Ontario Energy Board

Commission de l'énergie de l'Ontario

EB-2011-0038

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

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

BEFORE: Ken Quesnelle
Presiding Member

Cathy Spoel
Member

DECISION AND ORDER

Background

Union Gas Limited ("Union") filed an application dated April 18, 2011 with the Ontario Energy Board (the "Board") under section 36 of the *Ontario Energy Board Act, 1998*, S.O. c.15, Schedule B, for an order of the Board amending or varying the rate or rates charged to customers as of October 1, 2011 in connection with the sharing of 2010 earnings under the incentive rate mechanism approved by the Board as well as final disposition of 2010 year-end deferral account and other balances (the "Application").

The Application also requested approval for a cost allocation methodology to be used to allocate costs between Union's regulated and unregulated businesses. The Board has assigned file number EB-2011-0038 to the Application.

The Proceeding

A Notice of Application and Procedural Order No. 1 was issued on May 13, 2011, setting dates for interrogatories and responses to interrogatories. By letter dated June

14, 2011, the Federation of Rental-housing Provider of Ontario (“FRPO”), the Canadian Manufactures and Exporters (“CME”) and the City of Kitchener (“Kitchener”) (or the “Intervenor Group”) indicated that they intended to file intervenor evidence in this proceeding.

Procedural Order No. 2 was issued on June 17, 2011 setting out dates for supplemental interrogatories, intervenor evidence, interrogatories on intervenor evidence, responses to interrogatories on intervenor evidence, a Technical Conference, a Settlement Conference and a Settlement Proposal.

By letter dated August 9, 2011, Union advised the Board that the company and intervenors were unable to reach a settlement.

On August 15, 2011, CME filed a Notice of Motion (the “CME Motion”) for a Board Order requiring Union to provide the amount of a one time adjustment to the balance of Deferral Account No. 179-72 (Long-Term Peak Storage Services) to reflect corrections for Union’s use, in its calculations of deferral account balances for 2008, 2009 and 2010, of certain items that CME alleged were unauthorized and did not constitute “costs” of providing unregulated storage services. The CME Motion also requested an Order of the Board requiring Union to provide calculations of the Return on Equity it earned from its unregulated storage assets for 2008 and 2010 in a particular format.

Procedural Order No. 3 was issued on August 24, 2011, which set out the process for addressing the CME Motion.

On September 6, 2011, Union filed a Notice of Motion (the “Union Motion”) for a Board Order granting Union leave to file the affidavit of Chris Ripley sworn August 31, 2011 (the "Ripley Affidavit"), in response to the motion brought by CME. Union noted that the Ripley Affidavit includes information that is directly responsive to the allegations in the CME motion. Union noted that CME and other intervenors were aware of the method used by Union to calculate the amount recorded in Account 179-72 including the use of a "hurdle" rate in respect of storage related assets acquired by Union subsequent to the Board's NGEIR Decision to provide Long-Term Peak Storage Services. Union noted that granting leave to file the Ripley Affidavit would ensure a complete record before the Board upon which it can render a decision.

Procedural Order No. 4 was issued on September 8, 2011, which set out the process for addressing the Union Motion and set a date for the Oral Hearing.

On September 13, 2011, Union filed Minutes of Settlement relating to both the CME and Union Motions. The Minutes of Settlement stated that Union and CME had agreed to withdraw their respective motions on the following terms:

1. Union will file all of the information sought in the CME Motion;

2. The parties will not seek, directly or indirectly, any relief with respect to the Decisions of the Board in EB-2009-0052 and EB-2010-0039 regarding Deferral Account Nos. 179-70 or 179-72 or related thereto, including through a one-time adjustment to the balances in those accounts as contemplated by the CME Motion or otherwise;

3. 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;

4. Subject to paragraph 2 above, the parties will be at liberty to examine 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;

5. Subject to its right to contest the amount of costs claimed, Union agrees that it will not contest a claim for costs, by the CME or other parties, with respect to the time spent in dealing with the CME Motion and the Union Motion.

As agreed in the Minutes of Settlement, on September 15, 2011 Union filed the information requested in the CME Motion.

On September 19th to 21st 2011, the Board held a hearing in regards to all matters in this proceeding. On the morning of September 21, 2011 the Board heard the argument-in-chief of Union. At the hearing, the Board set out the schedule for the remaining procedural matters. Namely, the filing of argument by Board staff and intervenors and the filing of reply argument.

ALLOCATION OF COSTS BETWEEN UNION'S UTILITY AND NON-UTILITY STORAGE OPERATIONS

Background

In the EB-2010-0039 proceeding, there was a complete settlement regarding the allocation of costs between Union's regulated and unregulated storage operations. The effect of the settlement was to require Union to retain an independent cost allocation expert to study its allocation of costs between its regulated and unregulated storage operations.[1]

As required by the EB-2010-0039 Settlement Agreement, Union retained Russ Feingold of Black & Veatch as an expert on cost allocation matters. Mr. Feingold prepared a report entitled "Independent Review of the Accounting and Cost Allocation for Unregulated and Regulated Storage Operations" which is dated March 2011 and was filed by Union as part of its pre-filed evidence in the this proceeding.

The Intervenor Group filed intervenor evidence consisting of a report authored by John Rosenkranz entitled "Union Gas Storage Margins and Cost Allocation Proposal".

Both Mr. Feingold and Mr. Rosenkranz gave evidence at the hearing.

The Board has structured its consideration of the issues related to the allocation of costs between Union's utility and non-utility storage operations as follows:

1) Was it the Board's intent to implement a one-time allocation of plant between utility and non-utility on the basis of the 2007 Cost Study?

[1] See EB-2010-0039, Settlement Agreement.

2) If so, was the original one-time separation of Union's utility and non-utility businesses (implemented through the application of Union's 2007 Cost Study) effected appropriately?

WAS IT THE BOARD'S INTENT TO IMPLEMENT A ONE-TIME ALLOCATION OF PLANT BETWEEN UTILITY AND NON-UTILITY ON THE BASIS OF 2007 COST STUDY?

Position of Parties

CME submitted that the Natural Gas Electricity Interface Review ("NGEIR") Decision does not determine that the EB-2005-0520 Cost Study methodology and allocation factors must be used for the one-time allocation of plant. CME submitted that its 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.

CME's position is based on its reading of paragraph 1 on page 72 of the NGEIR Decision where 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 operation are discussed; along with the findings at page 74 of the NGEIR 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."[2]

CME noted that the above 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

[2] See EB-2005-0551, NGEIR Decision, p. 72.

> on which margins on short-term storage transactions are shared will also change.[3]

CME submitted that 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.

CME's position was supported by the London Property Management Association ("LPMA"), the Vulnerable Energy Consumers Coalition ("VECC"), the School Energy Coalition ("SEC"), FRPO, Kitchener, and Energy Probe.

