



# **ONTARIO ENERGY BOARD**

## **BOARD STAFF SUBMISSION**

**UNION GAS LIMITED**

**2011 EARNINGS SHARING & DISPOSITION OF DEFERRAL  
ACCOUNTS AND OTHER BALANCES**

**PRELIMINARY ISSUE**

**Board File No. EB-2012-0087**

**September 14, 2012**

## Introduction

Union Gas Limited (“Union”) filed an application dated April 13, 2012 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, 2012 in connection with the sharing of 2011 earnings under the incentive rate mechanism approved by the Board as well as final disposition of 2011 year-end deferral account and other balances (the “Application”). The Application also requested approval for the disposition of the variance between the Demand Side Management (“DSM”) budget included in 2012 rates and the revised budget approved by the Board in EB-2011-0327. The Board assigned file number EB-2012-0087 to the Application.

The Board issued a Notice of Application and Procedural Order No.1 on April 19, 2012 in which it adopted the intervenors in the EB-2011-0025 and EB-2011-0038 proceedings as intervenors in this proceeding. The Board also set out a timetable for the filing of interrogatories, responding to interrogatories, and for informing the Board regarding plans to file intervenor evidence.

In Procedural Order No. 2, dated June 27, 2012, the Board established a Technical Conference so that parties would have the opportunity to explore emerging issues such as the use of transportation contract attributes to yield shareholder margins.

The Board directed intervenors to file letters scoping the issues that will be pursued at the Technical Conference. The Board also established a Settlement Conference to be held on August 28 and 29, 2012. On July 10, 2012, the Board issued a letter rescheduling the Settlement Conference to August 21 and 22, 2012.

In Procedural Order No. 3, dated August 15, 2012, the Board determined that it will address the issue of Union’s treatment of upstream transportation revenues in 2011 as a distinct issue in this proceeding. The Board noted that it will hear this single issue as a Preliminary Issue in this proceeding and will issue a decision on it prior to holding a Settlement Conference.

The Board described the Preliminary Issue as follows: Has Union treated the upstream transportation optimization revenues appropriately in 2011 in the context of Union’s existing IRM framework?

The following is Board staff's submission on the Preliminary Issue.

## **Treatment of Upstream Transportation Optimization Revenues**

### **(a) Board Staff Submission**

Board staff notes that over the term of the IRM plan, Union optimized certain aspects of its gas supply plan. Union has effectively been creating Unabsorbed Demand ("UDC") charges, on a planned basis, and then using a feature of its Firm Transportation ("FT") contracts with TransCanada Pipelines ("TCPL") known as the Firm Transportation Risk Alleviation Mechanism program<sup>1</sup> ("FT-RAM") to generate revenues. Essentially, what Union has done is assign/exchange its TCPL FT contracts, which are paid for by ratepayers, in order to monetize the value of its FT-RAM credits and then find a cheaper way of transporting its Western Canadian gas supplies to their intended destination.

The difference between the monetized value of the FT-RAM credits and the costs of cheaper transportation has been treated as utility earnings and is subject to sharing under the auspices of Union's earnings sharing mechanism. In other words, on a planned basis, Union has been using a regulatory asset and selling it in the market and repurchasing a similar service at a lower cost, and treating the margins as utility earnings.

Board staff notes that Union has been treating the FT-RAM revenues, during the IRM Term, as utility earnings because it has classified these revenues as transactional revenues, which Union stated, would have formerly been recorded in the Transportation and Exchange Services Deferral Account (Account No. 179-69). In the context of the treatment of a similar type of revenue stream during the IRM term, Board staff believes that Union's approach was not unreasonable with respect to the FT-RAM related revenues.<sup>2</sup> Having said that, given the evidence that the Board now has before it as to the evolution of the classification, Board staff is of the view that the classification of such revenues should be revisited on a going forward basis.

In particular, Board staff notes that Union's FT-RAM related optimization activities are not the same as its other exchange services. Union's traditional non-FT-RAM

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<sup>1</sup> The FT-RAM program allows long-haul FT shippers to apply unutilized FT demand charges against their cost of interruptible transportation ("IT") service.

exchanges rely on excess transportation capacity that is temporarily surplus to its utility requirements for reasons beyond Union's control (i.e. weather, market demand, etc.). The FT-RAM activities are using utility assets, on a planned basis, that were contracted to facilitate Union's gas supply plan for system supply customers.

