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By electronic filing

October 3, 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

Please find attached the Written Argument of Canadian Manufacturers & Exporters ("CME").

Yours very truly,

Peter C.P. Thompson, Q.C.

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enclosure
c. Chris Ripley (Union)
Intervenors in EB-2011-0038
Kristi Sebalj (OEB)
Nancy Coulas (CME)

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EB-2011-0038

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

AND IN THE MATTER OF an application filed by Union Gas Limited for an order or orders amending or varying the rate or rates charged to customers as of October 1, 2011.

ARGUMENT OF CANADIAN MANUFACTURERS & EXPORTERS ("CME")

October 3, 2011

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I. INTRODUCTION

1. These submissions, on behalf of Canadian Manufacturers & Exporters ("CME"), have been organized under two (2) main topic headings, namely:

   i) Allocation of costs between regulated and unregulated storage operations; and

   ii) Margin calculations

2. The submissions with respect to storage issues that follows are informed by the assistance that counsel for CME have received from Messrs. Aiken, Gruenbauer, Quinn and Rosenkranz and their knowledge and experience with storage facilities and their operation. An understanding of matters related to storage facilities and their operation is essential to an appreciation of the issues that Union's proposals raise. Without assistance of this nature, it is very difficult for persons having little experience with storage facilities and their operation to fully appreciate either the complexity of the issues Union's proposals raise, or their deficiencies. Counsel for CME are indebted to these individuals for their perseverance in assuring that there is adequate information in the record to enable the Board to make an informed assessment of what we submit are a number of deficiencies in Union's proposals.

3. With respect to the assistance provided by Mr. Rosenkranz, we note that in his Argument-in-Chief, counsel for Union continues to criticize the qualifications of Mr. Rosenkranz.[1] We submit that this continuing criticism of Mr. Rosenkranz is inappropriate. The Board has already rejected Union's challenge to the qualifications of Mr. Rosenkranz. In rejecting Union's challenge to the evidence of Mr. Rosenkranz, the Board stated as follows:

> ***"We are informed by the conversation around the qualifications and they do go to weight. We have found that the evidence has been helpful and will assist the Board in making its determinations and***

[1] Transcript Volume 3, p.41, lines 22 to 28, and p.42, lines 19 to 21.

***therefore the Board will exercise its discretion and allow the evidence in.*"** (emphasis added) [2]

4. Having regard to this clear and unequivocal ruling, the continued attack on the qualifications of Mr. Rosenkranz is unwarranted. We submit that Mr. Rosenkranz's evidence is deserving of considerable weight. We submit that he was an exemplary witness. His oral testimony, and in particular, his responses to questions put by counsel for Union were clear and straightforward. He was courteous. Union's continuing criticisms of his expertise are without merit and should be rejected.

5. Another introductory point that we wish to emphasize is that when allocating costs between customer classes, it can be presumed that Union will take a balanced approach because its owner is indifferent to the outcomes of alternative allocations. However, this is not the situation that prevails when Union allocates costs between its regulated and unregulated storage operations. It cannot be presumed that Union will take a balanced approach when evaluating alternatives for allocating costs between utility ratepayers and the utility owner. It is much more likely to adopt an approach that favours its utility owner.[3] For this reason, the Board should be wary and should carefully scrutinize all proposals Union makes with respect to the allocation of costs between its regulated and unregulated storage operations.

6. A final point to be made by way of introduction pertains to our awareness of the drafts of Arguments that other ratepayer representatives plan to file. We have seen drafts of Arguments to be submitted on behalf of London Property Management Association ("LPMA"), Federation of Rental-housing Providers of Ontario ("FRPO"), City of Kitchener, and School Energy Coalition ("SEC"). While some duplication is inevitable, we have attempted to refrain from repeating points in their arguments with which we agree.

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[2] Transcript Volume 2, p.111, lines 14 to 20.
[3] See for eg. the "track record" discussed with Union witnesses at Transcript Volume 2, p.78, line 18 to p.80, line 25, and Tabs 2 and 3 of Exhibit K1.8.

II. ALLOCATION OF COSTS BETWEEN REGULATED AND UNREGULATED STORAGE OPERATIONS

A. Compatibility with NGEIR Decision and Avoidance of Cross-Subsidization

7. This subsection of our Argument is premised on the notion that the avoidance of cross-subsidization is a key ingredient of the Board's NGEIR Decision. Mr. Rosenkranz's analysis of Union's proposal was informed by this underlying principle.[4]

8. A primary concern is the question of whether the approach Union takes to the allocation of costs between its regulated and unregulated storage operations is compatible with one of the principle underlying concepts in the NGEIR Decision, namely that utility ratepayers should not cross-subsidize Union's unregulated storage operation.

9. It appears to be common ground that the starting point for an evaluation of the methods Union asks the Board to approve for allocating costs between its regulated and unregulated storage operations is the NGEIR Decision. The Decision in the NGEIR case was rendered in November 2006. Only one of the three members of the Board Panel that rendered the NGEIR Decision remains a Board member.[5]

10. In the NGEIR Decision, the Board found that all of Union's storage assets are operated on an integrated basis. It accepted that a cost allocation approach would be sufficient to separate Union's unregulated costs and revenues from its regulated costs and revenues for the purposes of determining Union's regulated rates.[6]

11. Union initially proposed a new cost study to determine the allocation of costs of storage between regulated and unregulated storage operations. However, in Argument, Union submitted that the Cost Study that it had completed in its 2007 case was adequate for the purpose of separating unregulated costs and revenues for regulatory rate-making purposes.

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[4] Transcript Volume 3, p.142, line 10 to p.143, line 18.
[5] Of the presiding Board members, only Vice-Chair Ms Chaplin remains as a member of the Board.
[6] EB-2005-0551 Natural Gas Electricity Interface Review, Decision with Reasons, November 7, 2006 ("NGEIR Decision") at pp.73 and 74.