Union noted that a number of the parties argue that Union should be required to file a further cost allocation study in its next rebasing hearing. Union also pointed to the relief that it is seeking. Union has asked for approval of the methodology used to effect the one-time separation of plant assets between Union's utility and non-utility businesses. Union submitted that provided the Board agrees with Union and Board staff's submission that the "utility asset" is fixed at 100 Petajoules ("PJs"), 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 submitted 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. Board staff supported Union's position.

Board Findings

The Board finds that the intent of the NGEIR Decision was to effect the one-time separation of plant assets between Union's utility and non-utility businesses. Therefore, there is no need for a subsequent separation (or the filing of another cost study).

The Board is of the view that the Board's intention in the NGEIR Decision was to set aside (or fix) 100 PJs of storage space as the utility asset. The Board's findings in this

[3] See EB-2005-0551, NGEIR Decision, p 102.

proceeding are based on the findings in the NGEIR Decision, where at page 83, the Board noted:

> The Board acknowledges that there is no single, completely objective way to decide how much should be reserved for future in-franchise needs. The Board has determined that Union should be required to reserve 100 PJ (approximately 95 Bcf) of space at cost-based rates for in-franchise customers.[4]

This passage is in the section of NGEIR Decision relating to the allocation of storage at cost-based rates. The passage cited above by CME is found in Chapter 7 of the NGEIR Decision which deals with the treatment of the premium on market-based storage transactions. Specifically, the passage relied on by CME is in the section dealing with the sharing of margins on short-term transactions. The Board notes that that issue is not related to the issue of whether the Board intended to implement a one-time allocation of plant between utility and non-utility on the basis of the 2007 Cost Study.

In making this finding, the Board is also guided by the text on page 101 of the NGEIR Decision where it refers back to the above passage on page 83 by stating:

> The Decision to require Union to notionally divide its existing storage into two pieces – "utility asset" (maximum of 100 PJ) and a "non-utility asset" (the balance of Union's capacity) is set out in Chapter 6.[5]

IF SO, WAS THE ORIGINAL ONE-TIME SEPARATION OF UNION'S UTILITY AND NON-UTILITY STORAGE BUSINESSES (IMPLEMENTED THROUGH THE APPLICATION OF UNION'S 2007 COST STUDY) EFFECTED APPROPRIATELY?

Position of Parties

Union provided evidence that it effected the one-time separation of its utility and non-utility businesses through the application of its 2007 cost allocation methodology. Mr. Feingold noted that "in my opinion the conceptual underpinnings and resulting or associated methodologies upon which Union's cost allocation process is based are well conceived, thorough and reasonable in their treatment of storage-related plants and expenses."[6] Mr. Feingold indicated that the conceptual underpinning of Union's

[4] See EB-2005-0551, NGEIR Decision, p. 83.
[5] See EB-2005-0551, Decision and Order at p. 101.
[6] See EB-2011-0038, Oral Hearing Transcripts Vol. 1, p 18.

utility/non-utility cost allocation methodology is the principle of cost causality, which he believes is a principle that the Board has consistently applied over the past number of years.

In its argument-in-chief, Union made note of the two main outstanding criticisms of Union's allocation of costs between its utility and non-utility storage operations brought forth by the intervenors and their cost allocation expert, Mr. Rosenkranz.[7]

First, Mr. Rosenkranz was of the opinion that the non-utility storage allocation factor should be based on the actual marketable storage capacity and deliverability at the time of the separation. Mr. Rosenkranz stated that Union's proposal to use cost allocation factors from its 2007 rate case causes a significant under-allocation of costs to Union's non-utility storage operation, and must be rejected.

Second, Mr. Rosenkranz indicated that resource optimization space should be included in the calculation of utility and non-utility storage allocation factors.

Union disagreed with Mr. Rosenkranz's assertion that the non-utility storage allocation factor should be based on the actual marketable storage capacity and deliverability at the time of separation (i.e. Union's 2007 Cost Allocation Study should have been redeveloped using actual 2006 information).

Union responded that Mr. Rosenkranz's suggestion is contrary to cost allocation principles. Union stated that actual events will change from year to year, as a result, primarily, of weather. Union noted that when determining cost allocation, as a fundamental principle you are attempting to reflect how particular systems were designed when they were built and assigning the related costs on that basis.

Union also noted that Mr. Rosenkranz's argument is inconsistent with the NGEIR Decision. Union asserted that on page 74 of that Decision, the Board concluded that Union's current cost allocation study (being the 2007 Cost Allocation Study) is adequate for the purposes of separating the regulated and unregulated costs and the revenues for ratemaking purposes.[8]

[7] See EB-2011-0038, Oral Hearing Transcripts Vol. 3, p. 42 onwards.
[8] See EB-2005-0551 Decision and Order at pg. 74.

Union provided the following counter-arguments[9] in response to Mr. Rosenkranz's argument that resource optimization space should be included in the calculation of utility vs. non-utility storage allocation factors.

Union first noted that this proposal is contrary to the principles of cost causality. It argued that resource optimization has no fixed costs and therefore, to allocate on the basis of space breaches the principle of cost causality. Also, Union stated that this proposal results in the allocation of non-existent costs. Finally, Union indicated that the proposal is inconsistent with how Union actually uses optimization space. Union only optimizes that portion of its storage capacity that is designated as non-utility.

CME took the position that if the 2007 Cost Study is to be used to implement the one-time separation of plant at December 31, 2006 then the plant allocation factor should be based on space only (as opposed to space and deliverability as proposed by Union).

CME submitted that the NGEIR Decision refers only to 100 PJs of space and says nothing about allocating plant based on deliverability. The approach proposed by Union (which derives the allocation factor for the one-time allocation of plant costs at December 31, 2006 using both space and deliverability) reduces the amount of plant that would be allocated to non-utility storage operations using the space only allocator.[10]

CME also submitted that 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.[11] For example, CME noted that it has 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.

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, CME submitted that if the 2007 Cost Study is to apply to allocate plant, then the plant allocation factor should be derived from space

[9] See EB-2011-0038, Oral Hearing Transcript Vol. 3, p. 48, line 28 to p. 52, line 25.
[10] See EB-2011-0038, Exhibit K2.4, p.3 which refers 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%.
[11] See EB-2011-0038, Exhibit K2.4, pp 6-7 showing Mr. Rosenkranz's deliverability allocation factor of 40.4% compare to Union's factor of 35.2%.

only as it was in the NGEIR Decision. CME submitted that 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.

In its reply argument, Union submitted 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.[12]

CME also asserted that Union 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.[13]

Union submitted 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 PJs 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. Therefore, Union submitted that no correction to the calculation is required.

CME was supported by LPMA, VECC, SEC, and Energy Probe with respect to the issues raised by CME above (namely, the use of space and deliverability in the calculation of the plant allocation factor and the error in the space allocator calculation),

FRPO and Kitchener submitted that there are major concerns with the methodology used by Union to effect the separation of plant as at December 31, 2006. Similar to the arguments noted in the previous section, FRPO and Kitchener submitted that a comprehensive review of Union's cost-allocation study should be made at the time of rebasing.

