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By electronic filing

September 14, 2012

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

Dear Ms Walli,

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

Please find attached the Written Argument submitted on behalf of Canadian Manufacturers & Exporters ("CME"), along with a Brief of Authorities.

Yours very truly,

Peter C. P. Thompson, Q.C.

PCT\slc
enclosures
c. Chris Ripley (Union)
Crawford Smith (Torys)
Intervenors EB-2012-0087
Paul Clipsham (CME)

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EB-2012-0087

IN THE MATTER OF the Ontario Energy Board Act 1998, S.O. 1998, c.15, (Schedule B) (the "Act");

AND IN THE MATTER OF an application filed by Union Gas Limited for an Order or Orders amending or varying the rate or rates charged to customers as of October 1, 2012

ARGUMENT OF CANADIAN MANUFACTURERS & EXPORTERS ("CME")

September 14, 2012

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I. INTRODUCTION

1. In this proceeding, ratepayers ask the Board to require Union to reimburse Upstream Transportation costs recovered in rates that exceed the amounts Union actually paid for those services. CME supports the ratepayer representatives who seek this relief.

2. In the submissions that follow, a detailed analysis is provided of facts and legal principles upon which ratepayers rely. This analysis is being provided in these submissions to assist those parties who relied on the experience of counsel for CME in proceedings before the Board to place relevant facts and applicable principles on the record.

3. This Argument will refer to documents that are part of the record in this proceeding and in Union's 2013 Rebasing proceeding. A primary reference document will be the CME Compendium filed as Exhibit KT1.3 at the Technical Conference held on August 21, 2012.

4. The Preliminary Issue that the Board has framed for determination is as follows:

> ***Has Union treated the Upstream Transportation optimization revenues appropriately in 2011 in the context of Union's existing IRM Framework?***

5. This Preliminary Issue raises important matters of principle. These principles pertain to Union's adherence to the concept underpinning the Board's regulation of Upstream Transportation costs as pass-through items of expense. This concept is that neither Union's ratepayers nor its shareholder gain or lose as a result of variances between actual costs and the amounts embedded in rates for pass-through items. This concept is also embedded in the provisions of the IRM Agreement under which Union has operated since 2008.[1]

6. Correspondence already submitted to the Board and found at Tab 32, 34 and 35 of the CME Compendium describes some of the background facts and the principles that the Board is urged to consider when determining the Preliminary Issue. The letter at Tab 34

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[1] See CME Compendium, Tab 20, EB-2007-0606 Settlement Agreement, para.5.1 where the parties agree that Upstream Transportation costs "... will not be adjusted by the price cap index but will be passed through to rates.".

includes a suggestion that legal precedents relating to the misuse of trust funds by a trustee apply to Union's actions in effectively converting to profits Upstream Transportation demand charges paid by ratepayers. That letter also expresses disagreement with Union's suggestion that matters pertaining to the Preliminary Issue "... have already been addressed." For reasons that follow, it is submitted that at no time did intervenors or the Board provide Union with an informed consent to convert to profits millions and millions of Upstream Transportation demand charges paid by ratepayers.

7. CME represents manufacturers. Union serves about 9,900 customers that it classifies as manufacturers.[2] Like other ratepayers, manufacturers are concerned if activities in which Union engages are incompatible with long standing principles embedded in the Board's regulation of gas utilities and in the IRM Agreement to which Union is a party. Ratepayers are not seeking to unwind the IRM Agreement or to punish Union as it argues.[3] Rather, the relief that they are proposing stems from the principles embedded in the IRM Agreement, namely, that Union cannot profit from amounts recovered in rates related to pass-through items of expense that exceed their actual costs.

8. The core question for the Board to resolve is whether the FT-RAM activities in which Union has engaged since 2008 are properly classified as revenue generating activities related to the provision of Transactional Services ("TS") Transportation Exchanges, as Union contends. Ratepayer representatives, including CME, contend that these FT-RAM activities are actions related to management decisions made to change the elements of the initial Gas Supply Plan reflected in Union's rates. The purpose of these decisions is not to optimize the use of idle capacity caused by factors beyond Union's control, being capacity that would remain idle but for Union's sale of a TS to a third party. Rather, their purpose is to acquire Upstream Transportation to carry utility gas to the Union system at

[2] EB-2011-0210, Exhibit J-C-3-14-1 (Corrected) and Exhibit JT1.6; Transcript Volume 2, July 12, 2012, p.85, line 23 to p.88, line 5.
[3] EB-2011-0210, Union Reply Argument, Transcript Volume 16, p.2, lines 22 to 27.

costs lower than those being recovered in Union's rates. These decisions, being matters within the control of Union, are made to change the Upstream Transportation elements of the Gas Supply Plan embedded in Union's rates so as to reduce those transportation costs. The outcome of these decisions taken to reduce transportation costs is the collection of amounts from ratepayers that are not needed for Upstream Transportation of utility gas. The amounts not needed for such transportation are properly classified as gas cost reductions. They are not profits as Union contends.

9. If the Board agrees with ratepayer representatives with respect to the core classification issue, then the net over-payments for Upstream Transportation costs in an amount of about $38.2M to December 31, 2011, should be reimbursed. This amount of $38.2M consists of the following:

   (a) Net over-payments to December 31, 2010 of $16.2M, and

   (b) Upstream Transportation over-payments in 2011 of $22M.

   If the Board agrees that some or all of these Upstream Transportation over-payments should be reimbursed to ratepayers, in conjunction with the clearance of 2011 Deferral Account Balances, then the 2011 earnings to be shared with ratepayers will be reduced by about $14.5M.[4]

10. Union interprets the Preliminary Issue that the Board has framed to constitute a Board determination that Union can keep the $16.2M of net over-payments held by Union at December 31, 2010.[5] We question the appropriateness of this interpretation because of the acknowledgement made by Union in its evidence in the 2010 Deferral Accounts Clearance proceeding to the effect that all Upstream Transportation over-payment

[4] See CME Compendium, Tab 50, for EB-2011-0210 Exhibit K7.3, cols.1 to 4 of line 3 for the $16.2M; col.5, line 1 for the $22.0M; col.5, line 2 for the $14.5M. See also Technical Conference Transcript, August 21, 2012, at p.28, line 9 to p.31, line 13. There may be an issue as to whether the $22M and $14.5M amounts should be lower. If there is, then this issue can be dealt with at the next phase of this proceeding.