12. The Board agreed with Union that the 2007 Cost Study was adequate for rate-making purposes. The Board also agreed that it was important to ensure that there is no cross-subsidization between regulated and unregulated storage operations. It is clear from the Decision that the Board Panel that rendered the NGEIR Decision envisaged that its findings with respect to the treatment of premiums on short-term storage services would dilute Union's incentive to use the cost allocation for the purposes of cross-subsidy. In this connection, the Board stated as follows:

> ***"We also conclude that Union's current cost allocation study is adequate for the purposes of separating the regulated and unregulated costs and revenues for ratemaking purposes. The Board agrees with the Board Hearing Team that it is important to ensure that there is no cross-subsidization between regulated and unregulated storage. However, the Board is content that with its findings on the treatment of the premium on short-term storage services (Chapter 7) Union will have little incentive to use the cost allocation for purposes of cross-subsidy."*** (emphasis added) [7]

13. The mechanism that the Board established in Chapter 7 of its Decision to deal with the premium on short-term storage services is what we characterize as an incentive/sharing mechanism applicable to asset optimization transactions that are supported by Union's total integrated physical storage assets.[8]

14. During the course of the NGEIR proceeding, there was little, if any, evidence about Union's use of integrated storage assets to support optimization transactions of a duration of two (2) years or greater. At the time of the NGEIR Decision, the transactional services that the integrated assets were capable of supporting were envisaged by the Board to be short-term.

15. At page 99 of the NGEIR Decision, the Board considers the short-term storage integrated asset optimization transactions in which Union and Enbridge Gas Distribution Inc. ("EGD") had engaged for several years to be equivalents.

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[7] NGEIR Decision at p.74.
[8] NGEIR Decision at pp.99 to 103.

16. The integrated physical assets used to facilitate these transactions can either be existing unused capacity or unused capacity that the storage operator creates. The transactional services supported by integrated physical assets encompass gas loans, resource optimization and encroachment services of the type described in the evidence in this proceeding. Union engages in these types of integrated asset optimization transactions for terms of two (2) years or more.

17. At page 101 of the NGEIR Decision, the Board noted that Union would determine its ability to execute an optimization transaction based on the amount of temporarily surplus space in the entire storage facility. The Board found that despite its decision to require Union to notionally divide its existing storage into two (2) pieces, it would not be possible to determine that any particular short-term asset optimization transaction physically utilizes space from either the "utility asset" or the "non-utility asset". The Board stated as follows:

> ***"As long as the utility and non-utility storage is operated as an integrated asset, it will not be possible to determine that any particular short-term transaction physically utilizes space from either the "utility asset" or the "non-utility asset." "*** (emphasis added) [9]

18. In establishing the revenue sharing mechanism applicable to optimization transactions supported by integrated assets, the Board stated as follows:

> ***"Given the impossibility of physically linking a short-term transaction to a specific slice of storage space, the Board considered other methods of determining the amount of storage margins that should accrue to Union's ratepayers. The Board has decided that the calculation should be based on how the costs of the storage facilities are split between the utility and non-utility businesses. Specifically, Union's revenues in any year from short-term storage transactions, less any incremental costs incurred by Union to earn those revenues, should be shared by Union and ratepayers in proportion to Union's allocation of rate base between utility and non-utility assets."*** (emphasis added) [10]

[9] NGEIR Decision at p.101.
[10] NGEIR Decision at pp.101 and 102.

19. The incentive feature of the sharing mechanism applicable to Union was determined to be 10% of the net revenues deemed to rise from the utility asset portion of the storage. With respect to this feature of the mechanism, the Board stated as follows:

> ***"With respect to Union, an argument might be made that an incentive is not necessary. Union will receive margins from short-term storage deals that are deemed to arise from the "non-utility" portion of its storage facilities. Thus, Union will already be motivated to maximize the revenues on all short-term transactions. The Board has decided, however, that it would be appropriate for Union and Enbridge to be treated consistently and to each receive 10% of the net revenues deemed to arise from the "utility asset" portion of storage."*** [11]

20. Based on the foregoing, we submit that when the Board expressed the view that it was satisfied that the mechanism that it established for the treatment of short-term storage services would provide Union with little incentive to use the cost allocation for the purposes of cross-subsidy, it had to be of the view that all integrated asset optimization transactions in which Union engaged would fall within the ambit of the short-term premiums account that was established in Chapter 7. We submit that the only way that the statement in the Decision to that effect has any validity is if premiums on <u>all</u> optimization transactions are shared in the manner that the Board established for short-term integrated asset optimization transactions.

21. The evidence in this case reveals that the treatment of the premium on short-term services is not diluting Union's incentive to use the cost allocation for the purposes of cross-subsidy. This is because the net revenues realized from all integrated asset optimization transactions are not benefiting the utility ratepayers and non-utility owner in proportion to their cost responsibility for the integrated physical assets that support the transactions. As a result of the evidence in this case, we are now aware that Union is treating a large portion of the asset optimization transactions in which it engages as falling outside the ambit of the short-term storage services sharing mechanism that the

[11] NGEIR Decision at p.103.

Board, in its NGEIR Decision, believed would dilute Union's incentive to use the cost allocation for the purposes of cross-subsidy.

22. Union has never questioned its obligation to optimize the use of its entire integrated assets to benefit both its utility and non-utility storage operations. Nor has Union ever questioned the NGEIR finding that utility and non-utility storage assets would continue to be operated as integrated assets. We submit that Union cannot reasonably question the NGEIR finding that it is impossible to distinguish whether any particular optimization transactions are supported solely by utility or solely by non-utility space. We submit that the concept that all optimization transactions are supported by the integrated physical assets cannot reasonably be questioned.

23. Union acknowledges that without the integrated physical assets, the optimization transactions in which it engages for a duration of two (2) or more years could not take place.[12] These optimization transactions are supported by the integrated physical assets in the same manner as those integrated physical assets support short-term transactions that fall within the ambit of the existing short-term storage services premium account mechanism.

24. At a conceptual level, the margins from these transactions should be treated exactly in the same manner as the NGEIR Decision treats margins on the optimization transactions that fall within the ambit of the short-term storage services incentive/net revenue sharing deferral account approach the Board established in its NGEIR Decision. The same integrated physical assets support both the short-term and longer-term optimization transactions. The costs of the integrated physical assets that support both types of optimization transactions are borne by both utility ratepayers and Union's non-utility storage operations. After deducting the storage owner incentive, utility ratepayers are conceptually entitled to a share of the net revenues associated with these

[12] Exhibit B3.60

transactions based on their proportion of storage Rate Base responsibility. Put another way, without a share of the net revenues from these transactions, utility ratepayers cross-subsidize Union's unregulated storage operations.