[12] See EB-2011-0038, Exhibit K2.4, p.7.
[13] See EB-2011-0038, CME Final Submission, pp. 15-16 for a full discussion of the error.

Kitchener also noted that Mr. Rosenkranz made several principal findings and recommendations as a result of his review of Union's cost allocation methodology and storage margin sharing calculations. Four of the findings relate to the allocation of costs to Union's non-utility storage operation.[14] Kitchener noted that it supports these recommendations, with some qualification around resource optimization and capital allocators, and submitted that the Board should adopt these recommendations in its findings in this proceeding.

Board Findings

The Board finds that Union has appropriately applied its 2007 Cost Allocation Study for the one-time separation of plant.

The Board notes that the non-utility storage allocation factor utilized by Union is in accordance with the NGEIR Decision. The Board's Decision in NGEIR stated at page 74, "We also conclude that Union's current cost allocation study is adequate for the purposes of separating the regulated and unregulated costs and the revenues for ratemaking purposes."[15]

The Board also notes that the fundamental premise upon which the non-utility storage allocation factor was developed is appropriate. Union's cost allocation methodology was formulated in a manner which reflects how particular systems were designed when they were built and assigns the related costs on that basis. Therefore, the Board does not agree with the position of Mr. Rosenkranz that the non-utility storage allocation factor should be based on the actual marketable storage capacity and deliverability at the time of the separation.

The Board also does not agree with CME's submissions regarding the use of space only as the plant allocation factor and the error regarding the calculation of the space allocator. The Board notes that the 2007 Cost Study was fully reviewed by intervenors and approved by the Board in Union's 2007 rate case (EB-2005-0520) and any issues or concerns should have been raised and addressed at that time.

[14] See EB-2011-0038, Exhibit K2.4, p. 1 for a summary of these findings.
[15] See EB-2005-0551, NGEIR Decision. p. 74.

The Board finds that no changes are necessary related to the one-time separation of Union's utility and non-utility storage businesses.

RESOURCE OPTIMIZATION

Background

Mr. Rosenkranz indicated that resource optimization space should be included in the calculation of utility and non-utility storage allocation factors.

Union noted that this proposal is contrary to the principles of cost causality citing that resource optimization has no fixed costs and therefore, to allocate on the basis of space breaches the principle of cost causality. Also, Union stated that this proposal results in the allocation of non-existent costs. Finally, Union argued that the proposal is inconsistent with how Union actually uses optimization space. Union's evidence is that it only optimizes that portion of its storage capacity that is designated as non-utility.

CME provided the following rationale for the sharing of resource optimization revenues with ratepayers.

CME noted that in the NGEIR Decision, the Board found that all of Union's storage assets are operated on an integrated basis. The Board 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. The Board noted that it was important to ensure that there is no cross-subsidization between regulated and unregulated storage operations.

CME submitted that it is clear 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-subsidization. CME pointed the Board to the following excerpt from the NGEIR Decision:

> 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.[16]

CME submitted that 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 years or greater. CME stated that 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.

CME noted that at page 101 of the NGEIR Decision, the Board stated that Union would determine its ability to execute an optimization transaction based on the amount of temporary 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 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".[17]

CME submitted 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 Storage account.

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

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[16] See EB-2005-0551, NGEIR Decision, p. 74.
[17] See EB-2005-0551, NGEIR Decision, pp. 101-103.

CME submitted that 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. Therefore, CME submitted that the concept that all optimization transactions are supported by the integrated physical assets cannot reasonably be questioned.

CME noted that 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 transactions based on their proportion of storage Rate Base responsibility.

CME stated 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. CME submitted that 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. CME was supported in this position by LPMA, VECC, SEC, FRPO, Kitchener, and Energy Probe.

CME, FRPO and Kitchener each submitted proposals for the sharing of resource optimization revenues with ratepayers.[18]

Union submitted that CME's argument is not valid. Union's position is that there is no failure of the incentive sharing mechanism (which the Board established in the NGEIR Decision to capture the net revenues of optimization transactions). Union noted that cost allocation is about the allocation of costs. It is not, as Mr. Rosenkranz and CME

[18] See EB-2011-0038, CME Final Submission, Para. 28; EB-2011-0038, FRPO Final Submission, p. 12; EB-2011-0038, Kitchener Final Submission, Para. 22.

suggest, about the distribution of benefits. Union believes that what CME has characterized as a cross-subsidy is better understood as not distributing benefits in a manner that CME considers equitable. Union submitted that this is in essence an argument for departing from the principle of cost causality and is contrary to the NGEIR Decision. Union noted that none of the intervenors, including CME, appear to suggest that resource optimization has fixed costs. As a result, there are no costs to allocate with respect to optimization.

Union argued that CME and its supporting parties 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. Union's reply evidence and its argument-in-chief both noted that 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. Union contends that 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.

Union submitted that it is 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. On a planned basis, Union only optimizes the non-utility asset, i.e. the amount of storage space above 100 PJs. Union is able to keep track of the non-utility space by reference to its ex-franchise contracts throughout the injection season.

Union did, however, acknowledge that it encroached on utility space to a small degree in 2009. It did not encroach at all in either 2008 or 2010.

Board Findings

The Board is not persuaded by the arguments of CME and the parties supporting its position. The Board is of the view that resource optimization space can not be included in the calculation of utility and non-utility storage allocation factors because there are no fixed costs to allocate. Therefore, any allocation of resource optimization space in the calculation would breach the principles of cost causality.

In regards to the argument put forth by CME and supporting parties that the revenues from *all* resource optimization activities should be shared with ratepayers, the Board disagrees. The Board finds that although Union's system is integrated, Union does plan its resource optimization activities around non-utility storage assets only. Union also tracks and records the use of non-utility space through analysis of its ex-franchise contracts throughout the injection season.

However, the Board does note that, in the past, Union has encroached on its utility space. The Board is of the view that the existence of Union's utility assets creates a situation where those assets effectively become an "insurance policy" in relation to Union's resource optimization activities on the non-utility side of its storage operations. Union's utility assets can act as a backstop on the rare occasions when Union oversells its non-utility storage space. The evidence suggests that the occurrence of this has been rare and it would be difficult to determine retrospectively to what degree, if any, Union relied on the existence of the utility assets in the conduct of its non-utility storage business to set contract terms and pricing.

The Board is of the view that there should be an ongoing monitoring of this potential encroachment so as to inform the Board as to the need to revisit this issue at a future date. The Board therefore finds that Union shall be required to monitor for and maintain records of all future encroachments and provide such information in its rebasing application.

TRANSPORTATION SERVICES FOR NON-UTILITY STORAGE OPERATIONS

Background

Board staff raised some concerns regarding the provision of transportation services for non-utility storage customers. Board staff submitted that when transportation for non-utility storage services is provided using assets connected to Union's Dawn operations a charge should be applied to reflect the use of utility assets. Union, in its evidence, agreed that if the asset is connected to Dawn operations through a transmission asset, there should be a charge for it.[19]

[19] See EB-2011-0038, Oral Hearing Transcripts, Vol. 1, p. 98, Lines 2-4.