[5] Union Argument-in-Chief, EB-2012-0087, Volume 1, September 7, 2012, p.4, line 25 to p.5, line 4.

amounts in prior years should be recorded in the appropriate deferral accounts for the year that is the subject matter of the current Deferral Account Clearance proceeding.[6]

11. We respectfully suggest that, in framing the Preliminary Issue, the Board did not predetermine that Union could keep over-payments made prior to January 1, 2011, with respect to Upstream Transportation pass-through items of expense. Such an interpretation is inconsistent with the trust principles that ratepayers say should apply to all such over-payments Union is currently holding. We submit that, having regard to Union's actions in the 2010 Deferral Account proceeding, it is open to parties to argue that the $16.2M over-payments to December 31, 2010, should be recorded in the appropriate 2011 Gas Supply Deferral Accounts and cleared with other 2011 Deferral Account balances. This is the interpretation of the Preliminary Issue that the Board has framed upon which this Argument is premised.

12. The intent of the submissions that follow is to assist the Board in its analysis of the important issues of fact and principle that have been raised. These submissions supplement submissions that ratepayer representatives have already made in the EB-2011-0210 proceeding with respect to the core issue of the appropriate classification for the outcome of Union's FT-RAM activities. The Transcript reference for CME's submissions on that core issue in that proceeding is Transcript Volume 15 dated August 24, 2012, at pages 158 to 188.

II. OVERVIEW

13. The submissions that follow are premised on the following propositions:

    (a) Because upstream gas costs are a pass-through item of expense under the Board's long standing regulation of Union, as well as under the IRM Agreement,

[6] See CME Compendium, Tabs 52 and 53, and see also para.99 and footnote 39 of these submissions.

Union is obliged to retain over-payments on account of such costs in trust for ratepayers;

(b) Legal principles related to trusts apply to pass-through items of expense. As a trustee and fiduciary, Union cannot profit from Upstream Transportation cost over-payments;

(c) The extent to which utility assets can be used to support Union's provision to third parties of TS is limited. Union is not free to use utility assets to operate as an unconstrained gas marketer operates. Upstream Transportation assets, falling within the ambit of the Gas Supply Plan upon which rates have been based, are only available to support TS activities if there is surplus capacity available as a result of factors beyond Union's control. Union's TS regime does not apply to a surplus that stems from an Upstream Transportation switching decision made by Union. The "optimization" activities that fall within the ambit of Union's TS regime comprise the provision by Union of TS to third parties that mitigate the costs of temporarily unused utility capacity that is available as a result of factors beyond Union's control.[7]

(d) A management decision to change the upstream elements of a Gas Supply Plan upon which rates have been based so as to create surplus capacity is not a matter beyond Union's control. A "surplus" arising from a decision within the control of Union, being its decision to refrain from using part of the Upstream Transportation components of the Gas Supply Plan and to acquire a substitute form of transportation, is a "surplus" that is ineligible as support for TS activities;

(e) Transportation services switching is not a TS activity. It is a Gas Supply Planning activity related to the Upstream Transportation component of the Plan. The

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[7] Union's definition of "optimization" contained in the Argument-in-Chief at Volume 1, p.6, is inappropriately broad. It does not recognize the limits on the type of surplus Upstream Transportation that can be used to support TS under the auspices of the TS regime that the Board established for Union.

impact on ratepayers of decisions made to change the Upstream Transportation components of a Gas Supply Plan by substituting the transportation service in the Gas Supply Plan with another cheaper form of service should be evaluated having regard to the cost outcome that would have prevailed had the transportation service actually used been included in the Plan at the outset. If it is prudent to use a transportation service that is cheaper than the transportation service embedded in the Gas Supply Plan, then it is prudent to plan and to forecast the cost of that less costly form of transportation at the outset;[8]

(f) TS transportation exchanges referenced in Union's C1 Rate Schedule and in Deferral Account 179-69 prior to its closure were stand-alone exchanges provided by Union to third parties seeking such services. These "Base Exchanges" could be supported by, first, the temporarily idle Upstream Transportation component of the Gas Supply Plan provided that the surplus was caused by factors beyond Union's control; and second, by Upstream Transportation beyond the ambit of and supplemental to the Gas Supply Plan that Union acquired to support the exchange service with the cost of such transportation outside the ambit of the Gas Supply Plan being charged to the third party acquiring that service from Union;

(g) Union's use of and the details of the forms of "combined" transactions that it has used in conjunction with its FT-RAM activities were unknown to ratepayers and the Board prior to Union's 2013 Rebasing Case. The issue of whether the outcome of such "combined" transactions is appropriately classified as TS revenues rather than as upstream gas cost reductions has never heretofore been considered;

[8] See EB-2011-0210 Transcript Volume 15, August 24, 2012, at p.186, line 14 to p.187, line 1 for submissions by counsel for CME pertaining to prudent Gas Supply planning.

