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BY EMAIL and RESS

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Our File No. 20120087

Ontario Energy Board
2300 Yonge Street
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2012-0087 – Union Gas – Preliminary Issue

We are counsel for the School Energy Coalition. These are SEC's submissions with respect to the preliminary issue.

Background

We have had an opportunity to review draft or final submissions from several of the other intervenors who are taking the lead with respect to the preliminary issue. We conclude as follows:

1. The details of the history and the legal issues have been described thoroughly by CME in their submissions. While, as we note below, the legal question of whether Union is technically a "trustee" with respect to gas costs may not be without dispute, overall we accept and adopt the history and legal analysis provided by CME.

2. BOMA's cogent analysis adds details of the Tolls Task Force, and in particular the role of Union, ostensibly as a representative of its ratepayers, as a proponent of the FT-RAM mechanism from which it is subsequently proposing to profit.

3. CCC sets out a thoughtful and useful step-by-step analysis of the issues relating to the preliminary issue and how it should appropriately be viewed by the Board.

In all three cases, we adopt and support these submissions.

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SEC Additional Submissions – General Principles

At a higher level, in our view the preliminary issue asks whether the Board has, over the last several years, intentionally blurred the distinction between the two parts of the regulated gas distribution business. We believe the Board has not done so.

SEC understands the structure of Union's regulated business, as established by the government (for example in the undertakings) and regulated by the Board, to be as follows:

- Union is granted a monopoly for the distribution of gas in particular areas of the province. It carries on that distribution activity as a business ***for its own account***, in order to make a profit, and as a result its rates are regulated to remove the ability to charge monopoly rents.

- Union is also charged with the responsibility to be the default supplier of gas to its distribution customers. This requires Union to both purchase gas, and transport it to the Union distribution system. Union carries on that default supply activity ***for the account of its ratepayers***. It is not a business, i.e. an activity in which Union is entitled to seek a profit. It is a responsibility Union takes on as a condition of being granted its monopoly distribution rights.

CME in its argument characterizes the default supply activity as an "express trust", in which Union is the trustee and the ratepayers are the beneficiaries. From a technical point of view, in SEC's view it is at least arguable that the requirements for creation of an express trust have not been met in this case.

However, the role of trustee is part of a broader category of roles called "fiduciaries". While many attempts have been made over the years to define "fiduciary" with precision, there is no disagreement amongst judges or academics that central to the relationship is the obligation to act in the interests of another rather than in your personal interests. Relationships that have this primary characteristic are in almost every case subject to fiduciary rules (e.g. trustee and beneficiary, director and corporation, lawyer and client, agent and principal, and many others).

Further, the rules for fiduciaries are not limited to defined relationships. Any relationship that has the primary characteristic will generally be fiduciary. Just as an example, the federal government is a fiduciary with respect to some parts of its responsibilities to First Nations. There are numerous examples of this nature, and the courts regularly state that, like the categories of negligence, the categories of fiduciary relationships are never closed.

Against this backdrop, the default supply activity is a responsibility placed on the distributor of gas. The distributor has the obligation to ensure that gas is available to deliver to its customers, and must put in place purchase and transportation arrangements to that end. Union also has the responsibility to carry out that activity in the interests of its ratepayers, by which we mean that it must procure gas and transportation prudently and effectively, so that the interests of the ratepayers are served.

It is because this is a responsibility rather than a business activity that all risk associated with the activity is placed on the ratepayers, and none on Union. Because Union is not eligible to be rewarded in the activity, it also takes no risk in the activity. All gas costs are a pass-through, trued up fully every quarter. All benefits and burdens are for account of the ratepayers.

There are two key aspects to the role of the fiduciary in this context.

First, all of Union's decisions with respect to the purchase and transportation of default gas supply must be made solely in the interests of the ratepayers, and not in the interests of Union or its shareholders. This is called the "fiduciary duty". It is inherent in the fact that the activity is by law and policy carried on for the account of the ratepayers.

Second, Union has an obligation to make those decisions as well as it is able. This is called the "standard of care". That is to say, like any fiduciary Union must apply its skill and judgment to maximize the interests of those to whom it owes the obligation, in this case the ratepayers.

But are there not exceptions? The answer is yes. The fiduciary duty, or the standard of care, can be altered in any given situation by the consent of the beneficiaries, or the consent of a court or other body empowered to consent on their behalf.

However, the law recognizes the high risk associated with allowing fiduciaries to act in their personal interests, and therefore sets a very high standard to claim an exception. The person, whether beneficiary or adjudicator, giving consent to the exception must have a) been made aware of every material fact that could have affected their judgment as to the granting of the consent, and b) given their consent in clear and unambiguous terms.