Board staff noted that this issue only arises in relation to storage services provided by the Jacob and Heritage pools. There are no direct issues regarding the Jacob Pool however, as this storage pool is still under development.

Regarding the Heritage Pool, Union noted that this pool is connected through the St. Clair Line which is currently classified as a non-utility asset and therefore no utility charge is required.[20] Board staff submitted that although the St. Clair Line is not currently a utility asset it very well could be in the future (depending on Union's decision whether or not to proceed with the Dawn Gateway Pipeline project). Board staff asked two questions and requested that Union respond to them.[21] Union responded to these questions on Pages 20-21 of its Reply Submission.[22]

FRPO noted that the issue of the use of transmission assets to deliver integrated storage services was not addressed in NGEIR. Prior to the separation, Union's cost study would have provided the appropriate allocation of costs for transmission and ratepayers shared a greater portion of the benefits of the integrated pool. However, if non-utility asset additions place storage space remote from Dawn, such as the Jacob Pool, FRPO submitted that ratepayers should be compensated for the use of the transmission assets. While FRPO accepted that, at this time, the Heritage Pool's access to Dawn is being treated as a non-utility cost; there is evidence that it may not stay this way.

FRPO submitted that for the non-utility storage to have access to Dawn using utility assets is not only a cross-subsidization issue, but also is a competition issue which was part of the original reasons for the NGEIR proceeding.

FRPO submitted that there is insufficient evidence to ensure equitable treatment of ratepayers for the use of utility assets in the facilitation of non-utility services and requested that the Board direct Union to include evidence on this issue in the rebasing filing. In the interim, for any remote non-utility or purchased storage through an affiliate or third party, FRPO submitted that the Board ought to direct Union to ensure that rate M16 be applied.

Board Findings

[20] See EB-2011-0038, Oral Hearing Transcripts, Vol. 1, p. 98, Lines 10-12.
[21] See EB-2011-0038, Board staff Submission, pp.15-16.
[22] See EB-2011-0038, Union Reply Submission, pp.20-21.

The Board finds that there is not enough evidence in this proceeding to make a determination regarding the use of transportation services for non-utility storage operations. The Board directs Union to include sufficient evidence on this issue in its rebasing application for the Board to make a determination at that time.

DISPOSITION OF DEFERRAL ACCOUNTS AND OTHER BALANCES

ACCOUNT NO. 179-70 SHORT-TERM STORAGE AND OTHER BALANCING SERVICES

Background

The Short-Term Storage and Other Balancing Services deferral account ("Short-term Storage account") includes revenues from C1 Off-Peak Storage, Gas Loans, Enbridge LBA, Supplemental Balancing Services, C1 Short-Term Firm Peak Storage, and C1 Firm Short-Term Deliverability. The net margin for Short-Term Storage and Other Balancing Services is determined by deducting the costs incurred to provide service from the gross revenue.

The credit balance in the Short-term Storage account is $0.657 million. The balance is calculated by comparing the actual 2010 net margin for Short-Term Storage Services of $16.753 million to the net margin approved by the Board of $15.829 million in the EB-2007-0606 Rate Order. The result is a net deferral credit of $0.924 million. The net deferral margin is adjusted to reflect the 79% Utility portion (EB-2005-0551) and is to equal $0.730 million, of which 90% or $0.657 million is shared with ratepayers.[23]

A cost of $2.261 million has been recorded in this account for 2010. This is the same cost that has been recorded in the account every year since the NGEIR Decision. Mr. Rosenkranz has argued that the amount that should be recorded in the account as a cost is $0.599 million. Mr. Rosenkranz indicated that the additional $1.662 million in costs ($2.261 million - $0.599 million) should be shifted to Account No. 179-72 Long-Term Peak Storage Services (the "Long-term Storage account").[24]

This disagreement arises due to differing interpretations of the NGEIR Decision. Union is of the view that the entire 100 PJ amount is considered the utility asset, while Mr. Rosenkranz is of the view that the utility asset is only the amount that is actually required for in-franchise customer needs in a given year.

[23] See EB-2011-0038, Application / Ex. A / Tab 1, p. 5.
[24] See EB-2011-0038, Ex. K2.4, pp. 11-12.

Union noted that the $0.599 million cost is the cost that Union originally calculated as part of its 2007 Cost Allocation Study and this was based on a forecast of being able to sell approximately 2 PJs of storage space on a short-term basis. However, Union stated that the NGEIR Decision set out that the amount above in-franchise storage requirements (which at that time was forecasted to be 92.1 PJs) up to the maximum set aside for in-franchise customers (100 PJs) would be available for sale on a short-term basis. Therefore, Union has included as a cost in the Short-term Storage account the costs of 7.9 PJs (100 PJs – 92.1 PJs) of storage space.[25]

FRPO noted that the issue of the utility asset is an interpretative issue as recognized in dialogue with the Board panel.[26] FRPO submitted that the cross-charge was not ordered by the Board in the NGEIR Decision and Union's treatment adds costs to ratepayers when Union had agreed to a revised forecast as part of the EB-2005-0520 settlement. CME submitted that if the NGEIR Panel expected a transfer of the cost of the 7.9PJ's back to the deferral account, they would not have ordered that the margins be split by the 79/21 ratio.

CME noted that its submission with respect to the cross-charge is linked to the remedy it proposed 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.

CME submitted that this cross-subsidy problem needs to be remedied by introducing a mechanism that will operate to include all integrated asset optimization transactions and net revenues realized from such activities under the umbrella of a deferral account that is analogous to the Short-term Storage 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.

CME noted that any fixed costs associated with transactional services were allocated to the Long-term Storage account. From that starting point, CME agrees that the issue of whether the cost shift of $1.662 million 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.

[25] See EB-2011-0038, Oral Hearing Transcripts, Vol. 3, pp. 29-33.
[26] See EB-2011-0038, Oral Hearing Transcripts, Vol. 2, pp. 25-27.

CME believes that the NGEIR Decision Panel envisaged that its treatment of premiums in the Short-term Storage account would capture the premiums from all optimization transactions supported by integrated physical assets. CME noted that there was no evidence in the NGEIR proceeding that Union's resource optimization transactions would not fall within the ambit of the Short-term Storage account.

CME agrees that all fixed costs covering the difference between in-franchise requirements and the 100PJs 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. CME was supported in this position by LPMA, VECC, SEC, FRPO, Kitchener, and Energy Probe.

Union reiterated its position that the calculated costs of $0.599 million in its 2007 Cost Allocation Study was based on its original forecast that Union would only 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. 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 the Short-term Storage account, as Union has done in every year since the NGEIR Decision. Board staff supported Union's position.