(h) The two forms of "combined" transactions in which Union engaged to support its FT-RAM activities were, first, a capacity assignment combined with a marketer provided transportation exchange ("Capacity Assignment") and, second, Union's combined use of the IT optionality that is available under the auspices of its FT contracts with TCPL ("IT Optionality");

(i) The Capacity Assignment cannot reasonably be classified as a TS activity because the "combined" transaction does not stem from an Upstream Transportation surplus caused by factors beyond Union's control. It stems from a planning decision made by Union management, to refrain from using and to assign its TCPL FT service to a marketer, and, concurrently, to acquire a substitute transportation service from that marketer.[9] Union assigns away its more expensive transportation service to acquire a cheaper transportation alternative and retains the amount by which the value of the assigned transportation to capacity exceeds Union's cost of acquiring a transportation exchange service from the marketer. The assignment to the marketer is not a TS exchange provided by Union to a third party. Union's TS regime does not include Capacity Assignments. The substitute transportation that Union acquires from the marketer is a Transportation Exchange service being provided by the marketer to Union. No TS service is being provided <u>by</u> Union to a third party. Neither the "combined" transaction nor any of its elements can reasonably be classified as a TS transaction falling within the ambit of Union's TS regime. As a matter of

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[9] The elements of the Capacity Assignment "combined" transaction are described in a number of places in the EB-2011-0210 record. Exhibit JT12.13, at Tab 41 of the CME Compendium, treats the components of the "combined" transaction as separate, separately priced components with the revenues for assignments exceeding the costs of the exchange. At the hearing, a Union witness characterized the "combined" transaction as a "bundled transaction". In Undertaking Response J7.6 at Tab 42 of the CME Compendium, the adjective "combined" is used to describe the transaction in the Technical Conference Transcript at p.51, lines 9 to 21. The elements of the transaction are described as "two independent transactions". We chose to use the word "combined" to capture the notion that the components of the transactions are related.

principle, Union holds the net benefit from the "combined" transaction in trust for ratepayers. As a trustee, it cannot convert this amount to profits;

(j) Under the IT Optionality "combined" transaction in which Union engages to support its FT-RAM activities, Union uses the IT Optionality that is available under the auspices of its FT contracts to carry utility gas to its system under the auspices of IT service and other costs different from those reflected in the Upstream Transportation forecasts that form part of the Gas Supply Plan and are embedded in rates. The total cost of this utility gas transportation substitute is less than the forecast cost of the FT service being recovered in rates. The remaining ratepayer funded FT-RAM credits are used to acquire IT service that is now incremental to Gas Supply Plan requirements as a result of Union's use of IT Optionality to carry utility gas to its system. This incremental IT is used to support Union's sale to a third party of a stand-alone exchange. However, the cost obligation associated with the acquisition of the IT service used to support that transaction is not transferred to the parties to that transaction. Union leaves this cost burden with ratepayers.

(k) The outcome of the IT Optionality "combined" transaction cannot reasonably be classified as a TS activity falling within the ambit of Union's TS regime because it does not stem from surplus or idle transportation capacity that has been caused by factors beyond Union's control. Rather, as in the case with the Capacity Assignment, a management decision to change the Upstream Transportation component of the Gas Supply Plan is the cause of the FT surplus. The outcome of the "transportation switching" that ensues under the auspices of the IT Optionality "combined" transaction should be classified by recognizing that surpluses stemming from management decisions within Union's control lie outside the ambit of Union's TS regime. As a result, Union holds the IT

Optionality purchasing power that is used to support the sale of an exchange to a third party in trust for the ratepayers. When Union uses that purchasing power, it does so not on its own account, but in its capacity as the trustee for the ratepayers who pay for the purchasing power that is being utilized. The money Union receives from the purchaser of the third party exchange, up to the value of the purchasing power used and paid for by ratepayers, is received by Union as a trustee for the ratepayers. As a trustee, it cannot appropriate that money to its own use.

(l) Another analytical approach that can be applied is to consider the cost impact on ratepayers is to consider the scenario where the change in the utility gas plan to use IT Opitionality rather than FT services to transport utility gas to Union's system had been forecast at the outset. In that scenario, the amounts recovered from ratepayers, at the outset, would not have included the ratepayer funded amount that Union uses to acquire IT to support and enhance the margins on its sale to third parties of stand-alone exchanges. The obligation to pay the costs of the transportation incremental to the Gas Supply Plan that is needed to support Union's sale of the exchange would rest where it belongs, namely, with the parties to the exchange transaction and not with ratepayers. When the outcome of Union's use of the IT Optionality "combined" transaction is analyzed in its proper context, then the margin realized from the stand-alone third party exchanges is to be held by Union in trust for its ratepayers up to an amount equal to the costs of the IT transportation that was acquired to support the exchange service provided by Union;

(m) Transportation switching for the purpose of achieving transportation costs savings to enrich Union's shareholder at the expense of its ratepayers cannot reasonably be classified as TS revenues. The outcome of the two forms of

"combined" transactions that Union has used are and should be classified as Upstream Transportation cost reductions;

(n) As a result of its misclassification of the "combined" transactions, Union has received over-payments to December 31, 2011, of $38.7M. As previously noted, this includes a net over-payment amount to December 31, 2012, of $16.2M. Having already acknowledged in a prior proceeding that Upstream Transportation over-payments, whenever they occur, are to be repaid, the amount Union should be required to reimburse to ratepayers is $38.2M for Upstream Transportation over-payments, subject to a reduction in 2011 earnings to be shared with ratepayers of about $14.5M; and

(o) Prior to its 2013 Rebasing Case, Union did not provide to the Board or to intervenors sufficient details of the FT-RAM activities in which it has engaged to enable them to provide an informed consent or to acquiesce, or to condone Union's classification of such activities as TS revenues rather than as Upstream Gas cost reductions. Union has no justification for keeping as profits the total over-payment amounts that have been withheld as of December 31, 2011.

14. In the sections that follow, we elaborate upon matters pertaining to the legal and Regulatory Framework and the relevant chronology that ratepayers urge the Board to consider when determining the Preliminary Issue it has framed.

III. LEGAL AND REGULATORY FRAMEWORK

A. Upstream Transportation Costs are a Pass-Through

15. It has been a fundamental principle of gas utility regulation in Ontario for many years that costs that a utility incurs to acquire, from third parties, upstream transportation to carry utility gas to its system are to be treated as a pass-through item of expense.

