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By electronic filing

August 3, 2012

Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge Street  
27<sup>th</sup> floor  
Toronto, ON M4P 1E4

Dear Ms Walli,

<b>Union Gas Limited ("Union")</b>	
<b>2011 Earnings Sharing and Disposition of Deferral Accounts and Other Balances</b>	
<b>Board File No.:</b>	<b>EB-2012-0087</b>
<b>Our File No.:</b>	<b>339583-000137</b>

The following submission is provided on behalf of Canadian Manufacturers & Exporters ("CME") and the Federation of Rental-Housing Providers of Ontario ("FRPO") pursuant to paragraph 1 of Procedural Order No. 2 in these proceedings dated June 27, 2012.

**A. ISSUES RE: UNION'S ACCOUNTING FOR UPSTREAM TRANSPORTATION SERVICES**

The foregoing parties submit that the issues related to Union's accounting for Upstream Transportation Services that should be addressed at the Technical Conference in this proceeding scheduled for August 21, 2012, and at the Hearing of the Application, are as follows:

- (a) Have all of the amounts Union received to December 31, 2011 to mitigate Upstream Transportation Demand Charges been properly recorded in Union Gas Supply Deferral Accounts, including Unabsorbed Demand Charges ("UDC") Deferral Account 179-108?
- (b) If not, then what additional amounts that Union received to mitigate Upstream Transportation Demand Charges should be recorded in these deferral accounts as of December 31, 2011 and cleared to ratepayers? and
- (c) What is the impact on the amount of 2011 earnings to be credited to ratepayers of clearing to ratepayers the foregoing total amounts.

## **B. BACKGROUND FACTS**

In large measure, matters of fact pertaining to each of these issues have been canvassed during the evidentiary portion of the hearing of Union's 2013 Re-basing Application.

### **1. Union's Inappropriate Activities**

A factual issue that is common to the 2013 Re-basing Application and the 2011 Deferral Account Clearance and Earnings Sharing calculation proceeding is whether Union has properly accounted for all amounts that it has received from 2007 onwards to mitigate Upstream Transportation Demand Charges actually incurred.

What has been revealed in evidence in Union's 2013 Re-basing case is that, since 2008, Union has been "optimizing" components of its Gas Supply Plan upon which its rates are based by creating UDC, on a planned basis, and then either concurrently assigning or exchanging its FT transportation contracts for services on the Mainline of TransCanada Pipelines ("TCPL") to:

- (i) monetize the FT-RAM credit value of its unused FT contracts;
- (ii) obtain cheaper means of delivering its Western Canadian gas supplies to their intended destination; and
- (iii) treating the difference between the monetized FT-RAM credits funded by demand charges recovered from ratepayers in rates, and the costs of the cheaper transport as utility earnings, rather than as a reduction to Union's upstream transportation costs.

Union has effectively been converting into profit TCPL FT demand charges paid by ratepayers. In substance, what Union has been doing is analogous to a service provider contracting for and charging his client for the purchase of an executive class transportation ticket to support the provision of services to the client, and then exchanging that ticket for a lower priced economy transportation service in order to treat as "profit" the difference between the amounts paid for executive and economy transportation service.

### **2. Profits Derived from Union's Inappropriate Activities to December 31, 2011**

The magnitude of the demand charge payments made by ratepayers that Union has effectively converted into profits under the auspices of these executive/economy class transportation services activities are disclosed in evidence in Union's 2013 Re-basing case. Exhibit K7.3 in that proceeding shows that, before earnings sharing, the profits realized by Union from these activities to December 31, 2010 were \$31.1 million.<sup>1</sup> After taking account of earnings sharing amounts of \$14.9 million<sup>2</sup> paid to ratepayers to the end of 2010, the net profits attributable to this approach were \$16.2 million<sup>3</sup> to December 31, 2010. A copy of Exhibit K7.3 is attached.

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<sup>1</sup> Exhibit K7.3, line 1, columns 1 to 4.

<sup>2</sup> Exhibit K7.3, line 2, columns 2 to 4.

