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By electronic filing

January 26, 2012

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

Dear Ms Walli,

Union Gas Limited – 2012 Rates Application
Board File No.: EB-2011-0025
Our File No.: 339583-000116

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

This document reflects two (2) corrections that should be made to the Argument we filed yesterday.

The first is in paragraph 10 on page 3. There are errors in the second sentence of this paragraph. This sentence has been corrected to read as follows:

> "Regardless of whether those contributing factors are under-budgeting of base year revenues, **over-budgeting of** expenses, cost cutting during the IRM period, or customer growth, or a combination thereof, the IRM Plan provides Union with substantial "headroom" to accommodate Z-factor ineligible increases in spending plans related to known risks in respect of which a prudent utility would take risk mitigation steps."

The second correction is in the first line of paragraph 33 on page 10. The word "submit" has been corrected to read "reiterate".

We are concurrently filing electronically this letter and the Corrected version of CME's Argument.

Yours very truly,

Peter C.P. Thompson, Q.C.

PCT\slc
enclosure
c. Chris Ripley (Union)
Crawford Smith (Torys)
Intervenors in EB-2011-0025
Paul Clipsham (CME)
OTT01\4896387\v1

EB-2011-0025

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, pursuant to section 36(1) of the *Ontario Energy Board Act, 1998,* for an order or orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas as of January 1 2012.

ARGUMENT OF CANADIAN MANUFACTURERS & EXPORTERS ("CME") (CORRECTED)

January 25, 2012

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INDEX

I. INTRODUCTION

1. These are the submissions of Canadian Manufacturers & Exporters ("CME") with respect to the unresolved issues in the Application by Union Gas Limited ("Union") for Ontario Energy Board ("OEB" or the "Board") approval of its rates for 2012.

II. CROSS-BORE SAFETY PROGRAM

A. Z-FACTOR

2. Union forecasts that its revenue requirement for 2012 for its recently introduced Cross-Bore Safety Program will be $1,873,000, and asserts that the costs for this program qualify as a Z-factor for 2012.[1]

3. To satisfy the Z-factor criteria, Union must demonstrate to the Board that the costs have been prompted by an event that is "outside the control of utility management", and relate to a risk that is "not a risk for which a prudent utility would take risk mitigation steps". In addition, the utility must lead convincing evidence to demonstrate that the costs it will incur will exceed the materiality threshold of $1.5 million.[2]

4. CME submits that Union has failed to discharge the burden of demonstrating that costs associated with this Cross-Bore Safety Program qualify for Z-factor treatment in 2012. The rationale for this position is provided below.

5. The fact that the installation of gas lines using trenchless technology might result in a gas line being bored into a sewer line has been a known risk for years.[3] Its occurrence in prior years was managed by Union and repaired as part of Union's regular plant damage procedures.[4]

6. Commencing in 2009, and in the midst of the operation of its 5-year IRM Plan, Union became more sensitive to the known risk associated with cross-bores. As a result, Union

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[1] Exhibit A, Tab 1, page 5, Table 2.
[2] The Z Factor eligibility criteria are listed at Exhibit A, Tab 1, page 12.
[3] Exhibit K2.3 and Transcript Volume 2, page 34, lines 14 and 15.
[4] Transcript Volume 2, page 36, line 4 to page 39, line 3, and Exhibit B10.2 Response (a).

decided to join Enbridge in taking a more pro-active approach to the investigation of the existence of cross-bores pertaining to its utility system.[5] CME submits that these decisions were taken voluntary by Union, and in accordance with its obligation, as a prudent utility, to manage known risks. The decision to become more pro-active with respect to the investigation of cross-bores and the level of the spending plans resulting from that decision, are not events beyond the control of Union's management.