25. The evidence indicates that the volumes associated with these optimization transactions of a duration longer than two (2) years are substantial.[13] The net revenues in any year are, according to Union, positive, although Union claimed that it could not provide details of the revenues and costs associated with these transactions.[14] Costs are front-end loaded so that net revenues in years 2 and 3 of these types of optimization transactions will likely be substantially greater than they are in year 1.

26. We submit that as events have unfolded, a material cross-subsidy situation has emerged with respect to integrated asset optimization transactions that are of a duration of two (2) or more years. The failure of the incentive/sharing mechanism that the Board established in the NGEIR Decision to capture the net revenues of these optimization transactions needs to be remedied. Without a remedy, a material cross-subsidy in favour of the non-utility storage operation will persist.

27. In his pre-filed evidence, Mr. Rosenkranz proposed to remedy the cross-subsidy problem that has emerged by adding the space sold under the auspices of these optimization transactions to the space allocator used to support the one-time allocation of storage plant between utility and non-utility operations.[15] Union objects to the approach on the grounds that it is not compatible with the principle of cost causality.[16]

28. Another approach that we submit is compatible with cost causality and the no cross-subsidy concept upon which the NGEIR Decision is founded is to either establish a new deferral account to capture optimization transactions having a duration greater than two (2) years, or to broaden the short-term deferral account that the NGEIR Decision

[13] Exhibit B3.40.
[14] Transcript Volume 1, p.126, lines 25 to 28.
[15] Exhibit K2.4, p.4.
[16] Transcript Volume 3, p.48, line 6 to p.47, line 10.

established to capture short-term and all other integrated asset optimization transactions. In this way, the conceptual objectives of the NGEIR Decision will be restored. Union will continue to be obliged to optimize the use of its entire integrated storage assets and, after deduction of a storage owner incentive payment, net optimization revenues will be shared with utility ratepayers and Union's non-utility storage operation in proportion to the value of Rate Base allocated between the utility and non-utility storage operations.

29. We submit that the interpretation that Mr. Rosenkranz ascribes to the NGEIR Decision is correct and makes good sense when one accepts that the Board believed and intended that all integrated asset optimization transactions would be covered by the incentive/sharing deferral account mechanism that the Board established for short-term storage services premiums.[17]

30. The utility portion of integrated physical assets used to set utility rates fluctuates from year to year up to the in-franchise clawback capacity limit of 100 PJs. The balance of the assets over and above the in-franchise requirement are classified as non-utility assets for rate-making purposes. The difference between the utility portion and 100 PJs is the non-utility portion of storage assets that is subject to clawback.[18] We submit that the cap was intended as a clawback limit and not as a dividing line between utility and non-utility storage assets for cost allocation and utility rate-making purposes.

31. As long as in-franchise requirements fall below the clawback "cap", the balance of physically integrated assets are, for cost allocation purposes, to be classified as non-utility assets. The difference between the utility requirement and the clawback "cap" is to be used for asset optimization transactions which were initially envisaged to be for terms

[17] Mr. Rosenkranz discussed his interpretation of the NGEIR Decision at Transcript Volume 2, p.119, line 27 to p.125, line 6; p.135, line 11 to p.136, line 20; p.137, line 1 to p.144, line 15.
[18] See NGEIR Decision at pp.82 and 83 where the 100 PJs is characterized as a "reserve" and NGEIR Decision at pp.101 and 104 where the clawback cap is characterized as a "maximum" and a balance above utility needs in any particular year is characterized as "non-utility assets".

of less than two (2) years but, as we now know, involve transactions of terms of two (2) or more years. All asset optimization transactions are to be subject to the incentive sharing mechanism that the Board established for short-term premiums. Traditional long-term transactions that do not form part of a resource optimization transaction of a duration of two (2) or more years are non-utility transactions that accrue entirely to the exclusive benefit of Union's owner commencing in 2011 when the four (4) year transition period established by the NGEIR Decision expires.

32. We submit that what we have described in paragraphs 30 and 31 is what the NGEIR Panel intended in its Decision and is the manner in which the Decision ought to be interpreted.

33. In the scenario where all integrated asset optimization transactions are covered by one incentive/sharing deferral account mechanism of the type that the Board established for short-term premiums, fixed costs associated with the difference between in-franchise requirements in a particular year and the clawback "cap" of 100 PJs will be allocated to that account, along with any incremental variable costs Union incurs to facilitate any and all optimization transactions, including those that have a duration of two (2) years or more. After deduction of the 10% incentive, the net revenues will be shared between the utility and non-utility storage operations in proportion to their respective Rate Base responsibilities.

34. We submit that including all integrated asset optimization transactions within the ambit of the incentive sharing mechanism is the only way of achieving the Board's stated objective in the NGEIR Decision of diluting Union's incentive to use the cost allocation for the purposes of cross-subsidy. Any structuring of the cost allocation by Union to allow it to stream the benefits of any optimization transactions exclusively to its non-utility operations facilitates creates a cross-subsidy of the non-utility operations by utility ratepayers.

35. In this proceeding, Union purports to distinguish between resource optimization transactions and other optimization transactions of less than two (2) years supported by integrated assets. We submit that in purporting to make this distinction, Union disregards the findings made in the NGEIR Decision that it is impossible to determine the extent to which it is utility or non-utility physical assets that support optimization transactions. We submit that this finding precludes Union from asserting that integrated asset optimization transactions of a duration of two (2) years or greater are supported solely by non-utility assets. The finding in the NGEIR Decision prevails and, as it turns out, that finding is supported by the evidence contained in the undertaking response Union has provided to Mr. Quinn which discredits Union's contention that it never uses utility assets to support resource optimization transactions of a duration of two (2) years or greater.[19]

36. Based on the NGEIR Decision finding, it is impossible for Union to establish that resource optimization transactions are supported only by non-utility assets, just as it is impossible for it to demonstrate that short-term optimization transactions of a duration less than two (2) years are supported only by utility assets. The distinction Union purports to make is invalid. The NGEIR findings cannot be disregarded.

37. We now know that there are a large number of integrated asset optimization transactions taking place that have a duration of two (2) years or more. Ratepayers are deriving nothing from the net revenues produced by these transactions. We reiterate that this produces a material cross-subsidy that needs to be re-dressed.

