DR QUINN & ASSOCIATES LTD.

VIA E-MAIL

May 12, 2009

Union Gas Ltd.
Attn: Mr. Chris Ripley
Manager, Regulatory Applications
50 Keil Drive North,
Chatham, Ontario
N7M 5M1

RE: EB-2009-0052 Deferral Account Dispositions FOR 2008

I have reviewed Union's Interrogatory responses submitted May 8, 2009 in the above-noted proceeding. Given the written nature of this proceeding and the deadline for argument due on May 15, 2009, on behalf of FRPO, I feel compelled to request clarification on Union's response provided to a FRPO interrogatory in Exhibit B3.1.

The submissions provided by Union were responsive in quantifying the components Short and Long Term Services. However, they were not responsive in providing detail or a description as requested in the interrogatory that would be helpful to the reader in understanding the significant variances from previous Board approved levels. To be able to submit a position on the levels in the respective accounts, one must have some detail to understand how a 30% increase in Revenue required an almost 400% increase in Costs for Short-Term Services or some description of Asset Related costs to explain a 5800% increase to support a doubling of Revenues.

FRPO would respectfully request Union's provision of this information in a timely fashion to support adequate time for intervenors to submit their final arguments at the end of this week. Thank you.

On Behalf of FRPO,

Dwayne R. Quinn

Dwayne R. Quinn
Principal
DR QUINN & ASSOCIATES LTD.

cc: Board Secretary (OEB)
Intervenors – EB-2008-0052
V. Brescia (FRPO)

May 14, 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 Response to FRPO Request for Clarification

Dear Ms. Walli:

Please find enclosed two copies of Union's Supplemental response to Exhibit B3.1.

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

UNION GAS LIMITED

Answer to Interrogatory from
Federation of Rental-housing Providers of Ontario ("FRPO")

Provide descriptions of the costs included in the Short-Term and Long-Term Peak storage deferral accounts, including an explanation for cost variances from Board Approved.

Response:

Short-Term Storage and Other Balancing Services

The short-term commodity costs are comprised of unaccounted for gas ("UFG") and compressor fuel.

The short-term demand costs are comprised of operating and maintenance ("O&M"), depreciation, property & capital tax, interest, income taxes, deferred tax drawdown and return.

The 2007 Board approved costs (EB-2005-0520) for the Short-Term Storage and Other Balancing Services deferral account were based on 2 PJs of Short-Term Peak storage. As part of the EB-2007-0520 Settlement Agreement, the Board imputed $12 million in margin, revenue net of costs, which was embedded in in-franchise rates. The costs were not changed and there was no indication of the costs associated with the higher imputed revenues. The 2008 deferral balance is calculated using total revenues and total costs. Comparing the 2008 actual costs with the 2007 Board Approved costs is not an accurate comparison, since the 2007 Board Approved costs did not identify the incremental costs to achieve the incremental imputed margin.

Long-Term Peak Storage Services

The long-term commodity costs are comprised of UFG and compressor fuel, net of customer supplied fuel.

The long-term demand costs are comprised of O&M, depreciation, and property and capital tax.

The long term asset costs are comprised of interest, return and income tax for unregulated assets. These costs were not forecasted as part of EB-2005-0520 resulting in a variance from the 2007 Board Approved costs.

EB-2010-0039 Settlement Agreement (excerpt)

20. Allocation of Costs between Union's Regulated and Unregulated Storage Operations

The parties agree that, upon approval of this Agreement by the Board, Union will commission an independent study ("the Study") of its cost allocation methodology for allocation of costs between its regulated and unregulated storage operations. The Study will also examine the attribution of revenues to deferral accounts 179-70 and 179-72 and provide a volumetric reconciliation between physical space and space sold "short term" and "long term". Union will solicit a person, group or organization to conduct the study ("Study Staff") by way of a request for proposals ("RFP"). Union will provide an opportunity to the other parties to comment on a draft version of the RFP and to suggest changes. Final drafting of the RFP and selection of Study Staff will be at the sole discretion of Union.

Union will take steps to ensure that, at or near the outset of the Study, the other parties will be provided an opportunity to present Study Staff with their concerns, questions, and/or opinions on the subject matters of the Study.

The Study will be filed by Union in connection with its application to dispose of 2010 deferral account balances with sufficient time to permit full discovery and review of the Study as part of the application.

Any changes that Study Staff may recommend to Union's cost allocation methodology will not be implemented until after receiving approval from the Board. Any findings or recommendations made by Study Staff will be adopted, if at all, on a prospective basis, and will have no impact on balances disposed of prior to 2010.

This Agreement is without prejudice to any party's right to disagree with, or challenge any of the findings of Study Staff.

Evidence References:

1. A/T4

2. B1.13, B1.14, B1.15, B1.16, B1.17, B1.18, B1.19, B2.05, B2.06, B3.34, B3.35, B3.37, B3.38, B3.39, B3.40, B3.41, B3.42, B4.07, B4.08, B4.09, B4.10, B4.11, B4.12, B4.13, B4.14, B4.15, B4.16, B4.17, B4.18, B5.08, B5.09, B5.10, B6.05, B6.06, B6.07, B6.08, B7.09, B7.10, B7.11, B7.13, B7.14, B8.09, B9.14

3. JT1.5, JT1.6, JT1.7, JT1.8, JT1.12

PRINCIPLES

Intervenors (INT) agree with Black & Veatch (B&V) that regulatory precedent, for example, the Natural Gas Electricity Interface Review (NGEIR) storage forbearance Decision, must underpin the Study. In our view, the Ontario Energy Board's (OEB) finding of an accounting separation model in the NGEIR Decision is a critical framing to the Study. Of the three models available to the OEB at the time of the NGEIR Decision to forebear from regulating the rates for ex-franchise storage services and new in-franchise storage services (accounting separation, functional separation, and divestiture) the accounting separation model for an integrated utility such as Union Gas (UG) is complex and opaque, particularly under an Incentive Regulation Mechanism (IRM). The use of the accounting separation model compels the B&V Study to examine and consider more than just the storage cost allocation methodology to ensure the intent of the NGEIR Decision is implemented in a fair and reasonable manner

PROCESS

- It was established at the outset of the meeting that the discussions were not covered by confidentiality.
- INT expressed a desire to ensure that the power of the SAP accounting system would be used to review the data sources at the sub-ledger level to stream costs to the appropriate accounts.
- B&V stated they would have an accounting process orientation creating a detailed flowchart to ensure understanding for the purposes of cost allocation.
- The process would be top-down and bottom-up resulting in computational accuracy and an audit trail.
- The cost allocation would be grounded in sound utility cost principles, reflect operational realities including the relationship between the assets and the service requirements of the respective services.
- INT requested that the underlying assumptions be articulated in the report to ensure transparency e.g., if an ex-franchise service is greater using assets allocated to in-franchise customers, then the costs and revenues should be in the deferral account.
- INT would document issues, questions and concerns and forward to UG for review and forwarding to B&V.

RECONCILIATION OF STORAGE SPACE

- One of the concerns expressed by INT is that it seemed like the sum of the parts was greater than the whole i.e., when the long-term storage (LT) sold was added to the 100 PJ set aside by the OEB in NGEIR for in-franchise use, the total was greater than the physical space that is available from UG. In response to FRPO inquiry prior to the technical conference, UG provided the LT storage for 2008 was 87.9PJ and for 2009 it was 91.2PJ. INT's understanding of UG's total working capacity of storage is significantly less than the sum of the in-franchise allocation and the amount of LT sold in either year.
- In response, it was opined by UG that it was multi-year gas loans that contribute to the perceived excess assets. INT would desire to see a reconciliation at a sufficient level of detail with accompanying assumptions to ensure that the revenues and costs are being streamed consistent with the Board's direction in this area. This reconciliation ought to start with the base storage allocations that underpinned rates to reflect that the starting point of what was included in in-franchise rates and provide actual utilization for each year to demonstrate the methodology worked.
- For the purposes of simplifying communication the following formula was developed in the meeting and may be helpful in explaining physical reconciliation:

  A1 + A2 + B = C, where:

  A1 = storage for in-franchise use

  A2 = excess in-franchise storage available for short-term market sales

  B = storage for long-term ex-franchise market

  C = total working storage

  And where A1 + A2 = 100 PJ cap under the NGEIR Decision

COST ALLOCATION

IMPUTED MARGIN

- One specific area of lack of understanding was evident from both EB-2009-0052 and EB-2010-0039 was the handling of imputed revenue as a result of the Settlement Agreement for EB-2005-0520 which included $12 million of imputed margin. INT noted UG’s position that only 2PJ of storage were allocated to 179-

70 prior to the agreement and more had to be sold to increase the revenue. Issues that were noted were:

- In response to FRPO inquiry regarding forecast utilization prior to the settlement conference, the schedule from EB-2005-0531 was provided showing C1 peak storage - Short Term (ST) being allocated 112,002 10^3 m^3 or 4.2PJ. That forecast is different from either the 2PJ that was proposed to be allocated or the 8PJ that was inferred in UG reply argument in EB-2009-0052. INT desire to know what asset costs were removed from base rates prior to ratemaking and what costs are being deducted from deferral account revenues to ensure there were no unintended mistakes in double-counting. INT would expect that the study would provide sufficient clarity on this issue.
- Further, in the same reply argument, UG inferred that the costs increased comparatively to revenue increases. INT stated that the costs should follow the assets and actual allocation as opposed to revenue which is greatly impacted by price i.e., there should be standard unit costs for asset costs and the amount of cost should not be influenced by the price of the service.
- Also, allocation methodologies for cost items such as Unaccounted for Gas (UFG) can be based on metrics for utilization. To the extent that the storage field is "turned over" more than once due to optimization, allocations such as UFG should not be double-counted by allocating more cost when the assets allocated stayed the same. INT would desire the study produce how these allocation methodologies ensure that there are no unintended over-recoveries for asset costs that may not have been foreseen in the original allocation and ratemaking methodologies and subsequent deferral account allocations.

- INT provided copies of Exhibit B6.08 in EB-2010-0039 to meeting participants. This CCK Interrogatory included a schedule template to present UG's storage revenues, rate base and costs for regulated and unregulated storage operations. The template was provided to illustrate how information might be presented to address and largely satisfy INT's questions and concerns with the proper matching of storage costs to revenues and the reconciliation of regulated and unregulated storage activity with consolidated activity. INT understands UG's position that storage revenue and cost data is not currently captured in sufficiently granular detail or format to enable the template to be completed. The template was provided to B & V as an example of how storage revenues, assets and costs might be presented in a transparent way to alleviate concerns with potential cross-subsidization or inadvertent or incorrect over-allocation or under-allocation of costs to revenues. There may be other suitable and practical ways to efficiently capture and present storage revenues and costs and related activity to achieve the same objective.

STORAGE RE-ALLOCATIONS

- INT expressed concern regarding the allocation of costs and benefits with re-allocations. As a result of EB-2007-0725, many large customers moved to the approved storage allocation methodology resulting in reductions to their level of cost-based storage. To the extent that the excess storage is re-contracted at market rates by a customer in a long-term contract or sold short-term, where do the revenues flow and are the costs following the storage i.e., are they in the respective deferral account or are they left in rates or both? To the extent that the storage had deliverability in excess of UG deemed standard deliverability of 1.2%, how is the incremental deliverability allocated physically and do the costs follow the asset allocations? INT would desire to see that the revenues, respective costs and equitable ratemaking are being employed in this area.
- Similarly, when UG moved additional storage from LT to ST to follow the OEB's orders, UG provided in this proceeding that the storage was moved with a 1.2% deliverability as opposed to the 1.667% in in-franchise rates or the 1.32% deliverability in LT before the shift. Notwithstanding that INT are not sure that this was the appropriate reallocation, how did the costs follow the deliverability recognizing that UG has a higher cost allocation methodology for Storage Peaking Service?

LONG TERM STORAGE

- UG has stated that incremental storage investment has been separated from utility storage investment. INT have been striving to determine how this accounting separation has been effected and what assumptions have been used for the allocation of costs for the purposes of the deferral accounts. Areas of concern range from:
    - UFG: If UFG costs are being allocated between deferral accounts on an actual basis based upon actual utilization, does that not have the effect of

increasing costs which reduce deferral accounts margins that are available for sharing while increasing profits that are not available for sharing unless UG over-earns by 200 basis points? Is there any compensating mechanism to "account" for this?

- Return: Underlying assumptions are being made about the level of return allocated as costs prior to distribution. INT are concerned that the level of return and underlying assumptions are presented in the B&V report. B&V stated that they will not make a value judgement on this practice. The study should note how Return is allocated to storage revenues and where and why it may differ from Return derived under the OEB approved formulaic methodology for rate-regulated utilities.

UNION GAS LIMITED

Undertaking of Steve Baker
To Board Chair

To provide the calculation of the premium amount annually for the last ten years.

The attached chart provides the S&T transactional gross margin before deferrals for the short term peak storage and balancing services and the long term peak storage services. Only nine years of data were readily available.

The short term peak storage and balancing margin captures the margin from the sale of peak storage, off peak storage and balancing service sales with a contract term of one year or less.

Long term peak storage contracts have terms longer than one year. The long term peak storage margins include C1 peak storage contracts and M12 contracts that have moved to C1 market based rates as they renew. For example, the GMi 22.6 PJ M12 storage contract moved to market based rates in 2001, and the Enbridge 21.6 PJ M12 storage contract moved to market based rates in 2006.

The chart also includes the high and low seasonal price spreads (summer to winter) which are a measure of the potential storage values for the upcoming winter season. As can be seen, the storage values can fluctuate during the year and have in fact been negative over this period.

Witness: Steve Baker / Steve Poredos
Question: June 20, 2006
Answer: June 26, 2006
Docket: EB-2005-0551

Union Gas Limited
Summary of Historical Storage Transactional Services sold at Market Based Rates
For the Years Ending December 31
($000's)

Line No.	Particulars	1997 (a)	1998 (b)	1999 (c)		2000 (d)	2001 (e)	2002 (f)	2003 (g)	2004 (h)	2005 (i)
		Actual									
1	Short term storage and balancing services margin										
	Gross Margin	8,625	11,110	6,736		2,417	2,847	14,950	11,463	22,027	15,306
2	Long term storage services margin										
	Gross Margin	-	1,427	(1,179)	(1)	242	1,669	5,169	9,014	16,271	16,451
3	Total Storage Services Margin	8,625	12,537	5,557		2,659	4,516	20,119	20,476	38,299	31,757
	Seasonal price spreads (Potential storage value)										
	US/MMBTU (also shown in Exhibit D Tab 2 Appendix L)										
	High		0.72	0.69		0.40	0.91	0.96	0.69	1.86	1.35
	Low		0.17	0.21		-0.05	0.18	0.44	-0.25	0.25	0.45

Notes:
(1) Timing Differences
(2) Line 1 would be credited to Account 179-70
(3) Line 2 would be credited to Account 179-72
(4) Gmi's 22.6 PJ of M12 storage is converted to C1 market based storage in 2001

UNION GAS LIMITED

Undertaking of Steve Baker
To Board Chair

To provide the additional volumes and average prices related to K.2.3.

Please find attached (Attachment 1) a chart showing the S&T transactional volumes and gross revenues related to the S&T transactional gross margins presented in Undertaking K.2.3 (also attached as Attachment 2).

The attached table provides:

1. The long term storage space sold at market rates on a calendar basis related to Account 179-72.
2. The short term and off peak storage space, as well as the park and loan space, sold at market rates on a calendar basis related to account 179-70.
3. The average annual total rate (gross revenue) achieved for long term storage space.
4. The average annual total rate (gross revenue) achieved for short and off peak space, as well as park and loan space.

Long and short term storage contracts have a term beginning on April 1 of any year and ending March 31 the following year. The chart has been presented on a calendar basis. Off peak storage space is virtually of unlimited supply since it is space available at all times of the year except during the peak period at October 31. Contracted off peak space will vary monthly with market conditions and customer demand. The chart includes the total off peak space sold annually.

Witness: Steve Baker / Steve Poredos
Question: June 27, 2006
Answer: July 7, 2006
Docket: EB-2005-0551

Union Gas Limited
Summary of Storage Quantities and Average Calendar Rates

Line No.	Particulars	1997	1998	1999	2000	2001	2002	2003	2004	2005
	Quantity (PJ's)									
1	Long Term Space- 179-72	6.7	6.7	12.2	21.8	33.2	37.8	48.7	46.6	43.0
2	Short term/ offpeak storage services including park and loan services - 179-70	50.9	27.6	29.6	45.8	67.4	48.5	42.6	32.8	30.3
(1)	Average Rate (CDN/GJ)									
3	Long Term Space- 179-72	0.20	0.87	0.46	0.45	0.49	0.67	0.59	0.68	0.69
4	Short term/ offpeak storage services including park and loan services - 179-70	0.19	0.53	0.33	0.36	0.15	0.76	0.51	0.85	0.74

Notes
(1) Rates were calculated using calendar revenues; contract details are not readily available in time permitted.
(2) Verifiable information was not available for the years 1997 & 1998, the information is best available.
(3) Timing differences may be impacting the calendarized average rate calculations/