Board Findings

As previously noted, the Board is of the view that the Board's intention in the NGEIR Decision was to set aside (or fix) 100PJs of storage space as the utility asset. The Board's findings in this proceeding are informed by the findings in the NGEIR Decision at page 83.[27]

The Board therefore finds that the entire cost amount (being $2.261 million) of the 7.9PJs of storage space (the amount of space available between the in-franchise requirements and the 100PJ cap) is allowable for inclusion in the margin sharing calculation in the Short-term Storage account. The Board notes that including only the $0.599 million amount as a cost in the Short-term Storage account results in in-franchise customers receiving margin sharing on the entire amount of sold short-term

[27] See EB-2005-0551, NGEIR Decision, p. 83.

storage above in-franchise customer needs (which has ranged from 87 PJs to 91.4 PJs in the 2007 – 2010 period) while only paying the costs on 2 PJs of that sold storage.

As previously discussed, the Board does not agree with the position of CME and the parties' supporting CME that all resource optimization related revenues should be included in the Short-term Storage account for sharing with ratepayers. Therefore, CME's rationale for removing the $1.662 million cross-charge is not relevant in the context of the Board's findings.

ACCOUNT NO. 179-72 LONG-TERM PEAK STORAGE SERVICES

Background

The Long-Term Peak Storage Services deferral account ("Long-term Storage account") includes revenues from High Deliverability Storage, T1 Deliverability Upstream Balancing, Downstream Balancing, Dehydration Service, Storage Compression, C1 Long-Term Storage, and Long-Term Peak Storage. The net margin for long-term storage services is determined by deducting the costs incurred to provide the service from gross revenue.

The balance in the Long-term Storage account reflects the ratepayer portion of the deferred margin or 25% of the difference between actual revenue in excess of the costs to provide long-term peak storage services and the revenue forecast in excess of the cost to provide these services as approved by the Board in the EB-2005-0520 Rate Order.

The credit balance in the Long-term Storage account of $8.652 million is 25% of the variance between the forecast of $21.405 million and the actual net revenues of $56.013 million.[28]

Some concerns were raised in regards to the calculation of the return component listed at Line 11 of the table provided at Exhibit B1.3. [29] There are two components of this return calculation: return calculated on incremental assets and return calculated on long-term storage contracts (Purchased assets).

[28] See EB-2011-0038 Application, Ex. A, Tab 1, pp. 5-6.
[29] See EB-2011-0038, IR Responses, Ex. B1.3.

Return Calculated on Incremental Assets

Incremental assets are storage assets built and operated by Union. Union applied what has been described in this hearing as the post-tax hurdle rate ("Hurdle Rate") to these assets. The Hurdle Rate is 14.4% which is higher than the Board approved return on equity ("ROE") of 8.54%.

LPMA, IGUA, CCC, VECC, SEC, CME, FRPO, Kitchener, Energy Probe and Board staff have all submitted that only the Board approved ROE should be allowed as a return related to incremental assets. The rationales provided by the various parties for this position fall into three broad categories:

1. The use of the Hurdle Rate is inconsistent with NGEIR and the Board's Decisions in EB-2008-0034 and EB-2008-0154;

2. Absent prior Board approval, the Hurdle Rate should be denied;

3. The Hurdle Rate results in a shift in risk from Union to ratepayers.

Submissions pertaining to: The use of the Hurdle Rate is Inconsistent with NGEIR and the Board's Decisions in EB-2008-0034 and EB-2008-0154

LPMA noted that as part of the EB-2008-0034 proceeding that dealt, in part, with the disposition of the 2007 balance in the Long-term Storage account, Union originally only included the revenues from existing storage and excluded the revenues from incremental storage. The Board's Decision and Order in the EB-2008-0034 proceeding stated that it did not agree with Union's interpretation of the NGEIR Decision and directed Union to include the revenues associated with all long-term storage transactions. In particular, the EB-2008-0034 Decision and Order stated at page 8:

> The Board finds that the NGEIR decision does not require or permit Union to modify the method of calculating the balance in account 179-72 for 2007. The balance should equal 75% of the excess of (i) actual net revenues (on all long-term storage transactions, that is, transactions that occurred both before and after the publication of the NGEIR decision) for 2007, less (ii) the Board-approved forecast net revenue $21.405 million.[30]

[30] See EB-2008-0034, Decision and Order, p. 8.

LPMA submitted that Union has consistently stated through interrogatory responses that there has been no change in the methodology to allocate costs to Union's unregulated storage activity from one year to the next. The response to Exhibit B5.2 in this proceeding indicated that there was no change from that used in EB-2010-0039. The response to Exhibit B7.02 in EB-2010-0039 confirmed that there was no change in methodology from that used in EB-2009-0052. In the response to Exhibit B5.2 in EB-2009-0052, Union confirmed that the actual net revenue had been calculated in compliance with the Board's EB-2008-0034 Decision. These interrogatory responses were included on pages 19 through 21 of the LPMA Cross-Examination Compendium which was filed as Exhibit K1.5.

LPMA submitted that Union has made significant changes in the calculation of actual net revenues between what it did in EB-2008-0034 for the 2007 account balances and the current proceeding for the 2010 account balances.

LPMA noted that Union has indicated that it has used the required return on equity on rate base for deferral account purposes and that this required return includes the Hurdle Rate.[31] In Exhibit B3.18 Union stated:

> The allocation of costs, including a required return on rate base investment that is calculated for deferral account disposition purposes, is consistent with the traditional revenue requirement calculation. This approach has always been used for deferral disposition purposes before and is consistent with the methodology used to cost storage services in the 2007 rate case, which was accepted by the Board in the NGEIR decision.[32]

LPMA noted that with respect to the required return used to cost storage services in the 2007 case, Union confirmed that it did not request and the Board did not approve a required return that was based on some assets earning a return on equity approved by the Board and some assets earning another level of return on equity.[33] LPMA noted that Union did, however, indicate that the methodology that includes the two returns has been used since the NGEIR Decision and that it has been included in the disposition of the deferral account since that point.[34]

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[31] See EB-2011-0038, Oral Hearing Transcripts, Volume 1, p. 139.
[32] See EB-2011-0038, Exhibit B3.18.
[33] See EB-2011-0038, Oral Hearing Transcripts, Volume 1, pp. 139-140.
[34] See EB-2011-0038, Oral Hearing Transcripts, Volume 1, p. 141.

LPMA observed that Union did not use the two returns (i.e. a Hurdle Rate) in the calculation of the margin sharing in the Long-term Storage account for the 2007 balances disposed of in the EB-2008-0034 proceeding even though this proceeding took place well after the NGEIR Decision of November, 2006. LPMA noted that this assumption is based on the clear statement from the Board, at Page 8 of the EB-2008-0034 Decision and order, that the NGEIR Decision "does not require or permit Union to modify the method of calculating the balance in account 179-72 for 2007".[35] Therefore, LPMA submitted that the inclusion of a Hurdle Rate is not consistent with prior Board Decisions (namely, EB-2008-0034, EB-2008-0154 and NGEIR).

