uniongas
A Spectra Energy Company

October 13, 2011

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

Dear Ms. Walli:

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

Please find enclosed two copies of the Reply Argument of Union Gas Limited for the above noted proceeding.

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

Yours truly,

[Original signed by]

Chris Ripley
Manager, Regulatory Applications

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

Filed: 2011-10-13
EB-2011-0038

ONTARIO ENERGY BOARD

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

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

REPLY ARGUMENT OF UNION GAS LIMITED

A. OVERVIEW

1. This is Union's Reply Argument, which should be read in conjunction with Union's Argument in Chief. This Reply Argument responds to the submissions of Board Staff and intervenors.

2. Union remains of the view, as outlined in its Argument in Chief, that Union's cost allocation methodology should be approved, the storage-related deferral account balances and DSM-related accounts for 2010 should be approved and cleared, and the unabsorbed demand costs should be approved (subject to the minor correction noted below).

B. COST ALLOCATION

3. Union seeks approval of its cost allocation methodology to allocate costs between its regulated and unregulated operations. Board Staff supports Union's position that the allocation methodology should be approved (Board Staff Submission, p. 5). Other intervenors, notably CME, FRPO and the City of Kitchener, oppose the requested relief. In this regard, they complain about:

(a) an alleged cross-subsidy;

(b) the use of Union's 2007 Cost Study to determine the separation of the storage plant costs;

(c) the combination of storage space and deliverability to determine the storage space allocator;

(d) the calculation of the space deemed unavailable; and

(e) the cost allocation in the rebasing hearing.

4. Each of these complaints is addressed below. In addition, CME submits that it was inappropriate for Union, in its Argument in Chief, to question the qualifications of CME's witness on cost allocation, Mr. Rosenkranz (Argument of CME, para. 3). CME takes this position on the grounds that the Board ordered that Mr. Rosenkranz's evidence be admitted and that in doing so the Board "has already rejected" Union's challenge to his qualifications. This complaint mischaracterizes the Board's decision to admit Mr. Rosenkranz's evidence. While the Board allowed the evidence of Mr. Rosenkranz on cost allocation, it acknowledged that there was disagreement about his qualifications and confirmed that "the conversation around the qualifications" of Mr. Rosenkranz "go to weight" (Transcript Vol. 2, p.111, lines 11-16). The weight to be given to Mr. Rosenkranz's evidence is thus a question that is squarely before the Board and Union did not act inappropriately in submitting that Mr. Rosenkranz's lack of expertise on cost allocation issues was demonstrated on cross-examination, and that his evidence should be given little or no weight (Argument in Chief, Transcript Vol. 3, p. 41, lines 22-28). In particular, his evidence should be given little or no weight insofar as it, as Board Staff correctly submits, "does not appropriately interpret the Board's Decision in the NGEIR proceeding" (Board Staff Submission, p. 5) and fails to have regard to Board-approved principles of cost causality.

The Alleged Cross-Subsidy

5. CME, FRPO and the City of Kitchener filed the evidence of Mr. Rosenkranz in this proceeding. His evidence in relation to cost allocation focused in large part on the storage plant allocator (Ex. K2.4). It was his position that the allocator should be adjusted to reflect storage space created by Union as a result of optimization activities undertaken by Union in relation to its non-utility storage space.

6. Union responded to this position in its Argument in Chief. In brief, Mr. Rosenkranz's proposal is not grounded in, and in fact departs from, cost allocation principles, and in particular

the fundamental principle of cost causality (Argument in Chief, Transcript Vol. 3, p. 42, lines 4-16). Rather than respond to Union's argument or any of the authorities cited by Union, CME and others have effectively resiled from Mr. Rosenkranz's position. They now seek the creation of a deferral account which would track margins earned by Union on long-term storage transactions. As the City of Kitchener put it:

> Kitchener respectfully submits that the net benefits of resource optimization transactions, even under long-term transactions, should continue to be shared in some equitable fashion with ratepayers, <u>if</u> the integration of storage pools truly provides the optimization mechanism. In other words, the physical and operational integration of the storage pools should provide an enduring benefit for ratepayers (as it does for Union) rather than a transitory one under the NGEIR accounting separation model. (Submission of Kitchener, para. 21)

This is not so much an interpretation of the NGEIR Decision as it is an attempt to relitigate that decision to a different outcome well after the Board rejected a motion to vary the order and the Lieutenant Governor-in-Council rejected a petition in respect of it. It is the articulation of the policy position that, in Kitchener's view, ratepayers should continue to share the net benefits of resource optimization completed under long-term transactions.

7. Similarly, CME submits that the "failure" of the incentive/sharing mechanism that the Board established in the NGEIR Decision to capture the net revenues of optimization transactions allows Union to cross-subsidize its non-utility business, and that this "failure" needs to be remedied (Argument of CME, para. 26).

8. Cost allocation is about the allocation of costs. It is not, as Mr. Rosenkranz and CME suggest, about the distribution of benefits (Transcript Vol. 2, p. 126. lines 12-15). What CME characterizes as a cross-subsidy is better understood as not distributing benefits in a manner that CME considers equitable (Argument of CME, para. 26). Again, this is in essence an argument for departing from the principle of cost causality and is contrary to the NGEIR Decision. None of the intervenors, including CME, appears to suggest that resource optimization has fixed costs. As a result, there are no costs to allocate with respect to optimization. CME's submissions on the purported shortcomings of the NGEIR Decision are another instance of CME attempting, as

Mr. Rosenkranz did in his evidence on cost allocation, to engage in a cost allocation analysis that departs from the fundamental cost allocation principle of cost causality.

9. Fundamentally, CME's argument is flawed in that it is based on a misreading of the NGEIR Decision. At paragraphs 30 and 31 of its argument, CME describes first the premise of its proposed new deferral account and the account itself. As is apparent from these paragraphs, CME's submissions hinge on its view that, "the cap [100 PJ] 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" (Argument of CME, para. 30).

10. However, for the reasons outlined in its Argument in Chief, with which Board Staff agrees, CME's premise is wrong. Simply put, the NGEIR Decision reserved 100 PJ as a "utility asset" with the remainder classified as "non-utility". For example, the Board held at pages 82 and 83:

> The Board concludes that its determination that the storage market is competitive requires it to clearly delineate the portion of Union's storage business that will be exempt from rate regulation. […]
>
> The Board concludes that it would be inappropriate, however, to freeze the in-franchise allocation at the level proposed by Union [92.1 PJ]. Union's proposal implies that a distributor with an obligation to serve would be prepared to own, or to have under contract, only the amount of storage needed to serve in-franchise customers for just the next year. <u>In the Board's view, it is appropriate to allow for some additional growth in in-franchise needs when determining the "utility asset" portion of Union's current capacity.</u> […]
>
> The Board has determined that <u>Union should be required to reserve 100 PJ (approximately 95 Bcf)</u> of space at cost-based rates for in-franchise customers. [Emphasis added.]

11. In the process of attempting to relitigate NGEIR, CME and others further confuse the issues of physical and accounting separation and proceed on the further mistaken premise that utility assets are used to support optimization activities. As pointed out in Union's reply evidence and its Argument in Chief, the method that Union has applied consistently since 2007 is the allocation of storage plant based on physical space, and what is allocated are the costs associated with that physical space (K1.9, pp. 4-5, Argument in Chief, Transcript Vol. 3, p. 48,

lines 11-14). The confusion of physical and accounting separation is a continuation of the conceptual confusion reflected in Mr. Rosenkranz's approach of building optimization space into the calculation of Union's storage space. This approach is based on a departure from the principle of cost causality, results in the allocation of non-existent costs and is contrary to the evidence of how Union uses the space (Argument in Chief, Transcript Vol. 3, p. 48, line 23 - p. 50, line 12).

12. Further, the distinction between physical and accounting separation is not a new issue for the Board. The Board addressed the issue in NGEIR. The Board understood that Union operates its storage assets on an integrated basis. As it held in determining that an accounting separation of the two businesses was adequate: "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'" (NGEIR Decision, p. 101). The same is equally true of long-term transactions and Union has not suggested otherwise.

13. However, it is simply incorrect to assert, as CME does, that because Union's storage system operates on an integrated basis Union's optimization activities give rise to a cross-subsidy. They do not. On a planned basis, Union only optimizes the non-utility asset, i.e. the amount of storage space above 100 PJ. Union is able to keep track of the non-utility space by reference to its ex-franchise contracts throughout the injection season (Transcript, Vol. 2, pp. 8, line 6 - p.10, line 18).

14. LPMA, for its part, makes a related argument, asking the Board to consider whether gas loans undertaken in support of long-term storage contracts should be reclassified as short-term transactions (Submissions of LPMA, pp. 16-17). But, again, the focus of the argument is wrong. The proper focus, under NGEIR, should be on whether the transactions make use of the "utility" or "non-utility" asset, and the evidence is that it is the latter. In any event, the transactions are clearly "long-term" in that they form part of, and are a necessary prerequisite to, the multi-year contracts entered into by Union (Transcript, Vol. 1, p. 123, line 8 - p. 125, line 5). As Mr. Isherwood confirmed to LPMA:

> MR. AIKEN: […] So then my question is what you are really doing is you are -- through the gas loans or through the resource optimization, you are not only selling years 2 and 3, but you are advancing the contract by one year? [Emphasis added.]
>
> MR. ISHERWOOD: In essence, that's true.

15. Short-term transactions, on the other hand, are derived from the excess utility space, i.e., the difference between 100 PJ and in-franchise requirements. The gas loans identified by LPMA do not fit into this category (NGEIR Decision, p. 101).[1]

16. Ultimately, despite all the creative arguments advanced by CME and others, the NGEIR Decision is clear with respect to the treatment of margins on long-term transactions: subject to the phasing-out mechanism, margins earned on sales supplied by the non-utility asset accrue to Union.

> The Board has determined that storage space in excess of the amount made available at cost-based rates (which is to be capped at 100 PJ – see Chapter 6) can be considered a "non-utility" asset. This is the space that will support Union's long-term storage sales. The Board finds that profits from new long-term transactions should accrue entirely to Union, not to ratepayers. (NGEIR Decision, p. 104)

17. As a final matter, Union acknowledges that it did encroach on utility space to a small degree in 2009. It did not encroach at all in either 2008 or 2010. Nevertheless, in the interest of satisfying any residual concerns in respect of this issue, Union will undertake to file in future proceedings the information produced in response to undertaking J.2.2 to provide additional comfort to intervenors and the Board.

[1] LPMA also asks the Board to direct Union to confirm that its revenues in 2010 equal or exceed the cost of the gas loans undertaken in the year ($8 million). Union confirms that the revenues do exceed the costs. While Union does not track loan costs by specific long-term storage contract, Union compared the actual loan costs incurred ($8 million) to the same underlying storage quantity at the average long-term storage price by month in 2010. The result is revenues of approximately $17 million.

The Use of the 2007 Cost Study to determine the separation of storage plant costs

18. Union applied its 2007 cost allocation method, which was a forecast developed as part of its 2007 rate case, to 2006 actual plant balances. This was the result contemplated in NGEIR.

19. In Mr. Rosenkranz's opinion, Union should have used actual information from 2006 to redevelop the earlier developed allocation factors. CME submits that the only reasonable interpretation of certain passages of NGEIR is that the 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" (Argument of CME, paras. 40-41). Others adopt this position.

20. As Union submitted in Argument in Chief, that approach is contrary to cost allocation principles and is not supported by NGEIR (Argument in Chief, Transcript Vol. 3, p. 43, lines 7-18). As Mr. Feingold testified, the approach proposed by CME and its witness runs contrary to established cost allocation principles. As he explained, the use of actual figures goes to "the heart" of cost causality and may result in less stable allocation factors.

> MR. THOMPSON: Okay. Well, maybe I didn't state that question properly. But why wouldn't one use the actual information to derive the allocation factors? What's the problem with that?
>
> MR. FEINGOLD: The problem goes to the heart of what most appropriately captures the concept of cost causation. And as I tried to describe in my earlier response to you, Mr. Thompson, if an asset is being designed to accommodate a certain maximum capacity or a certain maximum daily requirement on the part of customers, that is really, in my mind and my opinion, the driver on how costs are incurred associated with that facility or that asset, and it's most closely aligned to the maximum requirements that customers have for using that, as opposed to a peak-day demand during a 12-month period that could be lower or somewhat higher, based on factors that are not associated with the cost causation characteristics of that fixed asset in the ground. (Transcript, Vol. 1, pp. 82-83)

21. In Union's submission, the arguments advanced are simply another attempt to avoid a straightforward application of cost allocation principles in a manner that runs contrary to NGEIR

and a line of Board decisions on this issue reviewed in Union's Argument in Chief (Argument in Chief, Transcript Vol. 3, p. 38, line 25 - p. 41, line 22).

22. The passage in NGEIR referred to by CME addresses the split, 79/21, used to share the margin on short-term transactions. This may, and likely will, change as Union constructs additional storage assets. However, this issue is unrelated to the question of whether the 2007 cost allocation study was adequate to effect the one-time split (NGEIR, pp. 101-102; Union Argument in Chief, Transcript Vol. 3, pp. 31, line 3 - 32, line 18).

Deliverability

23. CME questions the deliverability data used by Union. CME submits that if the 2007 Cost Study is used to allocate plant then the plant allocation factor should be derived from space only, and not space combined with deliverability (Argument of CME, paras. 43-47).

24. Union submits that storage services are provided through a combination of space and deliverability assets. The 2007 Cost Study uses both space and deliverability allocators to allocate storage costs to rate classes. It is therefore appropriate to use a combined allocator to separate utility and non-utility storage plant. Using the average of the allocators is a simplifying assumption that both Mr. Feingold and Mr. Rosenkranz stated was reasonable (Ex. K2.4, p. 7).

Space deemed unavailable

25. CME submits that Union has made an error in the calculation of its space allocator by basing the allocation on 101.5 PJ of utility storage space instead of the 100 PJ reserved for utility use at cost base rates (Argument of CME, para. 48).

26. Union submits that the allocation of space in the 2007 Cost Study was based on Union's official working capacity at the time and correctly included the 1.5 PJ as an in-franchise space requirement. The 2007 Cost Study was fully reviewed by intervenors and approved by the Board in Union's 2007 rate case (EB-2005-0520). Union's use of the Board-approved allocators per the 2007 Cost Study is appropriate for the separation of utility and non-utility costs. Consequently, no correction to the calculation is required. In any event, the impugned calculation is not relevant to any of the matters at issue on this Application.

Cost Allocation and Rebasing

27. CME, FRPO and the City of Kitchener all argue that Union should be required to file a further cost allocation study in its next rebasing hearing (Argument of CME, paras. 52-57, FRPO Reply Argument, p. 17 and Submission of Kitchener, para. 40).

28. It is important to understand the relief being sought by Union. It has asked for approval of the methodology used to effect the <u>one-time</u> separation of plant assets between Union's utility and non-utility businesses. Provided the Board agrees with Union and Board Staff's submission that the "utility asset" is fixed at 100 PJ there is no need for a second or subsequent separation. Further, as Union explained, all new storage assets will be directly assigned to the non-utility business, obviating the need for a further study. Union also explained in its Argument in Chief that for those utility costs which are based on an allocation of total company costs (e.g., storage replacement assets, O&M), Union intends to file that total company information, including the allocations between its regulated and unregulated business. See Tab 8 of the compendium filed for Union's Argument in Chief.

29. Rather than respond to Tab 8 and Union's proposal, CME, FRPO and the City of Kitchener raise unspecified and unsubstantiated concerns in support of an argument that the Board should deny the relief requested by Union. There is no merit to this position. Union's proposal will afford parties a full opportunity to test the costs ascribed to Union's utility business. There is no reason why Union should be required to prepare and file a study that can have no impact on the result of the rebasing hearing.

C. STORAGE DEFERRAL ACCOUNTS

30. Two storage-related deferral accounts are in issue in the proceeding: Short-Term Storage and Other Balancing Services (179-70) and Long-Term Peak Storage Services (179-72). At issue is the proper calculation of the amounts recorded in those accounts for 2010. All parties agree that no other years are in issue.

179-72: Long-Term Peak Storage Services

31. Account 179-72 includes revenues from High Deliverability Storage, T1 Deliverability Upstream Balancing, Downstream Balancing, Dehydration Service, Storage, Compression, C1

Long-Term, and Long-Term Peak Storage. The net margin for Long-Term Services is determined by deducting the costs incurred to provide the service from gross revenue (Ex. A, Tab 1, p. 6).

32. The credit balance in Account 179-72 at year end, and available for disposition to ratepayers by final order, is $8.652 million. It reflects the ratepayer portion of the deferred net margin or 25% in 2010 (as determined by the Board in the NGEIR proceeding) of the difference between:

(a) the actual revenue in excess of the costs to provide Long-Term Peak Storage Services, and

(b) the revenue forecast in excess of the costs to provide these services as approved by the Board in the EB-2005-0520 Rate Order (Ex. A, Tab 1, p. 6).[2]

33. The costs to provide Long-Term Peak Storage Services include, among other items, a return on equity, interest and income taxes (see, for example, Ex. B6.01, EB-2010-0039). What the intervenors and Board Staff principally challenge is Union's use of a "hurdle" rate in calculating the allowable return on equity in respect of storage-related assets acquired by Union to provide Long-Term Peak Storage Services subsequent to the Board's NGEIR Decision (the "Hurdle Rate").

34. The arguments made by the intervenors fall into three broad categories:

(a) the use of the Hurdle Rate is inconsistent with NGEIR and the Boards decisions in EB-2008-0034 and EB-2008-0157;

(b) absent prior Board approval, the Hurdle Rate should be denied; and

(c) the Hurdle Rate results in a shift in risk from Union to ratepayers.

Each of these criticisms is misplaced.

[2] At page 13 of its submission Board Staff asks Union to file a schedule reflecting its comments with respect to Account 179-72. While Union does not agree with Board Staff's comments, that schedule is attached. (Board Staff also refers to Account 179-70 although no changes have been proposed in its submission.)

The Hurdle Rate is consistent with NGEIR

35. In the NGEIR Decision, the Board found that storage investment is more akin to exploration and development and is riskier than other distribution activities (NGEIR Decision, p. 51). The result of this, as Mr. Isherwood testified, is that storage investment requires a higher rate of return than the Board-approved rate of return in order to go forward (Transcript Vol. 1, p. 114, line 23 - p. 115, line 3).

36. Some intervenors, most notably CME and LPMA, referring to the Board's decisions in EB-2008-0034 and EB-2008-0154, suggest that the Board determined that there could be no change in the calculation of actual net revenues (Submissions of LPMA, pp. 5-6). This is the primary argument advanced by LPMA. This argument misunderstands the Board's decisions in those cases. As CCC acknowledges:

> CCC submits that the Board's decisions in EB-2008-0034 and EB-2008-0154 do not finally resolve the question of how Union could calculate revenues and costs included in account 179-72. The decisions only apply to the calculation of the amounts in that account for 2007, and only dispose of one issue, namely whether Union must include revenues and expenses from both pre- and post-NGEIR Decision storage contracts. CCC submits that the Board must look at what Union has done in calculating the accounts in 2010 to decide whether doing so is consistent with the NGEIR Decision. (Written Argument of CCC, para. 21)

Union agrees with this submission. EB-2008-0034 and EB-2008-0154 do not speak to the issue of costs, which is the context in which the debate over the appropriateness of the Hurdle Rate arises. The use of the Hurdle Rate is not inconsistent with the NGEIR Decision for the reason advanced by LPMA.

37. Union disagrees, however, with CCC's submission that the use of the Hurdle Rate has the effect of shifting the risks associated with storage investments from Union to ratepayers in a manner that is inconsistent with the NGEIR Decision (Written Argument of CCC, para. 25). This issue is discussed further below. Union further submits that the use of the Hurdle Rate is not inconsistent with the NGEIR Decision for any other reason.

The Clearance of Deferral Accounts requires Board Approval, not Prior Board Approval

38. Board Staff puts this criticism succinctly:

> Board Staff notes that the NGEIR Decision does not explicitly approve the use of a ROE above the Board approved ROE. Board Staff is of the view that without Board approval of the use of a hurdle rate (in excess of the Board approved ROE), the hurdle rate is not allowable in the calculation of margin sharing. Therefore, Board staff submits that only the Board approved ROE should be applied to the incremental assets for the calculation of margin sharing in the Long-term Storage account. (Board Staff Submission, p. 12)

39. While Board Staff submits that ROE above the Board-approved rate requires Board approval, it does not follow from this submission that such approval should be denied when, as here, it is sought. Union is seeking Board approval to the disposition of Account 179-72 just as it has done in the past and as it is doing in respect of all the deferral accounts contained in its application. It is appropriate for the Board, therefore, to consider the issue. Indeed, IGUA, in its argument, concedes that the Minutes of Settlement entered into by parties invite the Board to consider the matter. That is precisely what Union is asking the Board to do.

40. Further, Board Staff's argument fundamentally disregards the fact that Union has twice brought forward the disposition of this account, calculated in the very manner proposed in this Application. In both instances the disposition was approved by the Board and, most recently, in EB-2010-0039 following a complete settlement agreement.

41. ***EB-2010-0039***. As it has done in this proceeding, in April of last year, Union applied to the Board for an order or orders amending or varying the rate or rates charged to customers as of October 1, 2010 to account for the final disposition of 2009 year-end deferral account balances and earnings sharing pursuant to Union's Board approved incentive regulation mechanism.

42. Among the deferral accounts at issue in the application was Account 179-72. The Board assigned docket EB-2010-0039 to Union's application.

43. At the same time, Union filed its prefiled evidence in support of its Application. On June 28, 2010, Union served and filed responses to interrogatories asked in respect of Union's prefiled evidence. This evidence is discussed further below at paragraph 57.

44. By Procedural Order No. 1 dated June 1, 2010 the Board scheduled a Settlement Conference to commence on July 26, 2010. The Settlement Conference was duly conveyed and took place over two days, July 26 and 27, 2010. The Settlement Conference resulted in a comprehensive settlement in that agreement was reached on all issues in the proceeding. With respect to Account 179-72, at #3, the parties specifically agreed to Union's proposed disposition of the account.

45. By Decision and Order dated August 10, 2010 the Board approved the Agreement without modification. On September 3, 2010 a final rate order was issued reflecting the term of the Agreement including the disposition of Account 179-72.

46. ***EB-2009-0052***. A year earlier a comparable process unfolded. Union brought an application to the Board for an order approving the final disposition of 2008 year-end deferral account balances. The Board assigned docket EB-2009-0052 to that proceeding.

47. The parties in that case were unable to reach an agreement with respect to Account 179-72 and the proper balance in the account was litigated before the Board. In the result, by Decision and Order dated August 6, 2009 the Board approved Union's proposed disposition of Account 179-72 (Decision and Order, EB-2009-0052, p. 5).

48. In this context, it is more than strange for parties to now suggest that some further Board action was required.

Risk

49. Union does not agree that the use of the Hurdle Rate shifts the risk from Union to ratepayers. CME submits "We readily accept that all businesses use a hurdle rate to evaluate the economic feasibility of proposed incremental investments" (Argument of CME, para. 67(d)). The effect of intervenors' submissions, however, would be to deny that underlying business reality.

50. If the responding arguments of the Board and the intervenors had guided the spending decisions of Union's shareholder, and if the Hurdle Rate had not been used in Union's decision-making process, Union would not have been able to build or buy as many storage-related assets as it has. In the result, ratepayers would be worse off. Board Staff and the intervenors seek to retain the benefits that have accrued from the spending decision made by Union's shareholder while attacking the use of the Hurdle Rate that made those decisions possible (Transcript, Vol. 1, p. 114, line 23 - p. 115, line 3; p. 116, line 19 - p. 117, line 1). This position ignores the reality of how Union's shareholder allocates resources.

51. Intervenors also argue that the Hurdle Rate should not be applied because, under the NGEIR Decision, Union bears the risk associated with non-utility asset storage transactions. While ultimately correct, this argument fails to have regard to the fact that during the sharing period, Union does not have full exposure to the market price and therefore would not be fully compensated for the risk it has undertaken absent the Hurdle Rate (Transcript, Vol. 2, p. 59, line 23 - p. 60, line 7).

Purchased Assets

52. The storage-related assets acquired after the NGEIR Decision are of two kinds: (i) incremental, i.e., "built" assets and (ii) purchased long-term storage contracts. The two are indistinguishable from one another, both functionally and in respect of Union's rate of return. Nonetheless, Board Staff and all of the intervenors object to the inclusion of any return with respect to post-NGEIR purchased assets, basically on the grounds that long-term storage contracts are not an asset (Board Staff Submission, p. 12; Final Argument of SEC, paras. 3.2.26-27; VECC Letter; Submission of Energy Probe, para.13; Argument of CME, para. 66; Submission of Kitchener, paras. 13, 16; Written Argument of CCC, para. 31; Submissions of LPMA, p. 5; Comments of IGUA, p.1, 4; FRPO Reply Argument, p. 16).

53. While the distinction between a built asset and a contract is a meaningful one in many contexts, from the perspective of the spending decisions made by Union's shareholder in this instance, it constitutes a distinction without a difference. The nature of this risk is inherent in long-term storage development, whether bought or built. As Mr. Isherwood testified, the issue of legal ownership, as opposed to contractual obligation, is simply not relevant to the nature of the

risk posed to Union's shareholder (Transcript Vol. 1, p. 158, line 25 - p. 159, line 13). LPMA's complaint respecting "phantom assets" misses the mark for the same reason (Submissions of LPMA, p. 6).

54. As CCC acknowledged in its submissions, there is an argument that Union's approach is consistent with what CCC calls a "component" of the NGEIR Decision, "namely that storage investments in a competitive market are riskier, and that Union's revenues should be commensurate with the assumption of those risks" (Written Argument of CCC, para. 25). Insofar as ratepayers have been garnering the considerable benefits that have attended on these open-market risks without risking capital, it is appropriate for ratepayers to cover part of Union's costs through the application of the Hurdle Rate.

Attack on the conduct of Union

55. The SEC and LPMA criticize Union's practice in respect of the disclosure of the Hurdle Rate. SEC puts the matter as follows:

> First, the Board should not be in a situation in 2011 that it is now hearing for the first time about the inclusion of this phantom cost in Union's revenue and margin calculations. In our view, companies regulated by this Board should be expected to provide the Board with all material information that could reasonably be expected to affect the Board's decisions. They should do so without being asked, and neither intervenors nor the Board should be required to "ferret out" the truth. There should be no "getting away with it" at this Board. If more utilities adopted a practice of habitual transparency, Board processes would get to the issues faster, and less time and money would be spent on the many interrogatories and other discovery processes. (para. 3.2.10)

The statement above and the implications contained in it are false and offensive. It is no answer for SEC, in the very next paragraph, to suggest that it is compliant with the Minutes of Settlement and is not seeking relief with respect to previous years.

56. SEC, LPMA and all parties were aware from the evidence in EB-2009-0052, EB-2009-0101 and EB-2010-0039 that Union's proposed calculation of the balance of Deferral Account No. 179-72 included the use of the Hurdle Rate. For example, in Ex. B6.01 (EB-2010-0039, at

Ex. K2.1, Tab 13 in this proceeding[3]), Union, in answer to an interrogatory from FRPO, indicated that in 2008 and 2009 Union calculated the "Return" using the "Weighted Average Rate" of 3.96% and 4.48% respectively. The Weighted Average Rate of 4.48%, for example, is the weighted average of the return on Union's storage-related assets in place at the time of the NGEIR decision at the Board-approved rate of 8.54% and the return on assets acquired subsequent to the NGEIR Decision at the Hurdle Rate. Expressed as a percentage, the Weighted Average Rate of return in 2009 was 4.48% after taking account of Union's overall capital structure of 36% equity. 4.48% equates to a 12.4% return (taking into account Union's equity level: 4.48% / 36% = 12.4%). As is apparent on the face of the document, and as SEC, LPMA and all parties knew, this rate was higher than the Board's approved rate.

57. It was obvious that the Weighted Average Rate included a return in excess of the Board rate. As explained above, the evidence plainly disclosed Union's use of the Weighted Average Rate (i.e. the Hurdle Rate) in calculating Union's allowable return. Further, as Union submits in respect of the amount in Account 179-72 available for disposition in respect of year end 2010, there is nothing improper about the use of that rate, nor is it inconsistent with the Board's NGEIR Decision. Quite the contrary.

58. The fact that Union was using the Hurdle Rate was apparent in Union's evidence in earlier proceedings and in answers to interrogatories asked by parties, including SEC and LPMA. There is no merit in SEC and LPMA's submission that Union's disclosures with respect to its use of the Hurdle Rate were "insufficiently transparent". The use of the Hurdle Rate was apparent on the face of the documents.

59. Pointedly, the wholly inaccurate suggestion by SEC and LPMA that they were not fully aware of the Hurdle Rate used by Union was precisely the submission Union sought to respond to in the Ripley Affidavit on Union's confidential motion. Having agreed to Minutes of Settlement, the result of which included the withdrawal of that affidavit, SEC and LPMA should not be permitted to lob inaccurate allegations of impropriety at Union safe in the knowledge that they are protected by the confidentiality attached to the information contained in the Ripley Affidavit. Parties should be discouraged from conduct of this sort.

[3] See also K2.1, Tab 11 (EB-2010-0039, Ex. J1.4) and Ex. K1.8, Tab 8 (EB-2010-0039, Ex. B1.02).

Account 179-70

60. Union seeks to clear the credit balance in Account 179-70. The balance at year end available for disposition to ratepayers by final order is $0.657 million (Ex. A, Tab 1, p. 5, lines 12-14). Board Staff supports Union in seeking this relief (Board Staff Submission, pp. 9-10).

61. The amount of $0.657 million reflects, among other things, a cost of $2.261 million that has been recorded in this account for 2010 (Ex. A, Tab 1, Schedule 6). As Board Staff notes, the cost amount of $2.261 million has been recorded in this account every year since the NGEIR decision (Board Staff Submission, p. 8). Nonetheless, in its responding argument CME, supported by certain intervenors, challenges the correctness of this cost amount for 2008, 2009 and 2010 (Argument of CME, paras. 63, 75, supported by SEC, VECC, Energy Probe, LPMA and FRPO). CME submits that $1.662 million of the 2010 amount constitutes a "cross-charge" from Union's ex-franchise business, with only the remaining $0.599 million being a legitimate expense of the utility business (Argument of CME, paras. 75-77).

62. This $0.599 million cost amount proposed by CME is the same cost amount that Union originally calculated as part of its 2007 Cost Allocation Study (Ex. B3.12; Argument in Chief, Transcript Vol. 3, p. 29, line 26 – p. 30, line 10). Union calculated costs of $0.599 million in its 2007 Cost Allocation Study on the basis of its forecast that Union would be able to sell approximately 2 PJ of storage space on a short-term basis. Union revised this forecast because the NGEIR Decision made it clear that the amount set aside as a utility asset for in-franchise customers (100 PJ) less actual in-franchise storage requirements (forecast at the time to be 92.1 PJ) would be available for sale on a short-term basis (7.9 PJ). Since the 7.9 PJ are a utility asset available for sale, Union included the cost of 7.9 PJ of storage space, i.e., $2.261 million, in Account 179-70, as Union has done in every year since the NGEIR Decision (Ex. B3.12; Argument in Chief, Transcript Vol. 3, p. 24, lines 7-9, p. 30, lines 11-24; Board Staff Submission, p. 8).

63. As Board Staff points out, the disagreement between Union and CME about the appropriate cost to be attributed to Account 179-70 reflects an underlying disagreement about the correct interpretation of the NGEIR Decision (Board Staff Submission, p. 8). As described above, Union submits that the utility asset is comprised of the entire 100 PJ amount and is not, as

CME argues, limited to the amount required in a given year for in-franchise customer needs (Argument in Chief, Transcript Vol. 3, p. 30, lines 11-15).

D. DSM-RELATED ACCOUNTS

64. The only DSM-related deferral accounts at issue in the responding submissions of Board Staff and the intervenors are Accounts No. 179-75 - Lost Revenue Adjustment Mechanism (the “LRAM Account”) and No. 179-115 - Shared Savings Mechanism (the “SSM Account”)(together, the “DSM-Related Accounts”).

65. SEC argues that the balances in the DSM-Related Accounts for 2010 should not be cleared on the basis of unaudited DSM results because of what SEC describes as (i) “problems with the selection of the auditor and the conduct of the audit” and (ii) Union’s failure to file certain evidence in this proceeding (Final Argument of SEC, para. 2.1.2). SEC also characterizes the balances in the DSM-Related Accounts for 2010 as “unsubstantiated” (Final Argument of SEC, para. 2.2.6).

66. In claiming that the DSM-Related Accounts for 2010 should not be cleared, SEC is proposing a departure from what is, as Board Staff points out, the common practice of the Board. The Board’s common practice is to dispose of unaudited DSM-related amounts in Union’s earnings sharing and deferral account disposition proceedings and then to true-up those amounts in the year immediately following based on the actual audited DSM results. While SEC describes this common practice as “pretty exceptional”, SEC has not provided the Board with any reason to depart from this common practice (Final Argument of SEC, para. 2.4.5).

67. SEC appears to complain that there is not adequate evidence on the record of what it calls “the nature of the dispute” between Union and the intervenors “with respect to the audit” (Final Argument of SEC, para. 2.3.3). SEC also complains that there is no evidence on the record to substantiate Union’s statement in its Argument in Chief that there is no “substantive concern” about the results of the 2010 audit (Final Argument of SEC, para. 2.3.4).

68. SEC’s complaints are without merit.

69. To the extent SEC has substantive concerns about the audit, SEC has kept those concerns to itself. SEC's substantive concerns, if they exist, have never been articulated in this proceeding and, as far as Union can discern, no evidence has been filed in respect of them, no interrogatories were asked about them and they were not even hinted at in cross-examination. SEC's unarticulated and unsubstantiated allusions to these "problems" do not provide the Board with a basis for departing from its common practice of disposing of unaudited DSM-related amounts in Union's earnings sharing and deferral account disposition proceedings.

70. SEC acknowledges that the intervenors can challenge the audit in next year's true-up proceeding, as has been the practice in years past. Nonetheless, the SEC submits that following the Board's common practice in this regard is problematic because (i) the evidence is fresh now, (ii) Union knows that the amount will be disputed at the true-up proceeding, and (iii) consideration of the audit will follow, rather than precede, the Board's consideration of audit and evaluation terms of reference going forward in the EB-2011-0327 proceeding (Final Argument of SEC, paras. 2.4.8-11). Union submits that (i) has always been true and has never caused the Board to alter its common practice, (ii) is not relevant and, if relevant, may in any event change between now and the true-up proceeding, and (iii) is not compelling because nothing prevents the SEC from leading relevant evidence in the EB-2011-0327 proceeding. None of these considerations make it problematic for the Board to adhere to its common practice.

E. UNABSORBED DEMAND COSTS

71. Union agrees with LPMA that interest on the incremental balance should be calculated from the date that the balances were created rather than the date on which the relevant adjusting entry was made (Submissions of LPMA, p. 3). Consequently, and in accordance with Union's response to Exhibit J1.1, the interest on the incremental balance should be in the amount of $44,805 rather than $7,250. Union notes that while it makes considerable efforts to ensure the accuracy of all of its submissions, it is part of the purpose of interrogatories to confirm the accuracy of submissions and to guard against errors. Union appreciates that the issue was raised and is satisfied that the full extent of the $37,555 error has now been identified and can be corrected.

F. OTHER ISSUES IDENTIFIED BY BOARD STAFF

72. In its argument, Board Staff raised several questions for response by Union. Specifically, Board Staff asked:

(a) Are any charges related to the provision of transportation service for Heritage Pool storage services being recorded for eventual disposition to in-franchise customers? If not, why not?

(b) In the scenario that the development of the Dawn Gateway Pipeline does not proceed and the sale of the St. Clair Line is never actually completed, please provide a discussion of the implications for in-franchise customers of moving the St. Clair Line back into rate base. Will in-franchise customers ever recover the revenues related to the provision of transportation service for non-utility storage operations during the current period (when the line is classified as a non-utility asset)? After the St. Clair Line is shifted back into rate base, will a charge be applied to non-utility storage services for the use of a utility transmission asset?

73. Union's responses to Board Staff's questions are as follows:

(a) There are no charges being recorded against the unregulated storage operations for the provision of transportation to the Heritage Pool. The St. Clair Line used to provide transportation service between Dawn and the Heritage Pool is currently classified as a non-utility asset. The cost of this pipeline is being deferred to be fully refunded to ratepayers; a further credit to ratepayers for the use of this line by the unregulated storage operations is not appropriate.

(b) The St. Clair Line was removed from utility rate base in 2009. The amount included in approved rates is being deferred to be refunded to ratepayers. For 2009 and 2010 earnings sharing there are no costs or revenues related to the St. Clair Line in utility operations.

In the scenario where the Dawn Gateway project does not proceed, and the St. Clair Line is returned to utility rate base, the unregulated storage operations will be charged for transportation between Dawn and the Heritage Pool with a corresponding revenue credited to the utility operations. In approving the closure to the St. Clair Line deferral accounts an adjustment could be made to reflect the impact of a charge for transportation from Dawn to the Heritage Pool on the calculation of the long-term storage deferral account and the offset to the earnings sharing calculation.

◦ In 2009, the ratepayer portion of the long-term storage deferral account was 50%. Any cost adjustment to the long-term storage deferral account calculation would be offset by an adjustment to utility revenue that was also subject to 50% sharing. The result would have no ratepayer impact.

◦ In 2010, the ratepayer portion of the long term storage deferral account was 25%. Any cost adjustment to the long term storage deferral account calculation would be partially offset by an adjustment to utility revenue subject to 50% sharing. The result would be a refund to ratepayers equal to 25% of the charge for transportation to the Heritage Pool.

◦ In 2011 and 2012, pursuant to the NGEIR Decision, there is no longer any sharing of the net revenue from long-term storage with ratepayers. The revenue from the transportation service from Dawn to the Heritage Pool would be included in utility earnings subject to sharing.

G. CONCLUSION AND REQUESTED RELIEF

74. For all of the reasons set out above and in its Argument in Chief, Union respectfully requests an Order for:

(a) approval of final balances for all 2010 deferral accounts and an order for final disposition of those balances;

(b) approval of the market transformation incentive for 2010 and an order for final disposition of the balance;

(c) approval of the impact of federal and provincial tax changes in 2009 and 2010 and an order for final disposition of the balances;

(d) approval of $3.433 million as the customer portion of earnings sharing in 2010 and the proposed disposition of that amount to Union’s customers; and,

(e) approval of its regulated and unregulated cost allocation methodology.

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2007 Board Approved vs. 2010 Actual
Long-Term Storage Services Account 179-72

Line No.	Particulars ($000's)	2007 Board Approved ($)	2007 Cost % of Total Revenue	2010 Actual (10^3M^3)	2010 Actual ($)	2010 Actual vs. Board Approved ($)	2010 Actual vs. Board Approved (%)	2010 Cost % of Total Revenue
		(a)	(b)	(c)	(d)	(e)	(f)	(g)
	Revenue							
1	Long-Term Peak Storage	42,058		5,546,837	87,166	45,108	107%	
2	T1 Deliverability and upstream balancing	-		61	1,825	1,825	100%	
3	Downstream Balancing	-		107	742	742	100%	
4	Dehydration Service	-		-	1,257	1,257	100%	
5	Storage Compression	-		-	772	772	100%	
6	High Deliverability Storage	-		920,717	20,179	20,179	100%	
7	Total Revenue	42,058		6,467,723	111,941	69,883	166%	
	Costs							
	Demand							
8	O&M	(5,969)	(14%)		(11,078)	(5,109)	86%	(10%)
9	Depreciation	(4,538)	(11%)		(8,645)	(4,107)	91%	(8%)
10	Property & Capital Tax	(932)	(2%)		(1,661)	(729)	78%	(1%)
11	Return	(3,317)	(8%)		(7,038) (2)	(3,721)	112%	(6%)
12	Interest	(4,838)	(12%)		(11,349)	(6,511)	135%	(10%)
13	Income Taxes	(108)	(0%)		(3,555)	(3,447)	3,192%	(3%)
14	Total Demand	(19,700)	(47%)		(43,326)	(23,626)	120%	(39%)
	Commodity							
15	O&M	(955)	(2%)		-	955	(100%)	0%
16	UFG	(4,177)	(10%)		(1,397)	2,780	(67%)	(1%)
17	Compressor Fuel (1)	(3,437)	(8%)		(2,643)	794	(23%)	(2%)
18	Customer Supplied Fuel	7,614	18%		5,322	(2,292)	(30%)	5%
19	Total Commodity	(955)	(2%)		1,282	2,237	(234%)	1%
20	Total Costs (line 14 + line 19)	(20,653)	(204%)		(42,044)	(21,389)	104%	(38%)
21	Net Revenue (line 7 + 20)	21,405			69,897	48,492	227%	62%
22	Deferral Sharing (2010 - 25%)					12,123		

Notes:
(1) Includes compressor fuel and third party storage costs.
(2) Removed incremental return and return on purchased assets.