<sup>3</sup> \$31.1 million minus \$14.9 million

The same exhibit shows that in 2011, the “profits”, before earnings sharing, were an amount of \$22.0 million<sup>4</sup>. Because Union’s total profits in 2011 exceed the 200 and 300 basis point thresholds above the base return on equity (“ROE”) specified in the Settlement Agreement, the portion of these profits attributable to ratepayers is calculated by Union to be \$14.5 million<sup>5</sup>. Put another way, the 2011 earnings sharing amount payable to ratepayers will be reduced by 14.5 million if the Board requires Union to record the \$22.0 million Union characterized as “profits” as gas cost reductions in Union’s Gas Supply Deferral Accounts as of December 31, 2011.

### **3. Expected Profits from 2012**

Exhibit J7.11 in Union’s 2013 Re-basing case indicates that Union is now expecting to realize \$37.8 million of “profits” from this executive/economy transportation services exchange approach. None of this amount is likely to exceed the 200 basis points band above the base ROE specified in the IRM Settlement Agreement. The \$37.8 million now forecast for 2012 is \$23.6 million more than the \$14.2 million forecast shown in Exhibit K7.3, line 1, column 6. A copy of Exhibit J7.11 is also attached.

### **4. Total Expected Profits to December 31, 2012**

Based on the foregoing, and operating under the auspices of this executive/economy transportation contracting exchange approach, Union will have effectively converted to profits for its shareholder about \$61.4 million<sup>6</sup> of demand charges paid by ratepayers for upstream transportation services on TCPL.

## **C. GUIDING PRINCIPLES – UNION CANNOT PROFIT FROM ITS UNAUTHORIZED ACTIVITIES**

### **1. A Utility Cannot Profit from its Own Improper Acts**

CME, FRPO and others contend that without explicit prior Board approval, this approach to convert a portion of upstream transportation demand charges, paid for by ratepayers, to utility shareholder profit is improper and invalid. A utility such as Union cannot profit from items of expense treated as flow-through items by its regulator. Legal precedents relating to the misuse and/or misappropriation of trust funds by a trustee are, by analogy, applicable to Union’s actions in effectively converting to profits demand charges paid by ratepayers. CME and FRPO contend that Union must account to ratepayers for all of the net amounts it has received by virtue of its unauthorized actions of effectively converting to profits a portion of FT demand charges paid by ratepayers.

We are not seeking to unwind the IRM Settlement Agreement as Union contends. The relief that we seek stems from principles embedded in that Agreement, namely that Union cannot profit from reductions in pass-through items of expense.

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<sup>4</sup> Exhibit K7.3, line 1, column 5

<sup>5</sup> Exhibit K7.3, line 2, column 5

<sup>6</sup> \$37.8 million plus \$23.6 million

## **2. The Board Never Authorized Union to Effectively Convert Ratepayer Funded Demand Charges to Profits for its Shareholder**

Union justifies its actions on the grounds that “they have already been addressed”.<sup>7</sup> Union contends that its actions were authorized by the IRM Settlement Agreement in the EB-2007-0606 proceedings, consented to by Intervenor and approved by the Board. CME and FRPO strongly disagree with this contention. There is no evidence to demonstrate that Intervenor or the Board, expressly or impliedly, authorized Union to convert more than \$60 million of FT demand charges paid by ratepayers to profits for Union’s shareholder.

The facts on which Union relies, such as the closure of certain Transactional Services (“TS”) Deferral Accounts under the auspices of the EB-2007-0606 Settlement Agreement, and its use of the DOS-MN service from TransCanada, do not support Union’s contention that its actions were authorized. Conversion of ratepayer funded demand charges to profits was never part of Union’s operations under the auspices of the TS Deferral Accounts that were closed as a result of the foregoing Settlement Agreement. At no time did Intervenor or the Board provide Union with an informed consent to convert demand charges to profits.

All issues of fact pertaining to whether Intervenor and the Board authorized Union to effectively convert to profit more than \$60 million of FT demand charges will be determined by the Board panel hearing of Union’s 2013 Rate Case.

### **D. RELATIONSHIP BETWEEN ISSUES IN THIS CASE AND UNION’S 2013 RATE CASE**

The issues in this case relate to the manner in which Union should account to ratepayers for the profits it has derived from the unauthorized demand charge conversion activities. The conceptual question of whether Union is obliged to account to ratepayers for these profits will be determined in Union’s 2013 Rate case.

For the purposes of the 2011 Deferral Account case, we submit that the items of relevance are as follows:

- (a) The amount, as of December 31, 2011, that Union received to mitigate Upstream Transportation Demand Charges that is not recorded in Union’s Gas Supply Deferral Accounts. We say that this amount is \$38.2 million consisting of items described above, namely the \$16.2 million amount to December 31, 2010, net of earnings sharing amounts, and the \$22.0 million amount received by Union in 2011; and
- (b) The impact of 2011 earnings sharing of recording the \$38.2 million amount in Union’s Gas Supply Deferral Accounts at December 31, 2011. Based on the information provided in the 2013 Re-basing case, we believe that the 2011 earnings sharing amount to be credited to ratepayers should be reduced by \$14.0 million.

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<sup>7</sup> Torys’ June 18, 2012 letter to the OEB

A final determination of these two particular issues in the 2011 Deferral Account and Earnings Sharing Calculation proceeding will need to await the Board's determination of issues of fact in Union's 2013 Re-basing proceeding pertaining to the validity of Union's conversion of ratepayer funded upstream transportation demand charges into profits under the auspices of its executive/economy transportation services exchange activities.

**E. IMPLICATIONS FOR CLEARANCES OF 2011 DEFERRAL ACCOUNT BALANCES**

Until matters pertaining to the validity of Union's actions have been determined, the balance in the 2011 UDC Gas Supply Deferral Account 179-108 to be cleared to ratepayers and the related issue of the final 2011 earnings sharing amount cannot be made. However, the current balances in the UDC and other Gas Supply Deferral Accounts should be cleared to ratepayers with an express recognition of the fact that there may be an additional amount for 2011 to be cleared to ratepayers through Union's Gas Supply Deferral Accounts following the release of the Board's Decision in Union's 2013 Re-basing case.

At this stage, the amount of 2011 earnings sharing to be cleared for ratepayers should be calculated on the basis of an assumption that utility earnings could be reduced by \$14.0 million as a consequence of the Board's determination of issues of fact in Union's 2013 Re-basing case.

Undisputed balances in all other 2011 Deferral Accounts can be cleared at this time.

**F. CONCLUSION**

Based on the foregoing, we expect that the Technical Conference scheduled for August 21, 2012 will be confined to obtaining confirmation on the record in this proceeding of the amounts described herein and any other information not yet in the record pertaining to the issues framed at the outset of this letter.

Yours very truly,



Peter C. P. Thompson, Q.C.

PCT/kt

Encls

c.

Chris Ripley (Union)  
Crawford Smith (Torys)  
Intervenors EB-2012-0087  
Paul Clipsham (CME)

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**PORTION OF FT-RAM DEMAND CHARGE MITIGATION AMOUNTS  
NOT CREDITED TO RATEPAYERS – 2007 TO 2012**  
\$Millions

Line No.	(1) 2007	(2) 2008	(3) 2009	(4) 2010	(5) 2011	(6) 2012 Forecast	(7) Totals
1	0.4	5.0	14.0	11.7	22.0	14.2	67.3
2	0.0	4.5	7.0	3.4	14.5	0.0	29.4
3	0.4	0.5	7	8.3	7.5	14.2	37.9
4	0.3	0.6	0.1	0.2	0.6	0.3	2.0
5	0.0 <sup>(3)</sup>	0.0	1.0	6.2	0.1	2.7	10.0
6	0.3	5.1	8.5	10.9	15.4	3.1	41.4

- (1) This is the total released value obtained for pipe releases as shown in J4.1 adjusted to reflect only TCPL releases as those values were impacted by RAM credits.  
 (2) While the value directly attributable to the FT RAM program cannot be separated from the total value this has been included to recognize that the FT RAM program has increased the value of assignments of TCPL firm transport.  
 (3) Set to zero to recognize limited use of RAM credits prior to 2008.

UNION GAS LIMITED

Undertaking of Mr. Isherwood  
To Mr. Thompson

Please provide a forecast for the balance of 2012, assuming FT RAM continues for the balance of the year.

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As filed in J6.3, year-to-date June exchange revenue related to RAM is \$19.9 million. Union estimates RAM-related activity for the balance of 2012 to be an additional \$17.9 million, for an annual total of \$37.8 million. This includes \$3.6 million of the estimated impact of RAM continuing for November and December as filed in J.C-4-7-9 c).