By way of example, it is not consent to stand idly by and do nothing. A trustee cannot say "The beneficiaries knew I was speculating in the stock market with their money on my own account, and they didn't complain." A lawyer cannot say to his client "I'm going to borrow your cottage this weekend", and then rent it out for a profit and claim that he had consent. A corporate executive can't say "The company didn't even want the contract, so they would have consented to me taking it personally." None of these relieve the fiduciary of their obligations to act in the interests of their beneficiary.

This is all trite law.

SEC notes that we have cast the above analysis in the legal framework of fiduciary law. That is not essential to the argument. Even if there were no law of fiduciaries, all of the above principles would be simply good regulatory policy in circumstances in which a regulated entity has a responsibility to carry out an activity for the account of its ratepayers, and without any risk to the utility. Judges over the last more than 200 years have, in tens or hundreds of thousands of cases, established a robust framework to deal with fiduciary obligations. The Board can rely on that framework, either directly or by analogy, or the Board can work through all of the same issues itself. It is submitted that in either case, the result will be the same. The law of fiduciaries is based on common sense.

SEC Additional Submissions – Union's Actions

It appears to be common ground amongst all of the intervenors, and Board Staff (but perhaps not Union), that had the Board, when the IRM term commenced, been fully aware of what was going to transpire with respect to the FT-RAM program, it would have characterized those activities as relating to gas costs (i.e. part of the default supply responsibility).

Other parties have described why these are gas supply activities in detail, and we will not repeat them. We agree with the conclusion set out by Board Staff in their Submissions, and echoed by others:

> *"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." [p. 3]*
>
> *"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."[p. 7]*

In fiduciary terms, Union is carrying out its responsibility to the ratepayers to procure and transport gas supply at the lowest reasonable cost, i.e. it is meeting its standard of care.

It is central to the submissions of SEC and all other intervenors that these transactions are, in essence, gas supply transactions. If the Board does not agree, that is the end of the matter.

If the Board does agree, though, that these are gas supply transactions, then prima facie they come within the "for account of the ratepayers" part of Union's activities. In that activity, all risk and reward is assigned to the ratepayers.

The only way that would then not be true, for each year since these transactions commenced, would be if the Board had decided to carve out a part of the gas supply activity and allow Union to profit from it. In keeping with the fiduciary standard of consent, such a carve-out could only be effective as a consent if it had been granted after full disclosure of all material facts. Alternatively, it could be a more fundamental change in the regulatory construct, unrelated to the specific transactions.

Dealing first with the question of whether there was consent, Union and other parties have provided the Board with details of the various alleged consents. We won't repeat them. What is clear is that each of the allegations of consent is indirect, ambiguous, and lacking in disclosure of all material facts. Staff, in their Submissions, appear to acknowledge that, when they say [p.7]:

> *"Union should in the future provide more comprehensive disclosure when it partakes in new revenue generating opportunities."*

SEC believes that no reasonable person would categorize any of the alleged consents as being a fully informed consent, or even close to that standard. At best, some of the examples might come within the category of "acquiescence without full knowledge of all the facts".

Dealing then with whether the regulatory construct has been altered, the essence of that argument is that under IRM the utility has freedom to be creative in the pursuit of additional profits. Union relies on that concept as a foundation for allowing the pursuit of these profits.

With respect, that is entirely incorrect. IRM is a method for setting rates for the monopoly distribution business. It has nothing to do with the utility's responsibility for default supply. The financial aspects of that activity are governed by a separate system, a series of variance accounts and the QRAM process. Union's IRM did not change that.

Put another way, it may well have been within the Board's power to determine that some part of the default supply activity would no longer be for account of the ratepayers, but would be for the account of the shareholder. However, such a determination would be a fundamental change in the structure of gas distribution regulation. It is certainly not something that the Board would do by accident, or "in passing", or by implication. If the Board had wanted to revert to any part of the former system, in which Union was free to make a profit on gas supply, it should and would only have done so in a clear and unambiguous way, with a detailed discussion of the implications of that significant policy change on the overall system. None of that happened, because the Board never at any time intended to make any part of gas supply a profit-making activity.

Conclusion

This brings us back to the question we asked at the outset: Has the Board at any time changed or blurred the clear line between gas supply (for account of the ratepayers, and without utility risk), and distribution business (for account of the utility, and thus at utility risk)?

It is submitted that the Board continues to have a clear distinction between the two, and has not altered the line to move some parts of gas supply into the for-profit column. It follows inescapably from that distinction that activities by Union to reduce the cost of gas supply or transportation are part of its default supply activity, and have at all times been a pass-through to the ratepayers.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.

Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested Parties