Union noted that 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. Union submitted that this argument misunderstands the Board's Decisions in those cases. As CCC acknowledged:

> 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.[36]

Union agreed with this aspect of CCC's submission. Union noted that the EB-2008-0034 and EB-2008-0154 Decisions do not speak to the issue of costs, which is the context in which the debate over the appropriateness of the Hurdle Rate arises. Union submitted that the use of the Hurdle Rate is not inconsistent with the NGEIR Decision for the reason advanced by LPMA (or for any other reason).

Submissions pertaining to: Absent Prior Board approval, the Hurdle Rate Should Be Denied

[35] See EB-2008-0034, Decision and Order, p. 8.
[36] See EB-2011-0038, CCC Final Submission, para. 21.

Board staff submitted that the NGEIR Decision does not explicitly approve the use of a ROE above the Board approved ROE. Board staff was 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 submitted 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.

Union submitted that while Board staff is of the view that an ROE above the Board-approved rate requires Board approval, it does not follow from this position that such approval should be denied when it is being sought in this proceeding. Union noted that it is seeking Board approval for the disposition of the Long-term Storage account in this proceeding just as it has done in the past. Therefore, Union submitted that it is appropriate for the Board to consider the issue at this time.

Union also noted that 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 proceeding. In both instances the disposition was approved by the Board.[37]

Submissions pertaining to: The Hurdle Rate Results in a Shift in Risk from Union to Ratepayers

LPMA noted that Union indicated that the 8.5% Internal Rate of Return ("IRR") (which translates into the 14.4% Hurdle Rate defined previously) is the minimum threshold for the projects to at least go forward to be reviewed.[38] Union further indicated that projects above this minimum will not necessarily go forward. LPMA noted that Union has not provided any evidence as to what the expected IRR (or Hurdle Rate) is in relation to its unregulated storage investment. LPMA submitted that the expected IRR for the unregulated storage business could be well in excess of 8.5%.

LPMA submitted that the use of an IRR (or Hurdle Rate) is an appropriate tool for evaluating whether or not a project proceeds. However, it is not appropriate to use these rates for calculating margins in a deferral account. LPMA said that the use of the

[37] The cases that Union is referring to are EB-2009-0052 and EB-2010-0039.
[38] See EB-2011-0038, Oral Hearing Transcripts, Volume 1, p. 112.

Hurdle Rate on incremental assets implicitly shifts additional costs from the shareholder to ratepayers through the calculation of the margins to be shared.

LPMA noted that the NGEIR decision noted in several places that shareholders should bear the risk of new non-utility assets and that ratepayers will not bear the risks associated with these developments.[39]

LPMA submitted that the phase-out mechanism that the Board put in place in the NGEIR decision was to compensate Union for the risks of competing in the open market. LPMA indicated that this phase-out was a rough proxy for the conceptual approach discussed by the Board in the NGEIR Decision. The Board noted that the share accruing to Union would increase over the four year phase-out period to recognize that pre-NGEIR contracts would mature and a larger part of Union's total long-term margins would be generated by new transactions.
LPMA submitted that Union's proposal of using a Hurdle Rate effectively shifts the costs associated with the increased risk associated with the non-utility assets to ratepayers by reducing the margins to be shared with them. LPMA noted that this violates the intent of the NGEIR Decision which clearly indicated that the risks associated with new investments were to be borne by the utility and not by ratepayers.

For all of the reasons noted above, LPMA submitted that the Board should direct Union to remove the Hurdle Rate from the calculation of the return cost associated with incremental assets. LPMA noted that there is no reasonable justification to transfer return related costs associated with the unregulated assets to ratepayers in the calculation of the margin to be shared with them when the margin sharing proposed by the Board in the NGEIR Decision was a rough sort of "proxy" for the conceptual approach where the Board considered whether to require Union to record the margins on existing long-term contracts separately from the margins on new long-term contracts.

In its reply submission, Union did not agree that the use of the Hurdle Rate shifts the risk from Union to ratepayers. Union submitted that the effect of intervenors' submissions would be to deny an underlying business reality that 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. The result being that ratepayers would have been worse off.

[39] See EB-2005-0551, NGEIR Decision, pp. 4, 51, 54, 70.

Union submitted that 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. Union submitted that this position ignores the reality of how Union's shareholder allocates resources.

Union noted that the 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.

Return Calculated on Long-term Storage Contracts (Purchased Assets)

Long-term storage contracts (or purchased assets) refers to storage space that Union has acquired through long-term contracts. Union has also applied the Hurdle Rate of 14.4% to these contracts.

LPMA, IGUA, CCC, VECC, SEC, CME, FRPO, Kitchener, Energy Probe and Board staff have all submitted that no return should be allowed related to long-term storage contracts and that only the contract costs should be allowed in the margin calculation for the Long-term Storage account. The rationales of the various parties for this argument are similar to those discussed above related to the return calculated on incremental assets. The parties argued that the application of the Hurdle Rate to long-term storage contracts is not consistent with the NGEIR Decision (and other prior Board Decisions), that without prior Board approval the hurdle rate should be denied, and that it shifts risk from Union to the ratepayers.

An additional argument raised by intervenors and Board staff related to the return applied to long-term storage contracts is that long-term storage contracts are not an asset and therefore no return should be applied. Board staff framed the argument as follows.

Board staff noted that the long-term storage contracts discussed in this proceeding are no different from any other contracted service that Union retains. The rationale that Union provided for including an additional rate of return on long-term storage contracts

is that these long-term incremental storage contracts expose Union to significant market risks and therefore require additional protection translating to a higher return.[40] Board staff submitted that these are normal business risks voluntarily undertaken by companies in their day-to-day operations. If Union would not be able to sell this additional storage capacity, it would not enter into these contracts in the first place. Board staff submitted that regardless of the length of contract, contracted services (whether for general services or incremental storage space) do not attract a return as they are considered Operation & Maintenance ("OM&A") expenses. Contracted costs (which can also be described as operational expenses) can only be passed onto customers. Moreover, a number of these contracts are with related parties and this leads to a further increase in costs as the storage provider (related party) already includes the Spectra Energy hurdle rate as a cost and Union adds an additional rate of return on purchased assets as a cost item without incurring a capital expenditure.[41] Therefore, Board staff submitted that no return should be allowed to be applied to the long-term storage contracts (purchased assets).[42]

Union noted that 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, Union argued, is inherent in long-term storage development, whether bought or built. As Union 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.[43]

Union submitted that considering 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.

Board Findings

[40] See EB-2011-0038, Oral Hearing Transcripts, Vol. 1, pp. 115-116.
[41] See EB-2011-0038, Oral Hearing Transcripts, Vol. 2, pp. 75- 76.
[42] For related arguments from the intervenor groups see EB-2011-0038, SEC Final Submission, paras. 3.2.26-27; EB-2011-0038, CME Final Submission, para. 66; EB-2011-0038, Kitchener Final Submission, paras. 13 and 16; EB-2011-0038, CCC Final Submission, para. 31; EB-2011-0038, LPMA Final Submission, p. 5; EB-2011-0038, IGUA Final Submission, pp. 1 and 4; and EB-2011-0038, FRPO Final Submission, p.16.
[43] See EB-2011-0038, Oral Hearing Transcripts, Vol. 1 pp. 158-159.