38. We submit that the best way to deal with this material cross-subsidy problem on a prospective basis is the manner that is described in paragraph 28 of these submissions. We reiterate that the Board should direct Union, in its next case or on rebasing, to remedy the problem by either creating a new integrated asset optimization deferral account to capture integrated asset optimization transactions of a duration of two (2)

[19] Exhibit J2.2.

years or more on the same incentive/sharing terms that apply to the existing short-term deferral account. Alternatively, the Board could direct Union to enlarge the short-term premium deferral account so that it captures all short-term and other integrated asset optimization transactions, regardless of their duration. This, we submit, is the type of account that the NGEIR Panel believed it was creating when it established being the only type of account that operates to dilute Union's incentive to use the cost allocation for the purposes of cross-subsidy.

39. In summary, we submit that the absence of a deferral account that captures all integrated asset optimization transactions, regardless of their duration, is a major flaw in Union's current approach that needs to be corrected. The mechanism for correcting it is to create a new deferral account that will capture optimization transactions of a duration greater than two (2) years and upon rebasing, to merge that account with the short-term transaction account.

B. One-Time Separation of Plant Costs

(i) Use of the 2007 Cost Study to Determine the One-Time Separation of Plant Costs

40. We submit that the NGEIR Decision does not say that the EB-2005-0520 Cost Study methodology and allocation factors must be used for the one-time allocation of plant. Our interpretation is that the Board intended the 2007 Cost Study to be used for setting rates until the next rebasing, at which time, there would be a re-allocation of the pre-NGEIR legacy storage plant based on the amount of storage required by utility customers at that time.

41. The passages of the Board's NGEIR Decision that we submit lead to this conclusion are the passage at page 72 in the first full paragraph reciting the total Rate Base value of the integrated storage assets and the value of each of the components of that total allocated to regulated and unregulated storage operations; along with the findings at page 74 of the Decision where the Board concludes that:

> ***"... Union's current cost allocation study is adequate for the purposes of separating the regulated and unregulated costs and revenues for ratemaking purposes."*** (emphasis added)

As already noted, that finding and the related findings with respect to the avoidance of cross-subsidization are cross-referenced to the Board's findings on the treatment of the premium on short-term storage services in Chapter 7 of the Decision where the Board states as follows:

> ***"As indicated in Chapter 5, the allocation is currently 79/21 utility/non-utility. ... As and when Union requires more capacity for in-franchise needs (up to the 100 PJ cap) or adds storage capacity or enhances deliverability of its storage facilities, the cost allocation will presumably change. Once a revised cost allocation has been approved in a Union rates case, the basis on which margins on short-term storage transactions are shared will also change."*** [20]

We submit that, in combination, the only reasonable interpretation to apply to these passages is that the NGEIR Decision Panel expected that there would be an updated Cost Study on rebasing that would reallocate the pre-NGEIR legacy storage plant based on the amount of storage required by utility customers at that time.

42. However, if the Board agrees with Union that the 2007 Cost Study is to be used to determine the one-time allocation of plant at December 31, 2006, with that amount and other selected incremental information to be used to determine the plant balance on rebasing, then the question becomes how should the 2007 Cost Study be used to determine the one-time allocation of plant at December 31, 2006?

(ii) NGEIR Decision did not Combine Space and Deliverability to Allocate Plant Costs

43. The NGEIR Decision refers only to 100 PJs of space and says nothing about allocating plant based on deliverability. In the approach it proposes, Union combines space and deliverability to derive its allocation factor for the one-time allocation of plant costs at

[20] NGEIR Decision at p.102.

December 31, 2006. This reduces the amount of plant that would be allocated to non-utility storage operations using the space only allocator.[21]

44. Mr. Rosenkranz in his evidence viewed Union's approach of combining space and deliverability to produce a plant allocation factor as reasonable in the context of adjusting the space allocator to address the cross-subsidy issue pertaining to optimization transactions of a duration of two (2) years or more. The best approach to the optimization issue is as previously described in paragraphs 28 and 38 of this submission.

45. Moreover, Mr. Rosenkranz questions the deliverability data Union uses and there is a dispute with respect to the reliability of Union's delivery numbers, both in terms of physical amounts and utility requirements.[22] For example, we have never received a clear explanation from Union as to why the total delivery amount used for the EB-2005-0520 Cost Study was 2.36 PJs/day, even though the total deliverability of Union's underground storage pool was 2.56 PJs/day.[23]

46. Having regard to the unresolved disputes pertaining to Union's deliverability numbers and the fact that the NGEIR Decision only refers to space and says nothing about allocating plant based on deliverability, we submit that if the 2007 Cost Study is to apply to allocate plant, then the plant allocation factor should be derived from space only as it was in the NGEIR Decision. The plant allocation factor used in the NGEIR Decision based on space only should not be diluted by disputed deliverability numbers to produce a combined deliverability and space allocation factor that would reduce the amount of plant to be allocated to non-utility operations.

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[21] Exhibit K2.4 at p.3 referring to Union's space allocation factor of 40.2% and its deliverability factor of 35.2% to produce a final plant allocation factor of 37.7%.
[22] Exhibit K2.4 at pp.6 and 7 showing Mr. Rosenkranz's deliverability allocation factor of 40.4% compare to Union's factor of 35.2%.
[23] See Exhibit K1.9 at p.11 and the inadequate Interrogatory Response at Exhibit B3.64.

47. Having regard to the unresolved dispute with respect to Union's deliverability data, we submit that the appropriate approach is to adhere to the NGEIR approach to space allocation and not permit Union to dilute the space allocation factor that the NGEIR Decision applied by combining it with deliverability. If Union wishes to depart from the NGEIR Decision approach of using a space only allocation factor, then it can do so in its rebasing application on the basis of updated cost information but not before.

(iii) Union's Error in Calculating its Space Allocator

48. Union has erred in its calculation of its space allocator by basing the allocation on 101.5 PJs of utility storage space instead of the 100 PJs reserved for utility use at cost base rates by the NGEIR Decision.

49. On Exhibit B3.22, line 1, Union shows that the STORAGEXCESS allocator in the EB-2005-0520 Cost Study was based on total space of 154.0 PJs, an in-franchise requirement of 84.0 PJs, and an ex-franchise requirement of 70.0 PJs. Union explains that the 154.0 PJs excludes system integrity space and includes space deemed unavailable.