16. It matters not whether it is utility "obligation to serve" considerations or other factors that constitute the underlying rationale for this fundamental principle. The reality is that the principle has been a continuous feature of the Board's regulation of Union for decades and is a concept that is expressly embedded in the January 2008 IRM Agreement to which Union is a party. In its application, the principle means and is intended to mean that neither Union's shareholder nor its ratepayers can gain or lose if the costs of upstream transportation needed for utility purposes vary from the forecast amounts embedded in rates.[10]

17. By enshrining this principle in its Regulatory Framework for the gas utilities it regulates, the OEB has effectively created a trust relationship, with the utility as a trustee holding the amounts of any over-payments in trust for the ratepayers as beneficiaries. Money collected from ratepayers for the upstream transportation of utility gas are to be used for the sole purpose of transporting utility gas to Union's system. Requiring ratepayers to pay for all costs actually paid for upstream transportation of utility gas, regardless of the amounts collected in rates, means that the utility must hold in trust for the ratepayers all amounts collected in rates in excess of amounts actually paid for such transportation services.

18. It would be manifestly unfair and inequitable to impose on ratepayers an obligation to pay all costs for upstream transportation of utility gas in excess of those recovered in rates without concurrently imposing an equitable obligation on Union to retain over-payment amounts provided by ratepayers in trust for those ratepayers.[11] We submit that it cannot reasonably be asserted that the relationship between the utility and ratepayers with respect to over-payments made for the upstream transportation of utility gas is anything other than a trustee/beneficiary relationship. The trustee/beneficiary

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[10] See EB-2011-0210 Transcript Volume 4, July 16, 2012, at p.29, line 25 to p.32, line 6, where the principle that underlies the QRAM process and Gas Supply Deferral Accounts is that ratepayers pay the actual cost of supply.

[11] *Soulos v. Korkontzilas* (1997) S.C.J. No. 52 at paras.45 to 52. See CME Brief of Authorities, Tab 1.

relationship is a well established fiduciary relationship.[12] At a minimum, Union is subject to a duty of loyalty and an obligation not to profit from the payments ratepayers have made that exceed actual Upstream Transportation costs incurred by Union to carry utility gas.

19. Moreover, by agreeing in the January 2008 IRM Agreement to treat upstream transportation costs as a pass-through item of expense, Union expressly accepted to hold any over-payments of such amounts in trust for its ratepayers. The IRM Agreement reflects the establishment of an express trust. The intention of the parties to create upstream transportation costs as a pass-through item of expense is clear. The Agreement reflects the subject matter of the trust, namely, monies recovered by Union in rates to cover the actual costs it incurs to obtain from third parties the transportation of utility gas to its system. The Agreement reflects the certainty of the objects of the trust, namely, that neither the utility shareholder, nor its ratepayers can gain or lose if actual upstream transportation costs are greater or less than the forecast amounts for such costs recovered in rates.[13]

B. Scope and Intent of the QRAM Process and Gas Supply Deferral Accounts

20. The QRAM process and the Gas Supply Deferral Accounts are elements of the Regulatory Framework that are germane to a consideration of the Preliminary Issue.

21. The fundamental principle that upstream transportation costs are a pass-through item of expense is intended to be implemented through the combination of the QRAM process and Gas Supply Deferral Accounts. Union's Gas Supply Deferral Accounts are found at Tab 51 of the CME Compendium. These accounts and the balances to be recorded therein are intended to be and should be administered by the Board in accordance with their underlying intent, which is to assure that neither shareholders nor ratepayers can

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[12] Mark R. Gillen & Faye Woodman, *The Law of Trusts: A Contextual Approach* (Toronto: Edmond Montgomery Publications Ltd., 2008) at 75 [Gillen]. See CME Brief of Authorities, Tab 3.

[13] Gillen, *supra* note 2 at pp.79-85. See CME Brief of Authorities, Tab 3.

gain or lose if the actual costs of upstream transportation needed for utility purposes varies from the amounts recovered in rates.[14] The fundamental principle that upstream transportation costs are a pass-through item of expense should inform the interpretation of the scope of the accounts. It is the principle that breathes life into the accounts and not the reverse, as counsel for Union argues.

22. In combination, the Gas Supply Deferral Accounts are intended to capture the differences between the amounts recovered in Union's rates for Upstream Transportation services and the amount Union actually pays for the services it uses to move utility gas to its system. The TCPL Tolls and Fuels Deferral Account is a supplier specific Deferral Account. We submit that the intent of that account is to capture differences between the forecast costs of TCPL service recovered in rates and the actual costs Union pays to TCPL for those services. The Unabsorbed Demand Charges ("UDC") Deferral Account, on the other hand, is not TCPL specific. It covers differences between forecast and actual demand charges Union incurs for upstream utility transportation. We submit that if Union forecasts the use of one form of TCPL service and actually uses another, then the difference between the cost recovered in Union rates and the amounts actually paid to TCPL should be recorded in one of the Gas Supply Deferral Accounts and eventually reflected in Union's rates.

23. We submit that the TCPL Tolls and Fuels Deferral Account is intended to capture and should be interpreted to capture the difference between the amounts actually paid to TCPL for tolls and fuel and the forecast amounts for tolls and fuel recovered in rates. If Union's rates are based on a plan to use FT tolls and related STS rights to transport utility gas to its system from points upstream and Union then changes its plan and actually uses a combination of cheaper IT tolls and different STS amounts to carry that

[14] See EB-2010-0210 Transcript Volume 15, August 24, 2012, p.178, line 10 to p.179, line 4, for submissions from counsel for CME pertaining to the approach that should be followed when considering the intended scope of the Gas Supply Deferral Accounts.

gas to its system at a total cost to TCPL less than that recovered in rates, then the differences between actual costs paid to TCPL under the IT and other National Energy Board ("NEB") regulated tolls and amounts recovered in Union's rates for TCPL services should be captured and recorded in that deferral account. The cost consequences of TCPL load factor variances in the North can be recorded in this Deferral Account or in the UDC Variance Account. In the South, all variances between the landed costs that Union incurs in bringing utility gas to its system from points upstream should be reflected in the PGVA and other applicable Gas Supply Deferral Accounts. The wording of the Deferral Accounts cannot, we submit, override the trust relationship that exists between Union and its ratepayers with respect to payments that ratepayers have made that exceed actual Upstream Transportation costs incurred by Union to carry utility gas to its system.

