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VIA RESS AND COURIER

Ms. Kirsten Walli
ONTARIO ENERGY BOARD
P.O. Box 2319, 27th Floor
2300 Yonge Street
Toronto, Ontario
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Dear Ms. Walli:

Re: EB-2011-0038: Union Gas Limited (Union) 2010 Earnings Sharing & Disposition of Deferral Accounts and Other Balances.

Comments of the Industrial Gas Users Association (IGUA).

IGUA submits these brief comments on two issues arising from this application. Both issues relate to the deductions that Union proposes to take from storage services revenues in deriving 2010 earnings available for sharing with ratepayers.

Union has proposed the following deductions from 2010 long-term storage services revenues in deriving the amount of earnings available for sharing:

1. Deduction of an amount calculated to return to Spectra, prior to earnings sharing, a 14.4 percent "hurdle rate" on new storage investments (i.e. storage investments made since the Board's November, 2007 decision in the NGEIR proceeding).

2. Deduction of an amount calculated to return to Spectra, prior to earnings sharing, a 14.4 percent 'hurdle rate" calculated on expenditures made by Spectra to acquire storage space from third parties (some related and some not).

IGUA submits that neither of these deductions is warranted.

Other intervenors have been very active on these issues in this proceeding, and the Board will no doubt receive extensive argument from these other parties. IGUA will confine itself to brief comment on each of these two proposed deductions.

IGUA is party to Minutes of Settlement related to cross-motions brought in this application by CME and Union. Those Minutes of Settlement, filed herein as Exhibit K1.2, effectively request the Board to determine the appropriateness of these two deductions *ab initio* in this application, for the purposes of determining sharing of 2010 earnings and regardless of the settlement of 2008 and 2009 earnings sharing applications which settlements subsumed such treatment.

Hurdle Rate Deduction from Revenues from Union Storage Assets

In considering the appropriateness of Union's proposal to deduct from 2010 revenues an amount calculated to return to Spectra a 14.4 percent hurdle rate of return on new (post-NGEIR) storage investments, the Board should have reference to the history of rate treatment of Union's storage business.

In 1997 the Board approved Union entering long-term storage contracts with ex-franchise customers at market based rates.[1] From 1997 through to the effective date of the NGEIR decision, Union's shareholder earned the Board approved rate of return on its storage assets, and revenues in excess of this level of return were credited (for the most part) to ratepayers.

In the NGEIR decision the Board determined that it would forebear from regulating Union's storage business. The effect of this decision was to remove Union's storage assets from regulated rate base and to remove the costs of operating and maintaining those assets from Union's cost of service. Union would no longer be confined to earning a regulated rate of return on these assets, and following a period of transition ratepayers would no longer have any claim to the revenues earned by these assets.

In respect of the transition of Union's storage business from regulated to unregulated status, the Board in its NGEIR decision determined that it *"would prefer to have a smooth transition away from the status quo rather than an abrupt change in rates"*[2]. The Board directed such transition in the following terms[3]:

> *The Board considered whether to require Union to record the margins on existing long-term contracts separately from the margins on new long-term contracts. Under this approach, ratepayers would be credited with 90% of the margins on existing contracts for the remaining term of those contracts. This approach conceptually has appeal but could give rise to ongoing implementation questions. For example, the Board might have to consider how contract re-negotiations or defaults by customers are to be treated. This level of complexity and potential ongoing review is unwarranted.*

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[1] EB-2005-0551 *Decision with Reasons*, November 7, 2006, page 100, first full paragraph.
[2] Ibid, page 105, second paragraph.
[3] Ibid, page 107, first two full paragraphs.

> *The Board has concluded that it should adopt a simpler phase-out mechanism that is a rough sort of "proxy" for the conceptual approach described above. The phase-out of the sharing of margins on Union's long-term storage transactions will take place over four years. The share accruing to Union will increase over that period to recognize that contracts will mature and a larger part of Union's total long-term margins will be generated by new transactions. For 2007, forecast margins (on long-term and short-term transactions) now included in the determination of Union's rates will remain unchanged. After 2007, Union's share of long-term margins will be as follows: 2008 – 25%, 2009 – 50%, 2010 – 75% and thereafter – 100%.*

Under the transition mechanism between the regulation of, and the forbearance from regulation of, Union's storage business, Union would receive an increasing share of long-term storage revenues. These revenues would provide Union's shareholder with the ability to earn a competitive return on new storage investments in exchange for the risk to be taken by Union's shareholder in new storage investments. The basic premise of the Board's decision to forebear was that Union's shareholder would assume the risk of new storage investment, and would reap any reward flowing from that investment.