The Board finds that only the Board-approved ROE can be used for the margin sharing calculation in the Long-term Storage account related to incremental assets and that no return can be included related to long-term storage contracts.

The Board has determined that the application of the Hurdle Rate unfairly shifts risk related to Union's non-utility storage operations from the shareholder to the ratepayer. The Board notes that the intent of the NGEIR Decision was clear that the risks associated with new investments were to be borne by the utility and not by ratepayers.

The Board relies on the following passages from the NGEIR Decision in making this finding.

At page 4 of the Executive Summary, the Board stated:

> ... Union will not be required to share the profits on long-term storage transactions that use storage space not needed to serve in-franchise needs because that capacity now constitutes a "non-utility" asset for which the shareholders appropriately bear the risk.[44]

At page 51:

> Under forbearance, the utility shareholders would be expected to bear the risk of any storage development for the competitive market.[45]

At page 54, the Board stated that:

> Ontario consumers will not bear the risks associated with these new developments.[46]

At page 70:

> The utilities will bear the risk of these investments, not ratepayers.[47]

Finally, with respect to the transition related to long-term margins, the Board stated, at page 106, that:

> Union should reap the benefits and bear the risks of those new transactions.[48]

[44] See EB-2005-0551, NGEIR Decision, p. 4.
[45] See EB-2005-0551, NGEIR Decision, p.51.
[46] See EB-2005-0551, NGEIR Decision, p.54.
[47] See EB-2005-0551, NGEIR Decision, p.70.

The Board notes that the phase-out mechanism that the Board put in place in the NGEIR decision was to compensate Union for the risks of competing in the open market. The Board finds that the application of a Hurdle Rate in the margin sharing calculation does in fact result in an inequitable shifting of risk from the shareholder to the ratepayer and that this risk has already been addressed through the established (phase-out) sharing mechanism.

Regarding the application of a return on long-term storage contracts, the Board finds that these storage contracts are not assets and should not be treated as such. The Board finds that contracted services (whether for general services or incremental storage space) do not attract a return as they are considered Operation & Maintenance ("OM&A") expenses. Contracted costs (which can also be described as operational expenses) can only be passed onto customers. Therefore, no return can be applied to long-term storage contracts.

The Board directs Union to file an updated margin sharing calculation for the Long-term Storage account that reflects the Board's findings on this matter.

ACCOUNT NO. 179-108 UNABSORBED DEMAND COST (UDC) VARIANCE ACCOUNT

Background

The balance in Account No. 179-108 Unabsorbed Demand Cost Variance Account (the "UDC account") is not prospectively recovered or refunded as part of the approved Quarterly Rate Adjustment Mechanism ("QRAM"). It has therefore been included in the current proceeding. The credit balance of $4.615 million in the UDC account is the difference between the actual UDC incurred by Union and the amount of UDC collected in rates.[49]

LPMA (supported by VECC) has raised an issue with regards to the disposition of the UDC balance. The issue relates to the correction that Union has made in the calculations for the 2007 through 2009 figures.[50] LPMA noted that the correction amounts to a credit of $1.931 million out of the total credit to ratepayers of $4.615

[48] See EB-2005-0551, NGEIR Decision, pp.106.
[49] See EB-2011-0038, Ex. A, Tab 1, pp. 2-4.
[50] See EB-2011-0038, Ex. B2.1 for an explanation of these corrections.

million. LPMA noted that it supports the correction and the associated rebate to customers, with the exception noted below.
LPMA noted that, as shown in the response to Exhibit J1.1, Union proposed to include interest in the amount of $7,250 associated with the correction that Union made to the calculations for the 2007 through 2009 figures. This interest amount was calculated based on the date of the adjusting entry of August, 2010.[51] LPMA noted that the undertaking response indicates that if interest had been calculated based on when the balances were created; the amount would have been $44,805, an increase in the amount to be refunded to ratepayers of $37,555.

LPMA submitted that the Board should direct Union to increase the interest on the balance related to the error to reflect the higher amount of $44,805. LPMA stated that there is no reason that ratepayers would be entitled to the interest only from the date that Union posted the correction to the account. LPMA stated that ratepayers are entitled to the credits that were created in 2007, 2008 and 2009 and that ratepayers did not receive these rebates because of the error made by Union.

In its reply submission, Union agreed 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. Union submitted that 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.

Board Findings

As agreed to by Union, the Board finds that the interest on the incremental balance should be in the amount of $44,805 rather than $7,250. The Board directs Union to file an updated UDC account balance for disposition in this proceeding.

DSM-Related Accounts
Account No.179-75 Lost Revenue Adjustment Mechanism ("LRAM") Deferral Account
Account No. 179-115 Shared Savings Mechanism ("SSM") Variance Account

[51] See EB-2011-0038, Undertaking J1.1.

Background

Account No. 179-75 Lost Revenue Adjustment Deferral Account (the "LRAM account)" has a debit balance of $2.384 million. This balance includes volume variances related to 2009 audited versus unaudited demand side management ("DSM") activities and the unaudited volumes related to 2010 DSM activities.[52]
Account No. 179-115 Shared Savings Mechanism Variance Account (the "SSM account") has a debit balance of $5.985 million consisting of a $6.156 million debit from 2010 DSM activity and a credit of $0.170 million related to the 2009 audit true-up to DSM activity in 2010. In accordance with previous Board-approved practice, Union has proposed to dispose of the recorded SSM balance related to unaudited 2010 DSM activities. Recognizing this balance may still change following the audit, any amount disposed of would be subject to a future true-up. Any true-up amount would be captured in the deferral account for future disposition.[53]

SEC (supported by VECC and CME) submitted that it is not appropriate for Union to recover the LRAM and SSM amounts from ratepayers at this time for the following reasons:

(1) Unlike previous years, for 2010 the intervenor members of its Evaluation and Audit Committee had problems with the selection of the auditor and the conduct of the audit.[54]

(2) Union had evidence available early in this proceeding that could have assisted the Board and the parties in assessing this claim, but failed to file that evidence.[55]

SEC requested that the Board find as follows:

(1) The 2010 LRAM and SSM claims are not supported by any evidence, despite the fact that evidence is available. The fact that the evidence is expected to be the subject of a known dispute is all the more reason that it should be filed.

[52] See EB-2011-0038, Ex. A, Tab. 1, pp. 7-8.
[53] See EB-2011-0038, Ex. A, Tab. 1, pp. 10-11.
[54] See EB-2011-0038, SEC Final Submission, p. 5.
[55] See EB-2011-0038, SEC Final Submission, p. 5-7.

(2) Union should be directed to file a separate application, as soon as possible, for clearance of its 2010 LRAM and SSM balances based on a full evidentiary record.