7. In its pre-filed evidence, Union attempted to portray the TSSA Order in 2011 as the Z-factor event, beyond its control, that triggered the incurrence of the Cross-Bore Safety Program costs. See for example Exhibit A, Tab 1, page 13, where it is asserted that the costs associated with the program "... are required to comply with a TSSA Order ..." and in Exhibit B3.3 where it is asserted that the TSSA Order is the triggering event as follows: "An Order from the TSSA which results in cost increases for Union is not related to Union's prudency.". However, in cross-examination, Union's witnesses conceded that the TSSA Order had nothing to do with the decisions to incur the costs. Union's witness acknowledged that the TSSA Order simply confirms what a prudent utility should be doing to manage the Cross-Bore damage risk.[6] We reiterate that the incurrence of the costs was prompted by the voluntary decisions taken by both Enbridge Gas Distribution Inc. ("EGD") and Union to take a more pro-active approach to investigating a known risk. In fact, their voluntary actions prompted the TSSA Order, and not the reverse as Union attempted to portray in its pre-filed evidence.

8. Contrary to the submissions of counsel for Union[7], a new risk was not identified during the course of Union's 5-year IRM Plan. The reality is that voluntary decisions were taken by Union's management to escalate spending to investigate the known risks associated

[5] Transcript Volume 2, page 27, line 27 to page 29, line 16; and page 39, line 4 to page 41, line 3.
[6] Transcript Volume 2, page 40, line 26 to page 41, line 3.
[7] Transcript Volume 2, page 129

with Cross-Bores. Voluntary decisions to escalate spending on known risks do not qualify as a Z-factor.

9. Pursuant to Item 2 of the Z-factor criteria, costs incurred in relation to risks in respect of which a prudent utility would take risk mitigation steps are not Z-factor eligible. Such costs fall within the ambit of the spending coverage provided by the IRM Plan. The evidence with respect to the $210M of over-earnings under Union's IRM Plan during its five years of operation[8] confirms that the Plan provides more than adequate coverage for events for which there is no Z-factor eligibility, including spending increases during the term of the Plan in relation to risks in respect of which a prudent utility would take risk mitigation steps.

10. The factors contributing to the $210M of over-earnings under Union's 5-year IRM Plan will be examined in Union's Rebasing case. Regardless of whether those contributing factors are under-budgeting of base year revenues, over-budgeting of ~~and~~ expenses, ~~or~~ cost cutting during the IRM period, or customer growth, or a combination thereof, the IRM Plan provides Union with substantial "headroom" to accommodate Z-factor ineligible increases in spending plans related to known risks in respect of which a prudent utility would take risk mitigation steps.

11. Union's argument[9] to the effect that the TSSA Order is a causative factor in relation to the increased spending with respect to the known Cross-bore risk is without merit. Union's spending plans preceded the issuance of the Order. Moreover, the unequivocal acknowledgement by Union's witness that the TSSA Order merely confirms what a prudent utility should be doing with respect to a known risk means that, with or without the Order, the spending relates to a known risk in respect of which a prudent utility would take risk mitigation steps. Union is not being punished for being "out in front of the TSSA

[8] Transcript Volume 1, page 45
[9] Transcript Volume 2, page 129

Order" as its counsel argues. The subject matter of the TSSA Order relates to a risk that is Z-factor ineligible because it is a known risk in respect of which a prudent utility would take risk mitigation steps.

12. The risk of utility plant damage that stems from the clearing of plugged sewers containing a gas line cross-bore is no different than the risk of plant damage from any other third party intervention. The risk of third party damage to utility plant from all causes is something that all prudent utilities plan to mitigate.

13. There is a total amount already embedded in Union's rates to cover overall capital and O&M expenses with respect to avoidance of plant damage, and repairing plant damages including insurance premiums for damages caused by third parties.[10] Union has offered no evidence to show that the amount already embedded in rates is insufficient to cover its voluntarily planned Cross-Bore Safety Program costs. Clearly the total revenues to be produced by IRM rates in 2012 is sufficient to cover the amounts because, for 2012, Union is forecasting over-earnings in the order of some $29.9 million.[11] This evidence suggests that amounts embedded in Union's 2012 rates for all O&M costs, including line locate costs, exceed the amounts that Union plans to spend in 2012 on such items.

14. In short, the fact that Union has voluntarily chosen to spend more money in 2011 and beyond investigating the known risk of cross-bores is not an event outside the control of its utility management, nor do the costs relate to a risk that is not a risk for which a prudent utility would take risk mitigation steps. We submit that item 2 of the Z-factor criteria listed at Exhibit A, Tab 1, page 12 has not been satisfied. Accordingly, even if planned 2012 spending on Cross-Bore Program costs demonstrably exceeded $1.5M, the costs are Z-factor ineligible.

[10] Transcript Volume 2, page 34, line 17 to page 37, line 11.
[11] Transcript Volume 1, page 45, lines 9 to 13.

15. Moreover, in this case, there is a further reason why the Z-factor claim should be rejected. This is because the evidence on which Union relies to justify a 2012 forecast revenue requirement of $1.873 million is unsupported by objective data.

16. We submit that the evidence does not reasonably support a forecast of non-controllable costs in excess of $1.5 million, which is a further reason for rejecting the Z-factor claim.

17. The only objective data Union has provided to support the estimates pertaining to the O&M costs of $1.825 million, shown at Exhibit B1.1, is its 2011 experience which Union's witnesses discussed under oath at Transcript Volume 2, page 42, line 24 to page 52, line 7. Further details of the 2011 experience are shown in Exhibit J2.3. There is no data in the record to support the estimate that 70% of its 1.3M customers have sewer systems, nor is there any data in the record to support the assertion that, every year, 1% of the sewers of such customers will be blocked.[12]

18. Putting it at its highest the actual data for 2011 for the months of November and December shown in Exhibit J2.3 is all of the concrete support that Union can provide to support the 9,000 locates upon which Union relies to develop its estimated costs for 2012. The November and December 2011 "locates" data that Union has provided reflects an average monthly balance of 523 locates per month, or about 6,300 locates on a 12-month basis. This translates into 6,300 locates per annum rather than the 9,000 locates upon which Union relies. The use of 6,300 locates rather than 9,000 locates in the estimate at Exhibit B1.1 reduces the Z-factor requirement claim for 2012 by $405,000, or to a level below the $1.5 million threshold. This level of estimated costs is further reduced when one considers that the "Pro-active Investigation for potential cross-bores" costs, that Union includes in its forecast in Exhibit B1.1 in the amount of $200,000, and the publication of "Education Awareness Materials" costs included therein

[12] Transcript Volume 2, page 43, line 24 to page 46, line 10.

in the amount of $40,000, are costs related to actions that are completely within the control of Union's management. These items of costs in the estimate are clearly not beyond the control of management and do not satisfy the Z-factor criteria. The video assessment component of the estimate is also questionable, having regard go the fact that, in 2011, some 1,200 video assessments were conducted without revealing the existence of any cross-bores. The cost per assessment of about $300 is materially less than the $400 amount used in the estimate in Exhibit B1.1 and the need for Union to conduct any such assessments is questionable when the fact that 1,200 video assessments already conducted by Union revealed no cross-bores is combined with the fact that the municipalities themselves conduct routine video assessments of their sewers.[13]

19. Based on the foregoing, we submit that Union has failed to provide convincing evidence to demonstrate that the non-controllable costs associated with cross-bore locates in 2012 is likely to exceed $1.5M. Item 2 of the Z-factor criteria listed at Exhibit A, Tab 1, page 12 has not been satisfied.

20. For all of these reasons, the claimed Cross-Bore Program costs are not Z-factor eligible.

B. Deferral Account

21. The variance account Union seeks with respect to its 2012 Cross-Bore Safety costs relates to costs of the program that "… are included in rates.".[14]

22. Since the 2012 Cross-Bore Program costs are not Z-factor eligible, a variance account with respect to those costs cannot be granted pursuant to the provisions of the Settlement Agreement to which counsel for Union referred in his Argument-in-Chief.[15] Moreover, the costs of "locates" have never been regarded as costs deserving of

[13] See Transcript Volume 2, page 85, line 17 to page 89, line 17 revealing that the 41 cross-bores discovered in 2011 were as a result of routine video assessments conducted by municipalities.
[14] Exhibit A, Tab 1, page 18, lines 6 to 8.
[15] Transcript Volume 2, pages 100, 101 and 111.

variance account treatment. On these grounds alone, the Cross-Bore Safety Program deferral account request should be denied.

23. In their submission, Board Staff recognize the absence of convincing evidence demonstrating that Union will likely incur uncontrollable expenditures in 2012 exceeding $1.5M. Despite Union's failure to discharge the burden of proof with respect to the threshold issue, Staff suggests in argument that the Board should establish a deferral account with respect to 2012 Cross-Bore Program costs. This submission is flawed and lacks merit.

24. There can be no deferral account without a demonstration by Union that the costs qualify as a Z-factor. The costs do not qualify as a Z-factor for two reasons, namely:

i) Regardless of the amount to be spent, they relate to a known risk in respect of which a prudent utility would take risk mitigation steps; and

ii) There has been no demonstration that the uncontrollable 2012 costs will exceed $1.5M.

Absent a demonstration of Z-factor eligibility, the deferral account request must be denied.

C. Recovery in 2013 and Beyond

25. The fact that Cross-Bore Safety Program costs are ineligible for Z-factor treatment in 2012 has no impact on Union's planned spending in this area for 2013. Its 2013 planned spending for the Cross-Bore Safety Program will be part of its rebasing case in which parties will be able to determine the extent to which total costs embedded in rates for overall capital and O&M expenses with respect to plant damage compare to the actual costs that Union incurred over the IRM period on account of such items. Rebasing will cover the costs of Union's Cross-Bore Safety Program for the years 2013 and beyond.[16]

[16] Transcript Volume 2, page 46, lines 3 to 10, and page 92, line 17 to page 93, line 11.

III. TRANSITION TO US GAAP PENSION DEFERRAL ACCOUNT

26. The evidence provided during the course of the oral hearing on January 16, 2012, revealed that the deferral account Union is requesting is not related to any uncontrollable costs that Union expects to incur in 2012, nor does it relate to any costs that are not currently embedded in rates. Rather, the requested deferral account relates to the balance at December 31, 2012, of unamortized actuarial losses pertaining to pension and other employee benefit expenses. These unamortized actuarial losses were initially included for recovery in Union's rates in or about 2000 on the basis that their recovery would be amortized over 17 years to December 31, 2017, and recovered in rates in amount of about $3.8M per year.[17]

27. In these circumstances, it appears that ratepayer responsibility for these unamortized actuarial losses was established years ago and continued in 2007 when the Board fixed Union's base rates from which the approved 5-year IRM Plan operates to December 31, 2012. To our recollection, no deferral account was necessary in 2000 or in 2007 to assure recovery of the unamortized balances from year to year in future periods to December 31, 2017.

28. When acknowledging that the requested deferral account was not needed for ratemaking purposes, Union's witness stated that its sole purpose was to help Union convince its auditors that the unamortized actuarial losses will be recoverable in rates beyond December 31, 2012.[18] We question the need for a deferral account for that purpose when the Board's prior decisions establishing and continuing the $3.8M amortization recovery in Union's rates was sufficient to convince the auditors that these unamortized actuarial losses will be recoverable in future rates.

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[17] See Argument-in-Chief of counsel for Union at Transcript Volume 2, page 114, line 28 to page 116, line 17.
[18] Transcript Volume 1, page 38, lines 22 to 26, and page 77, lines 11 to 18.

29. We submit that the Board should be reluctant to approve deferral accounts that are not needed for ratemaking purposes. If Union wishes to change the already approved recovery of unamortized losses at the rate of $3.8M per year to December 31, 2017, then it can present its proposal to that effect in its 2013 Rebasing case. Declining the deferral account request that Union makes in this case will not, in any way, prejudice the future recovery in rates of $3.8M per year until December 31, 2017, or an accelerated rate of recovery should Union request such relief in its 2013 Rebasing case.

30. Moreover, there is a "cart before the horse" aspect of Union's deferral account request in this case because the Board is being asked to approve the establishment of the "tracking account" before it considers and approves Union's request to transition to US GAAP.

31. In the Hydro One Networks Inc. ("HONI") Transmission case on which Union relies, the Board has stated that it will not automatically approve utility requests to transition to US GAAP rather than MIFRS.[19] The appropriateness of Union's request that the Board approve its transition to US GAAP is being examined by the Board in the Preliminary Issue phase of Union's 2013 Rate Case. In these circumstances, we submit that it is more appropriate for the Board to determine issues pertaining to the timing of recovery of unamortized actuarial losses related to pension expenses at December 31, 2012, as a corollary of and not as a precursor to its decision pertaining to Union's request for regulatory approval to transition to US GAAP for ratemaking purposes.

32. The circumstances of this case are distinguishable from the circumstances in the HONI Transmission case on which Union relies. In that case, HONI's request for the deferral account was made in conjunction with and not as a precursor to the request for permission to transition to US GAAP. The Board's ruling, supporting the establishment of

[19] EB-2011-0268 Decision with Reasons, November 23, 2011, at page 4.

the account, was a corollary of and not a precursor to its decision approving HONI's transition to US GAAP. Moreover, in the HONI Transmission case, the Board was not dealing with a specific item of unamortized expenses that had previously been approved for recovery in HONI's Transmission rates over an amortization period expiring on or about December 31, 2017. Further, there was no acknowledgement in the HONI Transmission case, as there is in this case, that the specific deferral account being requested is not needed for ratemaking purposes.

33. We reiterate ~~submit~~ that the Board should be reluctant to approve a deferral account that is not needed for ratemaking purposes. However, if the account is established, as Union requests, then it should be made clear in the Board's decision approving the account that it is not a "regulatory asset" account, but simply a "tracking" mechanism, with the appropriateness of the amounts to be recorded in or to be cleared from the account to be determined in Union's 2013 Rate Case, either as part of the Preliminary Issue or in the subsequent phase of that proceeding.

34. The evidence indicates that because of reductions in the actual amounts being amortized in years following 2007, the actual unamortized balance at December 31, 2012 is less than the amount of $7.3M Union proposes to record in the tracking account.[20] Moreover, we and others have posed Interrogatories in the 2013 Preliminary Issue proceeding pertaining to matters related to the amounts to be recorded in and/or cleared to ratepayers from this tracking account. We submit that matters pertaining to this issue should be dealt with after Union has responded to those questions.

35. To summarize, no deferral account is necessary and Union's request for the account should be denied. In the alternative, if an account is established, then it should be made clear that it is not a regulatory asset account and that any amounts to be recorded in

[20] Mr. Shepherd questioned Union's witnesses about these factors at Transcript Volume 1 at pages 54 to 58.

and/or cleared from the account, including the period of amortization of such clearing, should be determined in Union's 2013 rates proceeding.

IV. CLOSURE OF LONG-TERM PEAK STORAGE DEFERRAL ACCOUNT

36. With the undertaking that Union's counsel provided on the record pertaining to the tracking of all asset optimization transactions of a duration of two years or more[21], and the issuance of the Board's Decision in EB-2011-0038 dated January 20, 2012, we agree that the long-term peak storage deferral account should be closed.

V. LATE PAYMENT WORDING

37. If the current wording is misleading as Union suggests,[22] then that misleading wording should be corrected to make it accurate. Misleading late payment penalty provisions can prompt class action litigation that affects all ratepayers. Misleading late payment penalty wording should not be perpetuated to maintain consistency with the wording on the bills of other utilities. Rather, all utilities should be encouraged to eliminate wording on their bills that could be misleading.

VI. COSTS

38. CME requests that it be awarded 100% of its reasonably incurred costs in connection with this matter.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 25th day of January, 2012.

Peter C.P. Thompson, Q.C.
Counsel for CME

[21] See Transcript Volume 2, page 1, lines 18 to 23.
[22] See Union's Argument-in-Chief, Transcript Volume 2, page 123, line 12 to page 126, line 15.