C. A Trustee/Fiduciary Cannot Use Trust Property for its Own Benefit

24. A Trustee cannot acquire or profit from trust property without the prior and informed consent of the beneficiaries or prior approval of the court. The House of Lords in *Regal (Hastings) Ltd. v. Gulliver and Others* (1942) 1 All E.R. 387 (H.L.)[15] enunciated the principle as follows:

> ***The general rule of equity is that no one who had duties of a fiduciary nature to perform is allowed to enter into engagements in which he has or can have a personal interest conflicting with the interests of those whom he is bound to protect. If he holds any property so acquired as trustee, he is bound to account for it to his cestui que trust.*** [16]

25. If a Trustee wants to acquire or profit from trust property, without having to account for the benefits, then the Trustee will require the informed consent of the beneficiaries. *Halsbury's Laws of Canada* outlines this proposition as follows:

[15] *Regal (Hastings) Ltd. v. Gulliver and Others* (1942) 1 All E.R. 387 (H.L.) [*Regal (Hastings)*]. See CME Brief of Authorities, Tab 4; as cited in *MacMillan Bloedel*, [1983] B.C.J. No. 802 at para.48 [*MacMillan Bloedel*]. See CME Brief of Authorities, Tab 5.

[16] See CME Brief of Authorities, Tab 4.

> ***Because of his or her responsibilities, a fiduciary sometimes learns of potentially lucrative opportunities, or acquires confidential information from, or on behalf of the principal that presents the fiduciary with an opportunity. <u>Without the informed consent of the principal, a fiduciary cannot seize such an opportunity for his or her own benefit without breaching the fiduciary's duty of loyalty. Even if the beneficiary declined to pursue the opportunity, or the opportunity could not have been realized for the benefit of the principal, a fiduciary that seizes such an opportunity without proper authorization must forfeit whatever profits are achieved.</u> The seizure of an opportunity belonging to a beneficiary is analogous to the misappropriation of property, and often involves the acquisition of a specific asset: accordingly, a constructive trust is often the most appropriate remedy. Where the false fiduciary acquires assets by seizing an opportunity that belongs to the beneficiary, a constructive trust may be impressed upon whatever assets the fiduciary has thereby obtained.*** (emphasis added) [17]

D. What Constitutes an Informed Consent?

26. One cannot consent without knowing the precise action to which one is consenting. In *Royal Bank v. Fogler, Rubinoff* (1991 CarswellOnt 544),[18] Justice Dubin of the Ontario Court of Appeal wrote that "[b]efore a beneficiary can be held to have consented to a breach of trust, it must be shown that the beneficiary was fully informed of its rights and of all the material facts and circumstances of the case" (Royal Bank at 54). Citing Waters, Justice Dubin added that a beneficiary cannot concur without fully understanding that with which it is concurring and there must be no question of concealment by the trustee (Royal Bank at 57). Perhaps most importantly, there must be some positive act or words which demonstrate that the beneficiary not only knew, but also approved of what was proposed or had been done (Royal Bank at 57).

27. Justice Festeryga of the Ontario Court of Justice, General Division, held in *692331 Ontario Ltd. v. Garay* (1997 CarswellOnt 3560)[19] that one "must know all the material facts and circumstances surrounding the breach of trust and, then, he must give specific

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[17] *Halsbury's Laws of Canada*, vol 1, 1st ed (LexisNexis Canada, 2011) at Trusts IV.2.(3)(c)(ii)C [*Halsbury's Laws of Canada.]*. See CME Brief of Authorities, Tab 6.
[18] *Royal Bank v. Fogler, Rubinoff* (1991 CarswellOnt 544). See CME Brief of Authorities, Tab 7.
[19] *692331 Ontario Ltd. v.* Garay (1997 CarswellOnt 3560). See CME Brief of Authorities, Tab 8.

informed approval or consent to the very breach of trust which had occurred, otherwise acquiescence is not a defence."

E. Acquiescence and/or Condonation

28. Acquiescence, like consent, imports full knowledge such that a beneficiary cannot be bound by acquiescence without being fully informed of its rights and all of the material facts and circumstances of the case.[20]

F. Laches and Injurious Reliance

29. For a defence of a breach of trust claim to succeed on the grounds of Laches or unreasonable delay in asserting a claim, coupled with injurious reliance, a defendant must establish that the claimant was possessed of sufficient material facts to be aware that a breach of trust was occurring and that, as a result of delay, circumstances have arisen that would make it unjust to allow the claimant to assert its complete legal rights.[21]

30. Having failed to provide material details of its use of and the forms of the "combined" transactions involved with its FT-RAM activities, Union could not reasonably expect that ratepayers, and the Board, would be prompted to question the proper way to classify the outcome of those activities prior to the full disclosure of the material facts that first occurred in the EB-2011-0210 proceeding.

31. The evidence upon which Union relies such as the events that took place during the course of the EB-2007-0606 case, the EB-2008-0220 case, and the EB-2009-0101 case, and, most recently, its reliance on the availability, in 2002, of FT makeup and Authorized Overrun Services ("AOS") from TCPL, falls well short of establishing that the ratepayers and the Board were aware of and acquiesced in Union's use of "combined" transactions to convert to profits millions of dollars of ratepayer funded FT demand charges on the basis of its unilateral decisions classifying such amounts as revenues stemming from TS

[20] *Royal Bank v. Fogler, Rubinoff* (1991 CarswellOnt 544). See CME Brief of Authorities, Tab 7.

[21] *M. (K.) v. M.(H.)* ([1992] 3 S.C.R. 6). See CME Brief of Authorities, Tab 9.

activities falling within the ambit of its TS regime, rather than as Upstream Gas Costs reductions.

32. Moreover, since Union, by its actions in the 2010 Deferral Account case, acknowledged that any over-payments on account of Upstream Transportation should be re-paid to ratepayers, regardless of when those over-payments occurred, Union cannot reasonably claim that a request from ratepayers for relief should be refused on equitable grounds. The over-payment amounts to December 31, 2011, net of earnings sharing amounts due to ratepayers in a total amount of $23.7M, represent a relatively small portion of the total over-earnings of about $239M[22] that Union realized to December 31, 2011, granting reimbursement relief to ratepayers that reduces total earnings to December 31, 2011, by amount of about 10% from $239M to $215M, does not alter the conclusion that the operation of the IRM Agreement has been beneficial to Union and its ratepayers.