50. The NGEIR Decision was based on a 2007 utility requirement of 92.1 PJs, which included 9.7 PJs of system integrity space. Adjusting for the utility asset cap, the 100.0 PJs, minus 9.7 PJs of system integrity space, gives you a maximum cost-based utility storage requirement amount of 90.3 PJs. The corresponding non-utility amount is 154.0 PJs, minus 90.3 PJs, which equals 63.7 PJs. The result is a non-utility storage allocation factor of 41.4% (63.7 PJ/154.0 PJs).

51. Union's calculation is shown on EB-2010-0039, Exhibit A, Tab 4, Schedule 2, lines 4-6. Union uses the same 154.0 PJs of space, but calculates an adjusted ex-franchise amount of 62.1 PJs and in-franchise amount of 91.8 PJs. The result is a non-utility storage allocation factor of 40.2%. Union's error can be easily seen by adding the 9.7 PJs of system integrity space back to Union's utility storage amount of 91.8 PJs. The

result is 101.5 PJs, not the 100 PJs prescribed by the NGEIR Decision. The difference is 1.5 PJs of space deemed unavailable that was added to the in-franchise storage requirement in the EB-2005-0520 Cost Study. The Board should direct Union to correct its calculation and to allocate plant based on the non-utility space allocation factor of 41.4%.

C. Scope of the Cost Allocation Study to be Filed upon Rebasing

52. Union seeks rulings from the Board that will allow it to narrow the scope of the cost allocation study that it files to support its rebasing application. We submit that the Board should refrain from ruling on the scope of the study that is needed to support that application in advance of seeing the rebasing application.

53. As already noted, the NGEIR Decision envisages that an updated cost allocation study would be filed in Union's next rate case and that the study would be broad enough in scope to determine the total Rate Base value for the whole of Union's integrated storage assets and the proportions of that total that are to be allocated to regulated and non-regulated operations.[24] That updated notional Rate Base value for total integrated storage assets will then be used in determining the proportion of integrated physical assets that are used to support optimization transactions. The point is for the study to comply with the provisions of the NGEIR Decision, it must be broad enough in scope to encompass a traditional Rate Base presentation for Union's entire integrated storage assets. To achieve this, Union must continue to provide both the utility and the non-utility storage plant continuity exhibits.

54. The notion expressed by Ms Elliott in evidence that interested parties will not see total information pertaining to total integrated storage plant is incompatible with the Board's findings.[25] Rate Base information pertaining to the entire integrated storage assets is

[24] NGEIR Decision at p.102.
[25] Transcript Volume 1 at p.94, lines 12 to 27.

relevant to a determination of the Rate Base responsibility factors of the utility and non-utility operations, as well as for testing the reasonableness of the Rate Base costs allocated to the utility for rate-making purposes.

55. During her testimony, Ms Elliott indicated that the scope of the operating costs that will be included in the updated Cost Study will cover both regulated and unregulated operations.[26] With respect to O&M costs, it is important to show for each cost category:

(a) Total company,

(b) Total storage, and

(c) Total utility storage.

This is the only way one can determine how storage costs are being allocated between utility and non-utility operations.

56. The breadth of the Cost Study pertaining to both total integrated utility plant and total O&M costs should not be constrained. That is what Union is proposing and its proposal should be rejected.

57. The Board should refrain from ruling on Union's request to narrow the scope of the Study that is needed to support the rebasing application in advance of seeing that application. Nothing should be done to prejudice a proper testing of cost allocations on a rebasing application, particularly when the Black & Veatch[27] ("B&V") Report expresses reservations about the lack of transparency in Union's approach. At this stage, the Board ought to refrain from taking action that forecloses scrutiny of matters pertaining to cost allocation issues on rebasing.

[26] Transcript Volume 1 at p.93, lines 15 to p.94, line 8.
[27] See for eg. Exhibit B2.6 referring to a number of recommendations B&V made to address deficiency in the transparency of Union's approach.

D. Non-Utility Use of Transmission Assets

58. Union's witnesses accept as valid the concept that ratepayers should be compensated for non-utility use of transmission assets.[28] We can explore on rebasing the extent, if any, to which Union is failing to adhere to these concepts and is thereby creating a cross-subsidization situation that needs to be remedied.

III. MARGIN CALCULATIONS

A. Introduction

59. The issue is whether Union has correctly calculated the 2010 balances in Deferral Accounts 179-70 and 179-72. As a result of the Minutes of Settlement pertaining to CME and Union's Motions, these issues are to be decided on their merits and without reference to intervenor acceptance and Board clearance of 2008 and 2009 balances and regardless of what was said and/or understood by participants in the July 2010 Settlement Conference in EB-2010-0039.

60. The Minutes of Settlement, which are filed as Exhibit K1.2, confirm that settlement was achieved because intervenors agreed that they would neither directly nor indirectly seek any relief with respect to the storage deferral accounts 179-70 and 179-72 for the years 2008 and 2009. These deferral account balances for 2008 and 2009 were previously subject to Board orders in EB-2010-0039 and EB-2009-0052. In exchange for this concession, Union agreed to provide all the information requested in the CME Motion, and to withdraw the Union Motion that sought to file evidence on communications during the EB-2010-0039 Settlement Conference.

61. Paragraph 3 of the Minutes of Settlement precludes Union from relying on intervenor acceptance of the 2008 and 2009 deferral account balances to support an argument that the methods it used are correct:

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[28] Transcript Volume 1 at p.97, line 4 to p.99, line 10.