Union's proposal to deduct sufficient revenues from long-term storage margins earned in 2010 to ensure that its shareholder meets a 14.4 percent internal investment hurdle rate, prior to the sharing of any earnings from Union's storage business, effectively shelters Union's shareholder from much of the risk of an unregulated storage business, while still allowing it to earn a significant reward from that business (in excess of 14.4 percent, given earnings available for sharing even following deduction of revenues up to the 14.4 percent hurdle rate). In effect, Union's proposal would require that ratepayers fund Union's unregulated storage business up to the internal unregulated business investment hurdle rate set by Union's shareholder, and then allow the shareholder to share in additional earnings above that internal investment hurdle rate.

Rather than the *"smooth transition away from the status quo"* intended by the Board, through application of the 4 year transition mechanism described in the NGEIR decision excerpts set out above, Union's proposal would result in the *"abrupt change in rates"* that the Board's transition proxy was intended to preclude. Union's shareholder's opportunity to earn a higher return on its storage business properly arises from Union's ability to price long-term storage services at market rates and to keep earnings from that business for itself, rather than returning them to ratepayers as in the past. The shareholder's opportunity to earn a competitive business rate of return is in exchange for assuming a competitive business degree of risk. Union's proposal for the last year of the Board directed transition period – 2010 - would shield its shareholder from much of this risk in 2010, while diverting to its shareholder much of the 2010 earnings benefit from the new storage assets.

In IGUA's submission this was not the Board's intention. It is the increasing proportion of long-term storage revenues retained by Union since 2008, layered on top of a Board approved ROE on those assets during the transition period, which compensates

Spectra for its investment risk related to new (post-NGEIR) storage facilities during the transition period. Union's proposal for 2010 represents a modification of the Board's directed transition approach that benefits Union's shareholder at the expense of Union's ratepayers, and should not be allowed.

Hurdle Rate Deduction from Revenues on Purchased Storage Space

Union purchases storage space from third parties, some related and some not, and uses this purchased storage space in the provision of market priced long-term storage services. This third party storage space is purchased at market price. Such market price includes a return on investment to the third party storage providers, to compensate them for their long-term investment risk in new storage facilities. To the extent that Spectra has an interest in such storage facilities (which it does in respect of some of the contracts in issue), Spectra earns a market-based return through the market price paid by Union for the use of such facilities, which return to Spectra is funded through regulated distribution rates.

There is little evidence on the record in this proceeding regarding the risk profile to Union of its commitments to third parties for the contracted storage space, as compared to the risk profile to Union for investment in its own storage facilities. It is self-evident; however, that purchasing storage space from a third party entails less risk than developing, owning and operating storage space directly. The reason that a business acquires use of an asset from another business rather than buying or building its own asset is precisely to reduce the acquirer's risk relative to the "build" option.

Ratepayers are already paying for the investment risk associated with purchased storage services through the market rate contract prices paid by Union to the third parties providing the storage space. Union proposes to recover, through diversion of earnings prior to derivation of earnings to be shared, additional "return on investment" in rates, even though Union's shareholder has not, in fact, made such investments or assumed the risks of such investments.

Such a deduction from long-term storage revenues available for sharing in 2010 should be disallowed.

Conclusion

For the purposes of calculating sharing of 2010 earnings, Union should be directed to:

1. apply the Board approved ROE to derivation of its revenues from long-term storage assets owned by Union; and

2. not apply any ROE on top of its expenses for storage space contracted from third parties.

Yours truly,

Cathy Galler

for: Ian A. Mondrow

c: Murray Newton (IGUA)
Chris Ripley (Union Gas Limited)
Crawford Smith (Torys LLP)
Lawrie Gluck (OEB Staff)
Intervenors of Record