G. <u>Transactional Services Regime and Base Exchanges</u>

33. This is another element of the Regulatory Framework that is relevant to the Board's consideration of the Preliminary Issue.

34. In the context of utility regulation, there are two (2) aspects of Union's TS regime that need to be emphasized. The first is the extent to which utility resources paid for by ratepayers can be used to support the provision of such services. The second is the type of services that fall within the ambit of arrangements that comprise the regulated TS regime that Union is authorized to provide.

35. The focus of our submissions is on the extent to which utility resources can be used to support the provision of such services. It is limited. Union's owner cannot use utility assets to operate as an unconstrained gas marketer. If Union's owner wishes to operate as an unconstrained gas marketer, then it can do so but only through an affiliate. Moreover, such an affiliate cannot control or manage Union's utility assets. The Board

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[22] EB-2010-0210, Exhibit K2.3, p.1, line 20, columns 2 to 5 inclusive.

made a ruling to that effect several years ago when Enbridge Gas Distribution Inc. ("EGD") proposed to effectively outsource the management of portions of its Gas Supply Portfolio to its gas marketing affiliate in Edmonton, AB. Excerpts from that Decision can be found at Tab 11 of the CME Compendium.[23]

36. The purpose of the TS regime that emerged in the 1990s was to provide Union with an incentive to optimize the use of utility assets that were temporarily surplus or idle as a result of factors beyond its control. With respect to the Upstream Transportation acquired by Union from third parties, under the auspices of its Gas Supply Plan, the objective of the TS regime was to prompt Union to optimize the use of these assets so as to mitigate the UDC attributable to idleness caused by factors beyond Union's control. Union and other utilities regulated by the Board had previously acted to mitigate costs associated with temporarily surplus utility assets. Prior to the 1990s, Union and other utilities optimized the use of such assets without an incentive. The TS regime does not authorize optimization of Upstream Transportation utility assets by means of decisions taken by Union's management to make widespread use of forms of Upstream Transportation cheaper than the forms of transportation reflected in the Gas Supply Plan upon which rates have been based.

37. The objective of the TS regime is not to prompt a Gas Supply Plan which includes Upstream Transportation services that the utility does not actually intend to use. Nor is its objective to prompt changes in the Upstream Transportation component of a Gas Supply Plan upon which rates have been derived such as the post-rate-setting substitution of the planned transportation component with a cheaper alternative at the

[23] The evidence of Union's Gas Supply Witness Panel indicated that Union's S&T Dept. effectively operates as the Gas Supply Plan Portfolio Manager on a day-to-day basis. The S&T Dept. apparently provides "guarantees" to the Gas Supply Dept. as a result of which the latter department has little first hand knowledge of the way in which the Gas Supply Plan assets are being utilized. See for example, EB-2011-0210 Transcript Volume 4, July 16, 2012, p.48, line 19 to p.50, line 9.

time that the Plan was formulated but as not used to forecast reduced transportation costs for the purposes of rate-setting.

38. The TS regime for mitigating costs associated with surplus utility assets does not exist to enable Union to profit from management decisions to refrain from using FT Transportation Services reflected in the Gas Supply Plan upon which its rates have been based and instead, opting to use different and less expensive transportation services. Until information was obtained from Union in the recent and on-going TCPL case before the NEB and in this case, the fact that Union was profiting as a consequence of the monetization of self-created UDC, concurrent with the use of transport cheaper than the forecast cost of transport being recovered from ratepayers, was a fact unknown to ratepayers and to the Board.

39. The TS transportation exchanges falling within the ambit of the TS regime that could be used to optimize the use of idle Upstream Transportation so as to mitigate its costs were stand-alone exchange transactions. Such stand-alone exchange services were provided by Union to a third party. By definition, stand-alone exchange services provided by Union to a third party were services whereby Union either took gas from a third party at a point off its system and concurrently delivered gas to that third party at a point on Union's system, or where Union took gas from a third party on its system and concurrently delivered that gas to that party at a point off its system.[24]

40. The exchange services covered by the TS regime that were known to ratepayers and the Board when the IRM Agreement was settled consisted of stand-alone exchange services provided by Union to third parties. Exchange services that Union acquired from others, such as marketers who use their own resources to support such services, are not part of Union's regulated TS regime.

[24] See CME Compendium, Tab 3 at p.8, Union's definition of an exchange modified by the Exhibit at Tab 9 of the Compendium. See also, Technical Conference Transcript at p.33, line 8 to p.36, line 3.

41. We reiterate that the stand-alone exchange services provided by Union to third parties could be supported by Upstream Transportation contracted for by Union to cover its utility gas transportation requirements, provided that such capacity was rendered idle because of factors beyond Union's control. Stand-alone TS exchanges could also be provided by Union to third parties using resources other than Upstream Transportation services covered by the Gas Supply Plan such as TCPL IT Service incremental to the utility transport plan and purchased by Union to support the exchange transaction. The cost of this Upstream Transportation that is incremental to the Gas Supply Plan is not charged to ratepayers but to the revenues being generated by the exchange transaction. These are Base Exchanges. As stand-alone transactions used to mitigate Upstream Transportation surpluses caused by factors beyond Union's control, they are distinguishable from the "combined" transactions that Union used to support FT-RAM activities, which are premised on decisions within Union's control to create surpluses so as to facilitate transportation switching that results in actual Upstream Transportation costs that are materially less than the amounts being collected in rates. We disagree with Union's argument that there are no differences between Base Exchanges and the "combined" transactions that Union uses to support FT-RAM activities.

42. Assignments by Union of surplus capacity under its Upstream Transportation contracts falling within the ambit of its utility Gas Supply Plan are not and never were a transaction that fell within the ambit of Union's TS regime.