> ***"Union will not take the position that acceptance by the parties in the settlement agreement in EB-2010-0039 of the disposition of Deferral Account Nos. 179-70 or 179-72 precludes the parties from challenging the correctness of the methods used in EB-2009-0052 and EB-2010-0039 in determining the balances in Deferral Account Nos. 179-70 or 179-72 and will not take the position that the Board is precluded from approving in this application a different method of calculating the deferral account balances in those accounts in 2010."***

62. In addition, while requests for corrections are to be limited to Union's margin calculations for 2010 only, the Agreement specifically allows intervenors to examine upon and argue that the calculations made by Union in prior years were incorrect. Paragraph 4 of the Minutes of Settlement provide as follows:

> ***"Subject to paragraph 2 above, the parties will be at liberty to examine on the material filed by Union and to argue that the methods of calculation used by Union, in determining the balances in Deferral Account Nos. 179-70 or 179-72, in 2008 and 2009 were incorrect, and that a different method or methods should be used in calculating the deferral account balances in those accounts in 2010."***

63. Accordingly, while relief can only be sought for 2010, the correctness of the methods used by Union in calculating balances in 2008, 2009 and 2010 is expressly agreed by Union to remain a matter in issue in this proceeding.[29]

B. Long-Term Services Margin Calculations – Account 179-72

64. The issues with respect to the correctness of Union's calculation of the 2010 deferral account balance in Account 179-72 include the following questions:

(a) With respect to incremental investments, whether Union can deduct as items of cost a "deemed return" and related taxes in an amount that is greater than the Board-approved return allowance and related taxes, and,

(b) With respect to purchased services, whether Union can deduct as costs any amount over and above the amounts Union actually pays to acquire those purchased services.

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[29] See Transcript Volume 3 at p.4, lines 13 to 15 where counsel for Union incorrectly submits that the methodology followed by Union for calculating the amounts in these deferral accounts is not in dispute.

65. Mr. Aiken's thorough and able argument on behalf of LPMA with respect to each of these questions convincingly demonstrates that any return and related taxes on incremental investments, greater than the Board approved return, and any amounts over and above what Union actually pays for purchased services are not deductible items of actual cost to be used in the margin calculations. We adopt and support Mr. Aiken's submissions and will attempt to refrain from repeating them in this argument.

66. Like Mr. Aiken and others, we urge the Board to find that the deductions Union has made to revenues for a hurdle rate of return and related taxes on incremental investments and for a deemed return on purchased services over and above amounts actually paid to the service providers are not deductible costs.

67. To support our submissions on these points, we rely on the factors outlined below:

(a) The forbearance relief Union requested in the NGEIR proceeding and Union's acknowledgement that it was not seeking any guarantees with respect to the returns so that it could earn from unregulated storage investments;[30]

(b) The decisions following the NGEIR Decision that preclude Union from recovering anything other than actual costs recognized in the method used to calculate margins that was applied when the NGEIR Decision issued;[31]

(c) Union's acknowledgement that the changes that it made in its calculation of margins to include items of deemed return and related taxes derived from its internal hurdle rate of economic feasibility on both incremental assets and purchased services were not specified in advance in an application to the Board and were never specifically requested or approved by the Board;[32]

[30] Transcript Volume 2, p.54, lines 10 to 25; p.56, line 25 to p.59, line 15.
[31] These decisions are summarized by Mr. Aiken in his submissions.
[32] Exhibit B3.54 and Mr. Aiken's submissions on this point.

(d) Union's acknowledgement that a hurdle rate is an economic feasibility threshold and not an item of cost;[33]

- We readily accept that all businesses use a hurdle rate to evaluate the economic feasibility of proposed incremental investments. However, once a decision has been made to proceed with the investments, all risk associated with achieving the economic feasibility target is covered by the gross revenues realized less actual costs. Deemed costs are not a legitimate item of expense for an unregulated business enterprise.

(e) Union's acknowledgement that under regulation, return is only brought into account after the return has been approved by the regulator. An unapproved amount for return is not recoverable as a cost in a regulatory context;[34]

(f) Union's acknowledgement that items of deemed costs are not actual costs for accounting purposes;[35] and

(g) Union's acknowledgement that a return amount on purchased services (i.e. an amount over and above what is actually paid for those services) would not likely be claimed or allowed under the auspices of regulation.[36] There is no rational basis upon which such deemed returns can be justified as a cost of providing unregulated services.

68. Based on the foregoing, we submit that, in the absence of prior Board approval for the materially changed items that Union unilaterally deducted from storage revenues for the purposes of determining amounts allocable to ratepayers, the deductions it made for a hurdle rate of return on incremental investments and for a deemed return on purchased services were improper and incorrect. The improper and incorrect deductions made in 2008, 2009 and 2010 lead to an understatement of deferral account balances. The

[33] Transcript Volume 2, p.62, lines 6 to 12.
[34] Transcript Volume 2, p.55, line 20 to p.56, line 6.
[35] See City of Kitchener submissions on this point.
[36] See Mr. Aiken's submissions on this point and Transcript Volume 2, p.74, line 26 to p.77, line 13.

deductions are not compatible with the forbearance relief Union requested and was granted in the NGEIR Decision. They operate to provide a "guarantee" that Union expressly acknowledged it never sought. The deductions are not compatible with the method used to calculate margins that was applied when the NGEIR Decision issued and they are not in compliance with the Decisions rendered following the NGEIR Decision that precluded Union from recovering anything other than actual costs recognized in the margin calculation method that prevailed when the Decision was issued.

69. While the use of a hurdle rate of return to evaluate the economic feasibility of proposed incremental assessments is sound economic policy, there is no principled basis upon which an unregulated enterprise can deduct a deemed return derived from that hurdle rate as an item of cost incurred to generate gross revenues. Without prior Board approval, all risks associated with Union's decisions to invest in incremental storage assets and purchased services rested with Union's shareholder. There is no rational basis upon which deemed returns associated either with incremental investments or purchased services can be justified as an actual cost of providing unregulated services.

70. The information displayed at Tab 15 of Exhibit K1.8 has been updated to reflect the evidence provided by Union witnesses at the hearing.[37] The updated Schedule is attached. The incorrect deductions in 2008, 2009 and 2010 for unapproved return on incremental investments, unapproved return on purchased assets, and unapproved taxes total $4.437M in 2008, $10.820M in 2009, and $13.882M in 2010. The ratepayer share of the incorrect deductions in 2008, 2009 and 2010 is $3.328M, $5.410M and $3.471M respectively.

71. Having regard to the calculation errors in 2010, we calculate that the 2010 deferral account balance is incorrect by the amount of $3.471M. This amount measures the

[37] Transcript Volume 2, p.72, line 11 to p.74, line 25.

unapproved return on incremental investments as the difference between the Board approved and the hurdle rate of return utilized by Union, plus related taxes.

72. Technically, once the forbearance order issued, Union should not be able to deduct any return as an item of cost in connection with incremental investments when determining long-term storage service margin to be shared with ratepayers. Outside the ambit of regulation, "return" is not an item of actual cost as Union's witnesses acknowledge.[38] Nevertheless, we have limited the adjustment for an approved return on incremental investments to the difference between the Board approved return and Union's hurdle rate because the method of calculating margins that prevailed when the NGEIR Decision was rendered included Board approved return on the long-term storage assets.

73. If no return is allowed on incremental investments, then according to our calculation, the amount of the adjustment that is required to correct the 2010 deferral account balance in Account 179-72 increases from $3.471M to $4.990M.[39]

74. Excluding the cost shift described in the submissions that follow, the credit amount to the long-term storage services balance should be increased by at least $3.471M.

IV. SHORT-TERM DEFERRAL ACCOUNT 179-70

75. Our submissions with respect to this account relate to the appropriateness of the cross-charge. Our submissions with respect to the cross-charge are linked to the remedy we propose to alleviate the cross-subsidy problem created by Union's streaming of integrated asset optimization transaction revenues having a duration of two (2) years or more exclusively to its non-utility storage operations.

76. As already noted, we submit that this cross-subsidy problem needs to be remedied by introducing a mechanism that will operate to include all integrated asset optimization

[38] Transcript Volume 2, p.56, line 8 to p.57, line14.
[39] This amount is derived from the figures in Exhibit K1.4, Attachment 2, at lines 2 and 3 of $6.369M and $6.630M respectively; a total of $13.226M; plus gross-up for taxes at 50.5% of $6.701M, for a total of $19.990M. Twenty-five (25) percent of this amount is $4.990M.

transactions and net revenues realized from such activities under the umbrella of a deferral account that is analogous to the short-term services deferral account that the NGEIR Decision established. The sharing mechanism should be the same for all integrated asset optimization transactions, regardless of the duration of those transactions.

77. It should be common ground that based on the calculation methodology that was applied at the time the NGEIR Decision was rendered, any fixed costs associated with transactional services were allocated to the long-term services non-utility Deferral Account 179-72. From that starting point, we agree that the issue of whether the cost shift of $1.662M of fixed costs should be charged as an item of cost in the short-term deferral account turns on an interpretation of the NGEIR Decision.

78. As already noted, we believe that the NGEIR Decision Panel envisaged that its treatment of premiums in the short-term deferral account would capture the premiums from all optimization transactions supported by integrated physical assets. We reiterate that, in this case, there was no evidence in the NGEIR proceeding that Union engaged in asset optimization transactions would not fall within the ambit of the short-term services deferral account.

79. We agree that all fixed costs covering the difference between in-franchise requirements and the 100 PJs clawback cap should be charged to a deferral account that captures all optimization transactions, but only when all of those transactions are covered by an incentive/sharing deferral account mechanism.

80. What is apparent in this case is that the net revenues realized from all optimization transactions are not being captured in a deferral account. There are large volumes of optimization revenues that Union treats as long-term storage services revenues rather than integrated asset optimization revenues. Until all of the net revenues related to these optimization transactions are being shared, the cost shift that Union has implemented is

unfair. The cost shift of about $1.662M that Union has introduced should be reversed with the cost to remain a charge to Account 179-72 until such time as ratepayers receive their share of integrated asset optimization transaction net revenues that stem from transactions having a duration of two (2) years or more.

81. Reversing the cost shift until such time as the utility receives its share of integrated asset optimization transactions of a duration longer than two (2) years is an appropriate fairness measure. Fixed costs should not be charged to the deferral account created to cover all optimization transactions until the net revenues from all those transactions are being included within the ambit of that account. On fairness grounds, it is inappropriate to burden ratepayers with the cross-charge before they begin receiving their share of the integrated asset optimization net revenues that Union realizes from transactions having a duration of two (2) years or more. Until that happens, the cross-charge shift is unfair.

82. Reversing the cost shift of $1.662M adds an amount of $1.182M to the short-term deferral account balance and reduces the long-term deferral account balance by $416M, all as shown on the column for 2010 at lines 8 and 11 in the Schedule attached hereto.

83. In its Argument-in-Chief, Union postulates that if the cross-charge is reversed, then it will be empowered to use the difference between in-franchise requirements and the 100 PJs ex-franchise clawback cap to support traditional long-term services and thereby eliminate revenues to be recorded in the short-term deferral account.[40] The NGEIR Decision clearly recognizes Union's obligation to optimize both utility and non-utility assets. We reiterate that we are only proposing that the cross-charge reversal be sustained until such time as all integrated asset optimization transactions are covered under the auspices of a deferral account analogous to the mechanism that applies to short-term transactions. If Union did not continue to market short-term services in the end-state that we envisage, then it would not be discharging its obligation to optimize the

[40] Transcript Volume 3, p.33, line 10 to p.34, line 3.

storage that utility ratepayers are paying for in rates. We submit that Union's assertion of a right to appropriate this space for traditional long-term services is contrary to the concepts upon which the NGEIR Decision is based. We urge the Board to respond to Union's submissions by reiterating that the NGEIR Decision calls for that space to be used to support integrated asset optimization transactions that produce revenues to be shared between the utility and non-utility storage operations in proportion to their respective Rate Base responsibility.

84. The foregoing submission by Union is but another example of Union's failure to apply the conceptual findings that underpin the NGEIR Decision consistently. We submit that Union adheres to NGEIR concepts when it perceives that they will benefit its owner and disregards them when they do not.

V. ADHERENCE TO SETTLEMENT AGREEMENT re: CME and UNION MOTIONS

85. Our submissions in this proceeding are based on the premise that all parties, including Union, will continue to abide by the provisions of the Minutes of Settlement. As already noted, pursuant to these Minutes of Settlement, the issue pertaining to the correctness of Union's calculation of margins in 2008, 2009 and 2010 is to be decided without regard to intervenor acceptance of deferral account balances in 2008 and 2009, or discussions held during the Settlement Conference in 2010; with any corrections in the method of calculating margins to be limited to the amount calculated by Union for 2010 only.

86. During the course of his Argument-in-Chief, counsel for Union served notice that Union was reserving its right to revive its Cross-Motion for Leave to Adduce an Affidavit from Mr. Ripley pertaining to discussions that took place during the July 2010 Settlement Conference.[41] Mr. DeRose represented CME during this Settlement Conference.

[41] Transcript Volume 3, p.6, lines 3 to 8.

87. If Union proceeds with such a motion, then we assume that we will be allowed a full opportunity to respond. On the basis of this assumption, we merely summarize in this Argument the points that we will make in response to such a motion if it is brought.

88. That summary of points is as follows:

(a) Union cannot proceed with a motion to withdraw from the Minutes of Settlement without first obtaining leave from the Board to withdraw from the Settlement pursuant to the provisions of Rule 32.05 of the Board's *Rules of Practice and Procedure*;

(b) The reservation of rights to revive the Motion is premised by unsubstantiated assertions about the nature of intervenor cross-examinations to which it is impossible to respond;[42]

(c) The assertions about the nature of intervenor cross-examinations are premised on an interpretation of the Minutes of Settlement that is incorrect;[43]

(d) Counsel for Union improperly assumes that he has already been granted leave to refer to an affidavit which the Board has never seen and upon which there has been no cross-examination, and then compounds that impropriety by asserting what the contents of that affidavit will establish,[44] an assertion with which we strongly disagree.

89. At this stage, we do not propose to elaborate any further on each of these improprieties. We will provide further elaboration on each of these points only if Union attempts to revive its motion for leave to file the Ripley Affidavit. We are not asking the Board to do

[42] No objections were raised during the questioning of Union's witnesses and counsel makes no reference to the Transcript where the questioning he is concerned about occurred.
[43] Contrary to the assertions at Transcript Volume 3, p.5, at lines 18 and 20, there is no acknowledgement from intervenors in the Minutes of Settlement with respect to the adequacy of Union's disclosure during the July 2010 Settlement Conference or otherwise. Rather, the Minutes of Settlement referred to in para.61 of these submissions expressly preclude Union from relying on intervenor acceptance of 2008 and 2009 deferral account balances to support a contention that the calculations in those years were correct.
[44] Transcript Volume 3, p.5, lines 15 to 18.

anything with respect to these improprieties at this time. These matters will only become "live" if Union attempts to withdraw from the Settlement and revive its Motion.

90. We urge the Board to decide the issues in this proceeding in accordance with the provisions of the Minutes of Settlement and without being distracted by what we submit are improper, unsubstantiated and provocative accusations that counsel for Union makes in his Argument-in-Chief.

91. If Union seeks to revive its motion, then the right of intervenors to seek a correction of the 2010 deferral account balance in an amount that encompasses errors in deferral balance calculations in 2008 and 2009, as well as 2010, will concurrently revive. We reserve our right to seek such a one-time adjustment to the 2010 deferral account balance in the event Union seeks to withdraw from the provisions of the Settlement Agreement and to revive its Motion.

VI. CLEARANCE OF SSM AND LRAM DEFERRAL ACCOUNTS

92. CME has had the opportunity to review the SEC draft submissions on the appropriateness of the Board clearing the trued-up 2009 SSM and LRAM deferral account amounts, and the unaudited 2010 SSM and LRAM deferral account amounts. To this end, CME adopts and relies upon SEC's submissions.

93. Without limiting the forgoing, CME does not oppose the clearance of the trued-up 2009 SSM and LRAM deferral account amounts. These amounts were originally cleared, on an unaudited basis, in EB-2010-0039. CME notes that when the unaudited 2009 SSM and LRAM amounts were originally cleared, there were no known material disputes.

94. As set out in SEC's written argument, disagreements have arisen during the 2010 Evaluation and Audit Committee ("EAC") process. CME submits that the practice of clearing unaudited SSM and LRAM amounts should be limited to only those circumstances where, despite the fact that the audit is not complete, there is nevertheless general consensus among the EAC that the unaudited SSM and LRAM

amounts are materially correct. Conversely, where there exists disagreement within the EAC in respect of the unaudited SSM and LRAM amounts, then those deferral account balances should not be cleared without a full evidentiary record. That evidentiary record should include, at a minimum, a completed audit that is subject to the public scrutiny of a hearing process. For these reasons, CME agrees with SEC that Union should be directed to file a separate application, as soon as possible, for clearance of its 2010 LRAM and SSM balances based upon a full evidentiary record.

VII. COSTS

95. CME requests that it be awarded 100% of its reasonably incurred costs in connection with this matter, including the reasonably incurred costs pertaining to the retainer of Mr. Rosenkranz by CME, FRPO and the City of Kitchener.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 3rd day of October, 2011.

Peter C.P. Thompson, Q.C.
Vincent J. DeRose
Counsel for CME

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EB-2011-0038

REVISED

Estimate of Incorrect and Unauthorized Deductions made by Union Gas Limited in its Long-Term and Short-Term Storage Margin Calculations

Line #	Unauthorized Items	2008 $000	2009 $000	2010 $000	Total $000
1	Unapproved "Return" on Incremental Investments [1]	$778	$2,675	$2,594	$6,047
2	Unapproved "Return" on Purchased Assets [1]	$2,115	$4,406	$6,630	$13,151
3	Unapproved Taxes (lines 1 + 2 x 55.4% for 2008; 52.8% for 2009, and 50.5% for 2010) [1]	$1,544	$3,739	$4,658	$9,941
4		$4,437	$10,820	$13,882	$29,139
5	Ratepayer Percentage Share	75%	50%	25%	
6	Ratepayer Share	$3,328	$5,410	$3,471	$12,209
7	Unauthorized Cost Shift from Long-Term to Short-Term Margin Calculation [2]	$1,662	$1,662	$1,662	
8	Ratepayer Share of Unauthorized Cost Shift (line 5 x line 7)	$1,247	$831	$416	
9	Unauthorized Deductions less Reversal of Unauthorized Cost Shift (line 6 minus line 8)	$2,081	4,579	$3,055	$9,715
10	One Time Deferral Account Balance Adjustment to Account No. 179-72 to remedy Incorrect Calculations in prior years				$9,715
11	One Time Adjustment to Short-Term Balance to remedy Unauthorized Cost Shift from Long-Term to Short-Term Deferral Accounts (3 x $1,182 = $3,546) [3]	$1,182	$1,182	$1,182	$3,546
12	Total Short-Term and Long-Term Deferral Account Balance Corrections	$3,263	$5,761	$4,237	$13,261

[1] Ex.K1.4, Attachment 2
[2] Rosenkranz Evidence, page 11
[3] Ex.K2.2, Rosenkranz Schedule 5, revised line 28