union's actual short-term storage sales of 7.9 PJ are $2.261 million, or an increase in short-term costs of $1.662 million from the original $0.599 million.

Both the revenues and costs associated with selling 7.9 PJ of excess utility storage space are accounted for in Union's short-term storage services deferral account for the purposes of calculating margins for sharing with ratepayers. This treatment is appropriate as it recognizes the costs of $2.261 million that were incurred to generate the short-term storage revenue associated with 7.9 PJ of short-term sales. This approach allows Union to properly recover the fixed costs allocated to C1 storage services in rates before sharing the short-term revenue with ratepayers.

Shifting $1.662 million in costs back to Union's long-term storage deferral account, as recommended in the Rosenkranz Report, is not appropriate and does not fully recognize the short-term costs incurred by Union in the provision of short-term storage services associated with 7.9 PJ of excess utility storage space. Had 7.9 PJ of short-term storage been forecasted in the 2007 cost study, Union would have allocated $2.261 million in costs.

4. <u>Storage and Transportation Access Rule Reporting</u>

The Rosenkranz Report relies on the storage index that forms part of the Storage and Transportation Access Rule ("STAR") requirements (Table 2, p. 6). This reliance is misplaced.

The Rosenkranz Report used the monthly STAR reporting to determine Union's total storage space for sale. The contract parameters reported under STAR represent the maximum parameters under the contract and may not represent the contractual rights in any given month. It is therefore not possible to equate the summation of the contractual entitlements under the STAR reporting and Union's system capability.

Further, the index of customers reports all firm storage contracts with a term of one month or greater and is not limited to the contracts that underpin the demands used for cost allocation purposes. For example, off peak storage contracts, which allow customers to inject in a summer month and withdraw in a later summer month, are excluded from the cost allocation process because they do not attract costs at peak periods.

The contracts that are listed on the storage index of customers with injection and/or withdrawal rights at Parkway are actually Winter Peaking Service contracts purchased to manage Union's winter shortfall at Parkway. They are not storage contracts and should not have been included in the index.

STAR reporting cannot be used for cost allocation purposes.

5. <u>Downstream Pipeline Balancing Service</u>

The Rosenkranz Report assumes that Union's transmission assets are used to provide non-utility storage services and concludes, therefore, that the transmission costs of the service should be attributed to Union's unregulated business. Union's Downstream Pipeline Balancing Service ("DPBS") is provided as an example of storage services that overlap with transportation (p. 9).

DPBS is a component of the Union's unregulated storage services used primarily by power customers. The DPBS provides customers with the ability to nominate changes to their exports at Parkway to TCPL every 15 minutes or 96 times per day. While Ontario's power generators are the most likely to contract for this service, it is open to all customers. One of the requirements of this service is that the DPBS contract holder must also hold firm Dawn to Parkway transportation service. While DPBS gives customers the right to adjust their nomination on a 15 minute basis, it does not provide the capacity to transport gas through Parkway to TCPL – this capability is provided by the underlying transportation contract. All gas that is injected into a customer's DPBS contract was transported via their Union Dawn to

Parkway transport contract, and withdrawals from the DPBS contract are limited to any unused (not nominated) Dawn to Parkway transport capability for that particular hour.

The DPBS does not rely on transportation costs that are not recovered – the transportation costs are fully recovered from the customer's Dawn to Parkway transportation contract.

6. Compression Horsepower

The Rosenkranz Report states that "Union should consider whether factors such as compression horsepower would result in a better allocation of direct operating costs" (p.1). Union does consider horsepower when allocating costs between the regulated and unregulated businesses.

As noted in Union's 2009 Deferral Disposition evidence, costs related to operating and maintaining the storage assets are allocated in the same manner as the underlying assets are allocated (EB-2010-0039, Exhibit A, Tab 4, page 14, lines 18 – 20). For assets that are used operationally for both regulated and unregulated storage and transmission operations, the horsepower allocator was one of the factors applied to determine the unregulated asset allocation. The same factors were used to determine the unregulated O&M for those facilities.

For new facilities, the operating and maintenance costs of those new unregulated storage facilities are allocated 100% to the unregulated storage operation, consistent with the asset costs for those new facilities. For assets that were in existence prior to the NGEIR decision, the factors used to allocate operating and maintenance expenses are updated annually based on current operations. As a result, as the compression requirements increase based on adding more facilities for the unregulated operation, so does the allocation of O&M expense.

7. Non-Utility Storage Allocator – Schedule 2

At Schedule 2 – Non-Utility Storage Allocated Corrected (p.15), the Rosenkranz Report makes certain adjustments to Union's proposed Non-Utility Storage Allocator. The adjustment contains a number of factual errors, making the proposals inappropriate for cost allocation.

As noted in above, resource optimization should be removed from the calculation of total available storage. Resources optimization is not a physical asset and generates no costs. It should not be included in total storage space available for sale.

Total deliverability is incorrect and should be based on maximum deliverability for Dawn. Total deliverability at Schedule 2, line 15 of the Rosenkranz Report is based on total Design Maximum Deliverability by pool as found at Exhibit B3.29. The deliverability capacity of each storage pool noted at Exhibit B3.29 represents the maximum deliverability of each individual pool. However, it is not possible to withdraw the maximum deliverability of each pool at one time.

The calculation of the Utility Deliverability Requirement at Line 18 is incorrect and already reflects space deemed unavailable. The Rosenkranz Report calculates the Utility Deliverability

Requirement as 80.8 PJ/82.4 PJ x 1.435. The 1.5 PJ of space deemed unavailable should not be removed from the formula. The 82.4 PJ is Union’s in-franchise requirement and does not include 1.5 PJ.