43. Before Union's 2013 Rebasing proceeding, neither the Board nor ratepayers were aware of the "combined" transactions that Union was utilizing to convert to profits millions of dollars of FT-RAM credits funded by ratepayers' payment of TCPL FT Demand Charges. Prior to the EB-2011-0210 proceeding, Union did not disclose all material details pertaining to either of the "combined" transactions that Union used in connection with its

FT-RAM activities, namely, the Capacity Assignment combination and the IT Optionality combination that we have previously described.

44. Union's "self-created" surpluses of Gas Supply Plan assets and its ensuing use of "combined" transactions to facilitate its acquisition of Upstream Transportation that was less expensive than the forecast cost of such services embedded in rates was a phenomenon unknown to ratepayers, prior to Union's 2013 Rebasing proceeding.

H. Scope of Deferral Account 179-69

45. This is yet another Regulatory Framework consideration that is relevant to a determination of the Preliminary Issue.

46. At the time of its closure, the Exchange Services to which Deferral Account 179-69 applied were Base Exchanges, as described earlier in these submissions. Deferral Account 179-69 has never applied to and does not encompass Transportation Exchange Services that Union acquires from a third party marketer. Deferral Account 179-69 never applied to the outcome of the "combined" transactions that Union used in connection with its FT-RAM related activities described above. The scope of this Deferral Account was never broadened to cover such "combined" transactions because Union never disclosed details of the material facts pertaining to these "combined" transactions prior to its 2013 Rebasing Case.

IV. CHRONOLOGY

A. Board Decisions pertaining to the emergence of Transactional Services Regimes

47. We have provided at Tabs 1, 2, 6 and 10 of the CME Compendium excerpts from Board Decisions pertaining to the emergence of the TS regimes provided by EGD and Union. These Decisions describe the limited extent to which upstream transportation assets falling within the ambit of the Gas Supply Plan can be used to support TS activities. For

example, the EGD Decisions at Tabs 1, 2 and 10 make it clear that utility assets can only be used to support TS if they are surplus to utility requirements.

48. Excerpts from evidence provided by Union in prior cases are provided at Tabs 3 and 8 of the CME Compendium. In particular, the Union evidence at Tab 8 recognizes that:

> ***With a balanced gas supply portfolio, which meets the forecast in-franchise and ex-franchise firm demands, there will be few, if any, firm assets available to support TS on a future planned basis.***

The extent to which such gas supply plan assets will be available depends on ... "weather and market variances". The portion of utility gas supply assets that is available to support TS activities is only the portion of those assets that is temporarily surplus because of factors beyond Union's control. This evidence confirms the limited extent to which utility Gas Supply Plan assets could be used to support TS activities.

49. We have already pointed out that Upstream Transportation that is incremental to Gas Supply Plan assets can be used to support such transactions. However, changing elements of a Gas Supply Plan after rates have been set and adopting different plan elements was never an activity that fell within the parameters of TS activities.

B. Gas Supply and Transactional Services Deferral Accounts

50. As already noted, the purpose of Union's Gas Supply Deferral Accounts, in conjunction with the QRAM process, is to assure that Union's ratepayers and its shareholder neither gain nor lose on differences between the forecast cost of gas and upstream transportation included in rates and the actual costs incurred. The TS Deferral Accounts applicable to Union's operations prior to the 0606 Settlement Agreement are found at Tab 14 of the CME Compendium. These Deferral Accounts apply to TS activities but not to activities that stem from Gas Supply Plan changes. We have already discussed these Deferral Accounts in the Legal and Regulatory Framework section of these submissions.

51. We agree that prior to their closure, TS Deferral Account 179-69 and the other TS Deferral Accounts that were closed operated in parallel with the Gas Supply Deferral

Accounts. However, this fact does not assist the Board in determining whether the outcome of the FT-RAM activities in which Union engaged are properly classified as Upstream Transportation cost reductions rather than as TS Transportation Exchange revenues.

C. Events Leading to Closure of Deferral Account 179-69

(i) Natural Gas Forum ("NGF") Report

52. The relevant excerpts from the NGF Report dated March 30, 2005, are reproduced at Tab 12 of the CME Compendium. Union relied on this Report to justify its proposals to close the four (4) TS Deferral Accounts eventually closed by agreement in the EB-2007-0606 proceeding. The NGF Report did not alter or dilute the fundamental principle that Upstream Transportation costs are a pass-through item of expense.

(ii) EB-2005-0520 Rate Case

53. Union's initial proposal to eliminate certain TS Deferral Account was made in the EB-2005-0520 Rate Case. The pre-filed evidence in that case, dated December 2005, is provided at Tab 14 of the CME Compendium. Union's rationale for its proposal was the contents of the NGF Report. Nothing in the evidence filed by Union suggests that a purpose of the proposal was to enable Union to take advantage of the FT-RAM features of TCPL's FT service, being a feature that was introduced on a pilot basis in July 2004.

(iii) The Natural Gas Electricity Interface Review ("NGEIR") Decision

54. The proposal to close the deferral accounts was renewed in the NGEIR Decision but again postponed. The NGEIR Decision did not alter or dilute the principle that Upstream Transportation costs are a pass-through item of expense.

(iv) The EB-2007-0606 Case

55. Union renewed its proposal to eliminate certain TS Deferral Accounts in the EB-2007-0606 Case. The evidence Union adduced to support that proposal is found at Tab 18 of the CME Compendium. Union did not provide any evidence pertaining to its FT-RAM

opportunities in this case. If Union was then aware of an ability to use "combined" transactions to take advantage of FT-RAM opportunities, then it failed to provide to participants in this proceeding material facts pertaining either to those opportunities or the "combined" transactions that could be used to take advantage of them to convert ratepayer funded FT demand charges to profits.