Specifically, Union is entering into transactions with third-parties to monetize the value of its FT-RAM credits, which are an attribute of its FT transportation contracts with TCPL. The value in these deals for Union's counterparty is the FT-RAM credit, without that credit, these transactions would not occur. The FT-RAM credit is a utility asset as the underlying contract costs which give rise to the credit are paid for by ratepayers. Therefore, the basis for the transaction undertaken by Union is the FT-RAM credit, which is a utility asset (part of gas supply). In Board staff's view, this type of transaction is properly classified as a gas supply transaction because Union is lowering the effective transportation price in the gas supply portfolio by entering into FT-RAM related transactions.

Board staff notes that the Board has always treated, for ratemaking purposes, gas commodity costs and upstream transportation costs as pass-through items. This fundamental principle is reflected in Union's existing IRM Framework Settlement Agreement as upstream gas supply and upstream transportation costs are listed in Section 5 as Y-factor items.<sup>3</sup> Therefore, in the future, Board staff suggests that on a principled basis, the FT-RAM related revenues should be treated as offsets to gas supply costs as argued by Board staff in Union's 2013 Cost of Service proceeding (EB-2011-0210).

### **(b) Board Staff Response to Union's Argument-in-Chief**

In its Argument-in-Chief, Union made a number of arguments as to why its treatment of upstream transportation optimization revenues is appropriate under its approved IRM Framework.

Union argued that reclassifying the FT-RAM related revenues as a gas cost reduction would be inconsistent with the past treatment by the Board and would effectively rewrite the terms of the IRM Framework agreed to by the parties and approved by the

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<sup>2</sup> See discussion on the Board's treatment of TCPL's Dawn Overrun Service – Must Nominate below.

<sup>3</sup> EB-2007-0606, Settlement Agreement at p. 15.

Board.<sup>4</sup> Board staff agrees that changing the treatment of the FT-RAM related revenues in the midst of the IRM term would be inconsistent with the past treatment afforded to these revenues by the Board during the IRM term.

Union noted that, in the EB-2007-0606 Settlement Agreement, parties agreed to the closure of the four Storage and Transportation (“S&T”) related deferral accounts on the basis that S&T margins built into rates be increased by \$4.3 million. Union stated that one of the closed accounts is relevant to FT-RAM related activities (Account No. 179-69). Union noted that the FT-RAM related revenues would have been captured in Account No. 179-69 during the IRM term had that account been in operation. Because the account was closed for the duration of the IRM term, the FT-RAM related revenues (and other transactional revenues) were treated as utility earnings during IRM. Union argued that this treatment was the clear outcome of the Settlement Agreement and is the appropriate treatment in the context of the IRM Framework.<sup>5</sup>

Union also stated that the Board dealt with the treatment of transactional revenues (including FT-RAM) twice during the IRM term (EB-2008-0220 and EB-2009-0101). Union noted that in the EB-2008-0220 proceeding (Union’s 2009 rates case), the issue of TCPL’s Dawn Overrun Service – Must Nominate (“DOS-MN”) was discussed. Union noted that, in the EB-2008-0220 case, the Board had to consider the treatment of activity supported by DOS-MN, which was another TCPL service (and an attribute of the FT contract).

In that proceeding, Union noted that it is not treating any benefit associated with the use of the DOS-MN as a Y-factor. Union stated that any benefit from the use of DOS-MN over the term of the incentive regulation framework would be used to contribute to the S&T transactional margins already included in in-franchise delivery rates, and would form part of Union's utility earnings. Also, in that proceeding, Union noted that the DOS-MN service is part of Union's transportation portfolio that is available for optimization through S&T transactional activity. Union stated that benefits resulting from transactions to optimize transportation capacity have historically been and will, in the future continue to be recognized as part of Union's regulated S&T transactional activity.<sup>6</sup>

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<sup>4</sup> Oral Hearing Transcripts, EB-2012-0087 at p. 4.

<sup>5</sup> Oral Hearing Transcripts, EB-2012-0087 at pp. 10-15.

<sup>6</sup> Oral Hearing Transcripts, EB-2012-0087 at pp. 45-56.

The Board made the following findings in EB-2008-0220:

Union noted that pursuant to the Settlement Agreement ratepayers were credited with a fixed amount reflecting a forecast performance of its transactional services business. Union also noted that the increased capacity that is associated with Dawn overrun may have benefits for ratepayers pursuant to the earnings sharing mechanism that continues in place. In other words, ratepayers have been already credited with an amount intended to reflect the transactional services activity of the company. Any additional revenues which may be occasioned by the new TransCanada service will not accrue under this heading, but may lead to earnings sharing distribution.

The Board finds Union's explanation with respect to this concern, which was raised by IGUA in its submissions, to be convincing. In the Board's view this is a fair approach that is consistent with the general architecture of the IRM plan and the Settlement Agreement.<sup>7</sup>

Union argued, in this proceeding, that Board's treatment of the DOS-MN related revenues, as discussed above, should be applied equally to its FT-RAM related revenues. Union argued that DOS-MN was a service attached to the TCPL FT tariff, the same as FT-RAM and therefore revenues related to both services should be treated in the same manner.

Union also argued that parties and the Board knew about FT-RAM as early as the EB-2009-0101 proceeding (Union's 2008 Earnings Sharing and Deferral Account disposition proceeding). In that case, Union significantly over-earned and triggered a review of its IRM Plan as it exceeded its approved earnings by more than 300 basis points. A driver of its over-earnings was an increase in short-term transportation and exchange revenue. Board staff asked an interrogatory in regards to the causation of the over-earnings.<sup>8</sup> Union's reply to that interrogatory included the following statement:

Union also focused on further optimizing its upstream supply portfolio. Union was able to extract value from new services introduced by upstream transportation providers, in excess of what was achieved historically. An example of these new services includes TCPL's firm transport risk alleviation mechanism, FT RAM, storage transportation service risk alleviation mechanism, STS RAM, and Dawn overrun service must

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<sup>7</sup> EB-2008-0220, Decision and Order, January 29, 2009 at pp. 8-9.

<sup>8</sup> Oral Hearing Transcripts, EB-2012-0087 at pp. 24-28.

nominate DOS MN. These new services provided increased opportunities for transportation exchange transactions in the market. These opportunities were also influenced by favourable market conditions experienced in 2008.<sup>9</sup>

Union noted that parties were aware that FT-RAM contributed to its over-earnings in 2008 (along with other transactional services) and at that time, interested parties could have argued for the reinstatement of the transactional margin related deferral accounts (i.e. Account No. 179-69) or could have argued for some other treatment of the FT-RAM related revenues. Instead, the parties agreed that the IRM Plan should remain intact and that amounts earned by Union 300 basis points above Board approved earnings should be shared 90/10 to the benefit of ratepayers (which was an increase from the 50/50 sharing applicable to earnings 200 basis points above Board approved established in the original IRM plan).<sup>10</sup> As such, Union argued that parties and the Board were aware that FT-RAM related revenues were being treated as utility earnings (and not gas supply cost offsets) in EB-2009-0101 and accepted that treatment.

Board staff agrees that the Board dealt with similar issues during the IRM Term (i.e. DOS-MN in EB-2008-0220 and FT-RAM in EB-2009-0101), and that changing this approach now would be a departure from past decisions.

The Board did turn its mind to related issues in both EB-2008-0220 and EB-2009-0101. In EB-2008-0220, the Board clearly decided that revenues generated from DOS-MN should be treated as utility earnings. Therefore, Board staff submits that Union's treatment of its FT-RAM related revenues (a similar service) under the IRM Framework is not unreasonable when analyzed through the context of the EB-2008-0220 Decision.

Union also argued that the Board and parties implicitly accepted Union's treatment of FT-RAM related revenues as utility earnings with their agreement/acceptance of the Settlement Agreement in EB-2009-0101. Board staff agrees that no party made the argument, at that time, for an alternative treatment of the FT-RAM related revenues and the Board accepted the Settlement Agreement which resulted in an increased level of sharing of utility earnings (which included the FT-RAM related revenues) with ratepayers. This supports Union's position that it is treating the FT-RAM related

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<sup>9</sup> EB-2009-0101, Exhibit B, Tab 1, Schedule 4.

<sup>10</sup> Oral Hearing Transcripts, EB-2012-0087 at pp. 24-28.

revenues appropriately under the IRM Framework. However, Board staff would like to note that in the EB-2009-0101 proceeding, information on the operational aspects of TCPL's FT-RAM program was limited.

Board staff is of the view that the FT-RAM related revenues should have been treated as gas supply costs, on a principled basis, at the outset of the IRM term. However, given the Board's decisions on issues similar to the FT-RAM related issue, Board staff submits that no change should be made to the treatment of these revenues during the IRM term. Union's treatment of these revenues was not unreasonable under the construct of the IRM Framework (and related past Board decisions) and Union should not be required to change the manner upon which these revenues are shared between ratepayers and shareholders at this time. Board staff submits that going forward (beginning in 2013), these revenues should be treated as an offset to gas supply costs.

Board staff submits that Union should in the future provide more comprehensive disclosure when it partakes in new revenue generating opportunities. The Board may want to consider introducing a formal reporting requirement for Union to disclose any material changes to what it is recording as transactional revenues as they occur to avoid situations such as this going forward.

All of which is respectfully submitted.