(3) The practice of clearing unaudited SSM and LRAM amounts should be limited to those circumstances in which:

(a) The audit cannot be made available during the proceeding for the deferral and variance account clearances, and

(b) There is no known material dispute about the amounts being proposed for clearance.

Union submitted that what SEC has proposed is a departure from what is the common practice of the Board. Union noted that 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. Board staff supported Union's position.

Board Findings

The Board notes that it has been a common practice of the Board to dispose of unaudited DSM-related amounts in Union's earnings sharing and deferral account disposition proceedings. The DSM-related amounts are then trued-up in the year immediately following based on the actual audited DSM results.

The Board understands SEC's concerns that there may be some issues with the proposed amounts (depending on the outcome of the final audit). The Board finds that the 2011 earnings sharing and deferral account disposition proceeding is the appropriate time to review the audited DSM results and parties can take any position on the audited results at that time.

The Board finds that the same process should be followed this year and therefore, it is appropriate to dispose of the unaudited DSM-related balances in this proceeding (which

will be subject to true-up in Union's 2011 earnings sharing and deferral account disposition proceeding) without any adjustments.

DISPOSITION OF OUTSTANDING DEFERRAL ACCOUNTS AND OTHER BALANCES

ACCOUNT NO. 179-26 DEFERRED CUSTOMER REBATES/CHARGES
ACCOUNT NO. 179-103 UNBUNDLED SERVICES UNAUTHORIZED STORAGE OVERRUN
ACCOUNT NO. 179-111 DEMAND SIDE MANAGEMENT VARIANCE ACCOUNT
ACCOUNT NO. 179-112 GAS DISTRIBUTION ACCESS RULE (GDAR) COSTS
ACCOUNT NO. 179-113 LATE PAYMENT PENALTY LITIGATION
ACCOUNT NO. 179-117 CARBON DIOXIDE OFFSET CREDITS
ACCOUNT NO. 179-118 AVERAGE USE PER CUSTOMER
ACCOUNT NO. 179-120 IFRS CONVERSION COST
ACCOUNT NO. 179-124 HARMONIZED SALES TAX
MARKET TRANSFORMATION INCENTIVE
FEDERAL AND PROVINCIAL TAX CHANGES
TAXABLE CAPITAL BASE CHANGES

Board Findings

The Board notes that no issues were raised regarding the above noted accounts and other items. Therefore, the Board finds that the proposed amounts (related to the above noted accounts and items) as listed in EB-2011-0038, Exhibit A, Schedule 1 are approved as filed.

EARNINGS SHARING MECHANISM

Background

The benchmark return on equity ("ROE") for 2010 was 8.54%. Union's actual ROE from utility operations in 2010 was 10.91% or 237 basis points above the 2010 benchmark ROE. This results in earnings sharing for 2010 of $3.433 million.

The actual ROE is compared to the ROE generated by applying the Board's approved ROE formula. If the difference between the actual ROE and the benchmark ROE is greater than 200 basis points but less than 300 basis points, the excess earnings are

shared 50/50 between Union and its ratepayers. For 2010, the difference is 237 basis points or $2.369 million, after tax. When grossed up for income taxes, the amount of the earnings sharing is $3.433 million. If the difference between the actual ROE and the benchmark ROE exceeded 300 basis points then that excess over 300 basis points would have been shared 90/10 to the benefit of ratepayers. This did not occur in 2010.

No parties raised any concerns regarding Union's ESM amount or calculation. A number of parties noted throughout the proceeding that the earnings sharing amount is subject to change if the Short-term and Long-term Storage Deferral Account balances are changed and if the Board approves revisions to Union's utility / non-utility cost allocation methodology.

Board Findings

The Board notes that no issues have been raised regarding Union's ESM calculation. The Board directs Union to file an updated ESM amount, if necessary, which reflects the Board's findings in this Decision.

ALLOCATION AND DISPOSITION OF 2010 BALANCES

Background

The allocation of 2010 deferral account balances, market transformation incentive and the 2010 Federal & Provincial tax change amounts to rate classes appears at Exhibit A, Tab 3, Schedule 1, Page 1. The allocation of 2010 earnings sharing amounts to rate classes appears at Exhibit A, Tab 3, Schedule 1, Page 2. With the exception of Account 179-124 Harmonized Sales Tax Deferral Account (the "HST account"), Union has indicated that the 2010 allocation proposals are consistent with the allocations approved by the Board in the EB-2010-0039 proceeding that dealt with the 2009 balances.[56] LPMA submitted that it supports the use of the allocations proposed by Union and previously approved by the Board for these accounts.

With respect to the HST account, Union noted that the allocation methodology to dispose of this account has not yet been approved by the Board and that it was requesting Board approval for the allocation proposal as part of this proceeding. Union's

[56] See EB-2011-0038, Exhibit B5.7.

proposal is outlined at in Exhibit A, Tab 3 and is based on use of three separate 2007 Board-approved allocators.[57] LPMA submitted that the approach proposed by Union is appropriate and should be approved by the Board for the HST account.

Board Findings

The Board finds that the proposed allocations of the 2010 balances are appropriate and are therefore approved.

IMPLEMENTATION

The Board directs Union to file a Draft Rate Order which reflects the Board's findings in this Decision. The Draft Rate Order must include working papers which provide:

- An updated margin sharing calculation for the Long-term Storage account which reflects the Board's findings on this matter;
- An updated UDC account balance which reflects the Board's findings on this matter; and
- An updated ESM amount, if necessary, which reflects the Board's findings in this Decision.

Once the Draft Rate Order has been filed and all parties have had the opportunity to comment on it, the Board will issue a subsequent Decision and Rate Order which will dispose of the 2010 balances on a final basis. Based on current timing, the Board will seek to have the resulting rate impact of this Decision implemented on April 1, 2012 to align with other rate changes expected to result from the Quarterly Rate Adjustment Mechanism ("QRAM") proceeding. The process for cost claims will also be set out in the subsequent Decision and Rate Order.

THE BOARD THEREFORE ORDERS THAT:

1. Union shall file the Draft Rate Order with the Board no later than February 3, 2012.

2. Board staff and intervenors who wish to file comments on the Draft Rate Order shall do so no later than February 10, 2012.

[57] See EB-2011-0038, Exhibit A, Tab 3, pp.5-6.

3. Union shall file responses to the comments of Board staff and intervenors no later than February 17, 2012.

All filings to the Board must quote file number EB-2011-0038, be made through the Board's web portal at www.errr.ontarioenergyboard.ca, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Please use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.ontarioenergyboard.ca. If the web portal is not available you may email your document to the BoardSec@ontarioenergyboard.ca. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file seven paper copies. If you have submitted through the Board's web portal an e-mail is not required.

All parties must also provide the Case Manager, Lawrie Gluck, Lawrie.gluck@ontarioenergyboard.ca with an electronic copy of all comments and correspondence related to this case.

DATED at Toronto, January 20, 2012.

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary