

PETER C.P. THOMPSON, Q.C.
T 613.787.3528

pthompson@blg.com

Borden Ladner Gervais LLP
World Exchange Plaza
100 Queen St, Suite 1100
Ottawa, ON, Canada K1P 1J9
T 613.237.5160
F 613.230.8842
F 613.787.3558 (IP)
blg.com



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July 22, 2011

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

Dear Ms Walli,

Union Gas Limited ("Union")
2010 Earnings Sharing & Deferral Accounts and Other Balances
Board File No.: EB-2011-0038
Our File No.: 339583-000104

Attached are the Interrogatory Responses provided by John Rosenkranz, which are being filed on behalf of Canadian Manufacturers & Exporters ("CME"), Federation of Rental-housing Providers of Ontario ("FRPO") and City of Kitchener ("Kitchener").

Yours very truly,

A handwritten signature in blue ink, appearing to read 'Peter Thompson', with a long horizontal flourish extending to the right.

Peter C.P. Thompson, Q.C.

PCT/kt
Encl.

c. Dwayne Quinn (FRPO)
Jim Gruenbauer (Kitchener)
Intervenors in EB-2011-0038
Paul Clipsham

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EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 1

Ref: Page 1, 2nd paragraph

The evidence provides a number of findings and recommendations related to Union's Non-Utility Storage Operation and Storage Service Deferral Accounts on page 1. However, it does not state the basis for these findings and recommendations.

For each finding and recommendation, please clearly indicate whether Union has deviated from any Board decisions or guidelines. Please provide references (to Board decisions/guidelines).

Response:

The findings and recommendations on page 1 summarize the findings and recommendations that are explained later in the evidence. Deviations from Board decisions and common ratemaking guidelines are listed below under bullet points summarizing each of the findings and recommendations.

- Calculate the non-utility storage allocation factor based on the actual marketable storage capacity and deliverability at the time of the separation.

Union's proposed methodology appears to be inconsistent with the NGEIR Decision, where the Board stated that there should be no cross-subsidization between utility and non-utility storage operations. (NGEIR Decision, p. 101)

- Improve transparency of internal estimates and judgment calls used in allocating costs.

This is necessary to allow the Board to confirm that costs are allocated correctly, to ensure that the utility ratepayers are charged reasonable rates.

- Union should consider whether other objective factors, such as compression horsepower, would result in a better allocation of direct storage operating costs.

Cost allocation should be tied to cost causation to produce reasonable rates.

- Full or partial approval of Union's proposed methodology must not preclude parties from investigating Union's implementation of that methodology, including support for Union's actual and estimated costs, in future rate proceedings.

This is necessary to allow the Board to confirm that costs are allocated correctly, to ensure that the utility ratepayers are charged reasonable rates.

- Eliminate "return on purchased assets" expense for third-party storage service contracts.

Margins should be calculated using actual third-party storage costs.

- Use the Board-approved return on equity for new storage investments when calculating margins for the Long-Term Storage Deferral Account.

Even under forbearance, margin sharing on storage services is a rate-setting activity under the jurisdiction of the Board. Union should therefore calculate costs for margin-sharing purposes using the Board-approved rate of return. The actual return Union's shareholder realizes from investing in non-utility storage assets is derived from its share of the operating margin on market-priced long-term storage services over the life of the assets. Using the Board-approved return for the margin sharing calculation during the brief phase-out period required by the NGEIR Decision is necessary to maintain the integrity of utility rates, and will not prevent Union from meeting its shareholder's internal "hurdle rate" for new investments.

- Shift \$1.662 million of fixed cost of service from long-term storage to short-term storage for the purpose of calculating margins.

Subtracting these costs from short-term storage revenues for the purpose of calculating margins is inconsistent with the Board's view that margins on asset optimization transactions should be calculated using direct marginal costs. (NGIER Decision, p. 100, EBRO 494-93)

EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 2

Ref: Page 3, last paragraph

With respect to Union's storage plant allocation methodology, Mr. Rosenkranz comments that "it is unreasonable to use out-of-date estimates developed for an entirely different purpose when actual storage supply and utilization information is at hand."

- a) Please explain what is meant by "an entirely different purpose".

Further in the same paragraph it states that:

The projections used in the EB-2005-0520 Cost Study were estimates for the year 2007, based on information available in 2005. These numbers do not correspond to year-end 2006, which is when the one-time separation of storage plant occurs to coincide with the late-2006 date of the NGEIR Decision. More importantly, however, there is no reason to use stale estimates when the allocation can be done using actual information.

- b) Please clarify if the "stale estimates" mentioned above refers to the numbers presented in the Schedule 1 of this evidence.
c) Please clarify if the "actual information" mentioned above refers to the numbers presented in the Schedule 2 of this evidence.
d) If the answers to b) and c) above are no, please provide the stale estimates and the actual information and calculate the variances between the two sets of information.

Response:

- a) The EB-2005-0520 Cost Study was not prepared for the purpose of making a permanent separation of Union's utility and non-utility storage plant as of December 31, 2006. It was prepared for an entirely different purpose, namely, for calculating utility rates at a time when all of Union's storage assets, including assets used for ex-franchise sales under the C1 Rate Schedule, were classified as utility assets.

It is also worth noting that, since all of the margins on C1 storage sales, less a small share retained by Union as an incentive, were returned to utility customers, at the time of the EB-2005-0520 Cost Study, it was less important that these cost allocation factors be "just right", since utility customers would be compensated for any under-allocation of costs to C1 storage through higher storage sales margins. On the other hand, the non-utility storage allocation factor used for the one-time separation of non-utility storage plant will have a permanent impact on the utility rate base that will be used to set cost-based rates for utility services. It will also affect the allocation of storage O&M costs, since Union proposes to allocate certain costs on the basis of utility and non-utility plant. Since margin sharing on long-term storage sales was terminated by the NGEIR Decision, there is no mechanism to compensate ratepayers if there is an under-allocation of costs to Union's non-utility storage operation. A non-utility storage allocation factor that is too low will cause utility

customers to pay rates that are unnecessarily high, and create a windfall for Union's shareholder.

- b) Yes, the reference to "stale estimates" means the allocation factors from the EB-2005-0520 Cost Study that are presented in Schedule 1.
- c) Yes, the reference to "actual information" means the numbers that are presented in Schedule 2.
- d) Not applicable.

EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 3

Ref: Page 4, 1st paragraph

This evidence states that “to avoid cross-subsidies between utility and non-utility operations, storage plant should be allocated based on the utilization of the storage assets. For the utility storage operation, this is defined by the storage space and deliverability that are reserved to meet utility needs. For the non-utility storage operation, utilization is measured by the storage services that can be sold from the nonutility assets. Union’s proposed methodology is not consistent with this basic principle. For example, ‘storage deemed unavailable’ is treated as available storage space, which inflates the share of plant costs allocated to utility storage services.”

- a) Please provide references to any Board Decision for “this basic principle” mentioned above.
- b) Please list all areas that Union’s proposed methodology is not consistent with the basic principle.

Response:

- a) In the NGEIR Decision, at page 74, the Board endorsed the principle that there should be no subsidies between utility operations and non-utility storage operations by stating:

“The Board agrees with the Board Hearing Team that it is important that there is no cross-subsidization between regulated and unregulated storage.”

- b) Union’s proposed methodology appears to be inconsistent with the “no cross-subsidy” principle because the non-utility storage allocation factor is too low. This results in an under-allocation of plant and operating costs to Union’s non-utility storage operation, causing utility ratepayers to subsidize Union’s shareholder.

There are several features of Union’s proposed methodology that cause an under-allocation of costs to Union’s non-utility storage operation:

- The total storage space and deliverability numbers used by Union are low relative to the actual amount of marketable storage space available to Union and the actual deliverability of Union’s underground storage pools at the end of 2006.
- It appears that Union has assigned a specific amount storage space to non-utility services (70 PJ), and defined the remaining capacity as utility service (see, for example, Exhibit B3.22, Attachment 2). If this is the case, this is the opposite of the allocation method prescribed by the Board, which defines the utility storage asset based on the utility requirement (up to the 100 PJ cap), and defines the non-utility asset to be “the balance” of Union’s available capacity (NGEIR Decision, p. 101).

- Union treats “space deemed unavailable” as available capacity. Under the methodology proposed by Union, this has no effect on the non-utility storage space, which is fixed at 70 PJ, but artificially inflates the utility storage share.

EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 4

Ref: Page 4, 2nd paragraph

The third comment on Union's storage plant allocation methodology states that:

The storage numbers Union uses for ratemaking purposes significantly understate the amount of long-term non-utility storage service that Union is actually able to sell. This is illustrated by Table 1, which compares the actual storage space and utilization information for 2009 (from Exhibit B3.4), with Schedule 16 of the B&V Study, which shows actual storage capacity for October 31, 2009. Most of the numbers on the two sides of the table are consistent. However, the Total Utilization number from the B&V Study is 14.9 PJ higher, which appears to directly correspond to the amount of Resource Optimization space.

- a) Please clarify the cut-off date of the actual storage space and utilization information for 2009 in Table 1 (from Exhibit B3.4).
- b) If the answer to a) is not October 31, 2009 in Table 1 (which is the cut-off date for the actual storage capacity from the B&V Study), please provide an explanation of which the storage space and utilization quantity at two different dates are comparable.

Response:

- a) & b) Mr. Rosenkranz understands that Union does its storage planning based on an annual injection-withdrawal period that begins in April and ends in March. October 31, 2009 therefore corresponds to the mid-point of the 2009 storage year. While not exactly the same, Mr. Rosenkranz believes that the data shown on the two sides of Table 1 are "comparable" for the purpose of showing a significant discrepancy between the actual utilization of storage capacity shown in the B&V Study and the utilization numbers Union provides in Exhibit 3.4.

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EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 5

Ref: Page 6, 1st paragraph

The evidence states that:

Schedule 2 shows the relative utilization of marketable storage space by Union's utility and non-utility storage operations using actual storage information for 2006 in place of the projections from the EB-2005-0520 Cost Study.

Please clarify whether the 2006 actual storage information existed at the time of the EB-2005-0520 Cost Study?

Response:

Mr. Rosenkranz understands that Union filed its application in EB-2005-0520 with the Board in December 2005, but does not know when the cost study was prepared, or when the projections used in the cost study were developed. In any case, based simply on the filing date, the actual information for year-end 2006 did not exist at the time of the EB-2005-0520 Cost Study.

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EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 6

Ref: Schedule 2, Line 15

The reference EB-2011-0038, Exhibit 3.29 is provided in line 15 for the Union Underground Storage of 2.563 PJ/day. However, Board Staff was not able to find this number in the noted Exhibit.

Please provide a detailed calculation as to how the Underground Storage of 2.563 PJ/day was arrived at. Please provide references.

Response:

The Union Underground Storage deliverability number of 2.563 PJ/day is the sum of the Design Maximum Deliverability amounts for the Union storage pools shown in the third column of Exhibit 3.29.

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EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff**Interrogatory 7****Ref: Schedule 2, Line 18**

Line 18 on Schedule 2 Utility Deliverability Requirement 1.407 was explained as 80.8 PJ/82.4 PJ x 1.435.

Please provide the references for each of the numbers (80.8 PJ, 82.4 PJ & 1.435).

Response:

Union was not able to provide the actual storage deliverability requirements for utility services for 2006 that corresponded to the storage space requirements in Exhibit 3.4 (see Exhibit 3.57). The Utility Deliverability Requirement of 1.407 PJ/day was calculated using the deliverability requirement of 1.435 PJ/day from the EB-2005-0520 Cost Study (Schedule 1, Line 16). This number was adjusted using the ratio of: (a) the 2006 utility space requirement of 90.5 PJ (Exhibit B3.4, Line 9), minus Integrity Space of 9.7 PJ ($90.5 - 9.7 = 80.8$), and (b) the utility space requirement from the EB-2005-0520 Cost Study of 92.1 PJ (Schedule 1, Line 9), minus the same Integrity Space amount ($92.1 - 9.7 = 82.4$).

EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 8

Ref: Page 7, 2nd paragraph

The evidence states that

Averaging the corrected space and deliverability allocation factors shown in Schedule 2, the corrected non-utility storage allocation is 43.4% (Schedule 2, Line 25). The corrected non-utility storage allocation factor is 15% higher than the 37.7% factor proposed by Union.

Please provide the implications on 2010 earnings sharing if the non-utility allocation factor is changed from 37.7% to 43.4%.

Response:

The evidence does not address the 2010 earnings sharing implications of changing the non-utility storage factor from 37.7% to 43.4%.

With respect to the 2010 storage deferral accounts, changing the non-utility allocation factor used in the one-time separation of storage plant should not affect the costs assigned to long-term storage or the resulting margins. This is because the costs and cost allocation for pre-NGEIR storage assets will not change until the next rate rebasing. The only adjustments to be made to storage costs for the purpose of calculating margins will be to account for incremental costs that are directly related to new non-utility storage assets.

However, Union appears to have done something different. In the case of fixed O&M cost, Union recalculates non-utility storage O&M costs each year by applying the non-utility storage allocation factors from its proposed methodology to actual total company O&M (see Exhibit B2.7). Because the non-utility storage allocation factor affects Union's O&M factors, changing the non-utility storage allocation factor from 37.7% to 43.4% would increase the non-utility storage O&M costs calculated by Union, and reduce the margins shared with ratepayers. This happens only because Union has inappropriately used its proposed cost allocation methodology--which, if approved, will be used at the next rate rebasing--to recalculate storage O&M costs for all non-utility storage assets, including pre-NGEIR assets, between rate cases.

EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 9

Ref: Page 7, last paragraph

The evidence states that:

The proposed methodology for projects that combine replacement and incremental storage assets is also reasonable in principle, but requires Union to make judgment calls about which capital costs are strictly replacement, and which capital costs create incremental service. Union must be required to provide documentation to demonstrate the reasonableness of these allocations.

In Union's view, when should such documentation to demonstrate the reasonableness of these allocations be filed with the Board? Should it be allocated as part of COS rate application to the Board?

Response:

Mr. Rosenkranz's view is that the allocation of capital costs for these types of "hybrid" storage projects should be documented at the time the new plant is placed into service, and he recommends that Union make an annual filing describing exactly how costs were allocated between utility and non-utility plant for all such projects completed in the previous year (see response to Interrogatory 13.) If this information has not been previously filed with the Board and made part of the public record, this information should be provided with the next cost of service rate application.

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EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 10

Ref: Page 8, Comment 1: Allocation based on labor time estimates

The evidence states that:

Union's use of labor time estimates to allocate storage support activities and overhead costs is arbitrary and opaque. Of particular concern is the fact that Union does not appear to have a process in place to document and validate these estimates.

Please suggest an allocation factor which is more accurate than the labor time estimates used by Union and provide an explanation of which it is more accurate. Please explain what procedures should be followed to ensure accuracy in this area.

Response:

The use of labor as an allocation factor may be unavoidable. However, the allocation can be made less arbitrary and more open to verification by requiring employees that have a significant involvement with the non-utility storage operation to prepare timesheets to track the actual time spent on non-utility and utility functions, instead of relying on estimates prepared annually by their managers.

EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 11

Ref: Page 8, Comment 2: Allocation of direct operating costs based on plant costs

The evidence states that:

Since compression facilities tend to have relatively high maintenance costs compared to other storage plant, an allocation factor other than storage plant, such as compressor horsepower, would be a better allocator of compression O&M costs.

Please provide the basis for the above statement that “compression facilities tend to have relatively high maintenance costs compared to other storage plant”. Please provide the percentage if available.

Response:

The statement that compression facilities tend to have relatively high maintenance costs relative to other storage plant, such as wells and storage lines, is a general observation based on past experience with storage development projects and pipeline rate proceedings. The relative costs will depend on the specific circumstances, so there is not a specific percentage or factor. The reason for the recommendation is that the relationship between compressor O&M costs and compressor horsepower is likely to be closer than the relationship between compressor O&M costs and total storage plant.

EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff**Interrogatory 12****Ref: Page 10, 2nd paragraph**

The evidence states that:

To keep utility customers from unfairly subsidizing Union's non-utility storage operation, Union should provide an appropriate credit to the transmission cost of service for the use of utility transmission assets for non-utility storage transactions.

- a) Please provide any quantified information on the transmission cost of service used by non-utility transactions.
- b) Please provide the resulting implications on Union's storage cost allocation.

Response:

- a) As an example, if the Heritage and Jacob pools are found to use transmission facilities, the recommendation is that the utility cost of service would be credited based on the cost-based transportation rate for third-party storage operators defined in the M16 rate schedule. At current rates, the resulting credit to the utility cost of service for transportation services used by these two pools is estimated to be in the range of \$500,000 to \$1,000,000 per year.
- b) Requiring Union's non-utility storage operation to pay for the use of regulated transmission and distribution facilities would reduce the cost of service allocated to transportation services, but should have no implications for the allocation of storage costs.

EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 13

Ref: Page 10, E. Recommendations – Storage Cost Allocation #2

Recommendation number 2 states that:

Union should provide an annual report describing how the costs of each “hybrid” storage project placed in service during the previous year were allocated between the non-utility and utility plants.

- a) Please explain in detail what the “hybrid” storage project refers to.
- b) With respect to the “annual report” mentioned above, should it be an audited report? How should the annual report be used?

Response:

- a) “Hybrid” storage projects refers to projects that include both replacement plant and incremental plant (see response to Interrogatory 9).
- b) This report does not necessarily need to be an audited prior to filing. The purpose of this information is to verify that the capital costs for these projects have been correctly allocated between non-utility storage plant and utility storage plant, for use in the next cost of service rate proceeding. The benefits of an annual report are to allow Board Staff and other interested parties to review the allocation close to the point in time when the facilities are placed in service. The contents of these reports would be subject to further scrutiny in subsequent rate proceedings.

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EVIDENCE OF JOHN ROSENKRANZ ON BEHALF OF CME, FRPO, AND KITCHENER

Answer to Interrogatory from Board Staff

Interrogatory 14

Ref: Schedule 5, Line 11

Line 11 on Schedule 5 "Eliminate income tax on premium" of -2,764 was explained as a "Pro rata adjustment".

Please provide the detailed calculation of the -2,674 pro rata adjustment with applicable references.

Response:

The reduction in income tax was estimated by calculating the ratio of Income Tax to Return for 2010 (Schedule 4, Line 18 and Line 10), and applying this ratio to the change in the Return shown on Schedule 5, Line 10.

Calculation: $(8,215/16,262) \times 5,294 = 2,674$