56. The consideration that Union proposed to obtain ratepayer agreement to the proposed closure of the four (4) Deferral Accounts was an amount of $4.3M in addition to the amounts embedded in the Board approved EB-2005-0520 rates. The additional consideration of $4.3M, when evaluated against the balances that had previously accumulated in the four (4) Deferral Accounts being closed, (on average, about $8.513M for the years 2004, 2005 and 2006)[25] represented only a portion of those accumulated credit balances. This was the information available for use in evaluating the reasonableness of Union's proposal to embed a further $4.3M in rates in exchange for ratepayer agreement to Union's proposal to close the four (4) TS Deferral Accounts. Union did not pay any amount of consideration to ratepayers with respect to its subsequent conversion to profits of millions of dollars of ratepayer funded FT demand charges under the auspices of the "combined" transactions in which Union subsequently engaged to support its FT-RAM activities.

57. At the time of the closure of the four (4) TS Deferral Accounts, the ambit of Union's TS "exchange" activities known to ratepayers and the Board was limited to stand-alone TS Transportation Exchanges provided by Union to third parties being the Base Exchanges described earlier in these submissions. Ratepayers and the Board could not reasonably be expected to know that the proposal to close the Deferral Accounts and the parties' acceptance thereof would subsequently be relied upon by Union as constituting an

[25] See CME Compendium, Tab 19. We calculate the total credits in the four (4) Deferral Accounts closed to be $11.078M in 2004, $7.289M in 2005, and $7.122M in 2006, for an average of $8.513M per year. Ratepayers accepted an embedded amount of $4.3M as consideration for their agreement to the closure of these accounts.

informed consent by ratepayers and the Board to engage in FT-RAM activities for the purpose of converting to profits millions of dollars of ratepayer funded FT Demand Charges.

D. Events Subsequent to Closure of Deferral Account 179-69

(i) EB-2008-0220 Case

58. Union relies on events that took place during the course of this particular proceeding to support its contention that the Board considered and approved a classification of the outcome of its FT-RAM activities as TS revenues rather than Upstream Transportation cost reductions.

59. This proceeding pertained to Union's request for approval of its 2009 Rates. Its pre-filed evidence dated September 2008 is found at Tab 22 of the CME Compendium. There is nothing in any of the evidence filed by Union in that proceeding pertaining to the FT-RAM activities in which Union was then beginning to engage. One party asked an interrogatory pertaining to a new DOS-MN service being offered by TCPL. The question posed implied that the service could be used to reduce the costs of the Upstream Transportation included in the Gas Supply Plan on which Union's rates had been based. Union's response to the question provided few details of the DOS-MN service. Union's response implied that it would use the service to support TS activity. To ratepayers and the Board, the phrase "TS activities" referred to the provision by Union of stand-alone TS services to a third party under the auspices of its Board approved TS regime.

60. Information pertaining to the DOS-MN service obtained subsequently and found at Tab 21 of the CME Compendium indicates that the service was designed to prompt deliveries at Dawn that would be incremental to the deliveries being shipped under the auspices of FT service. Unlike FT-RAM, a failure to use FT service was not a pre-requisite to the availability of DOS-MN. Put another way, unabsorbed FT demand charges were not the source of funding for DOS-MN. While we did not know it at the

time, we now know that DOS-MN was not a substitute for FT service but a very cheap "overrun" service designed to prompt the flow to Dawn of commodity incremental to the commodity being carried to Dawn by a shipper under the auspices of its FT contract.

61. There was no oral hearing in this case. In its Argument, and relying solely on the information contained in the undertaking response that appeared to be suggesting that the cost of Upstream Transportation covered in the Gas Supply Plan might be reduced, we questioned why reductions in Upstream Transportation costs would not be flowed through to the benefit of Union's ratepayers. In its Reply Argument, found at Tab 25 of the CME Compendium, Union indicated that it would be using the DOS-MN service to support S&T Transactional activity. In its Decision, the Board accepted Union's characterization of its planned used of the service as a TS activity. As already noted, a TS activity is the provision by Union of a stand-alone TS service to a third party under the auspices of its TS regime. There was no scrutiny in that case of the actual use that Union made of the DOS-MN service.

62. As a result of information filed in Union's 2013 Rebasing case, we now know that the service was not actually used by Union to support the provision of a TS to a third party as the Board had concluded in its 0220 Decision. Rather, the DOS-MN service was actually used by Union to replace commodity that it had forecasted would be purchased at Dawn. Actual landed costs of commodity at Dawn that are less than the commodity cost at Dawn embedded in rates result in pass-through commodity cost savings that must be credited to ratepayers.[26]

63. There is little, if any, similarity between the DOS-MN service and the FT-RAM attributes of the FT service Union acquires from TCPL.

64. The 2008-0220 Decision could not reasonably be construed as an informed consent by the Board to Union's treatment of the outcome of its FT-RAM activities conducted under

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[26] See CME Compendium, Tab 49, and Technical Conference Transcript at p.60, line 9 to p.62, line 16.

the auspices of the then undisclosed "combined" transactions as TS revenues rather than as Upstream Transportation cost reductions.

(ii) EB-2009-0101 Case

65. Union also relies on events that occurred in this proceeding to support its contention that the Board has approved its classification of the outcome of its FT-RAM activities as TS revenues rather than as Upstream Transportation cost reductions. This proceeding concerned an application by Union to clear its 2008 Deferral Accounts and to establish the ratepayers' share of earnings sharing for 2008.

66. The evidence dated April 2, 2009, an interrogatory response dated April 21, 2009, the Settlement Agreement dated June 4, 2009, and excerpts from the Board Decision in this proceeding dated June 8, 2009, are found in the CME Compendium at Tabs 27, 28 and 29. The evidence revealed that Union had achieved over-earnings of more than $82M in 2008, being the first year of its operation under the auspices of the IRM Plan. The evidence indicated that the causes of the over-earnings were transportation related revenues of $37.7M. However, there was no disclosure at the time of the extent to which those transportation revenues were FT-RAM related. The evidence in Union's 0210 proceeding reveals that only $5.0M[27] of the transportation related over-earnings were attributable to FT-RAM activities.

67. The total over-earnings of $82M triggered a review under the parameters of the IRM Agreement and exposed Union and ratepayers to the risk of an "off-ramp" outcome. The consent by all parties to the revision of the earnings sharing formula in this case was not an informed consent by ratepayers with respect to the classification of the FT-RAM activities in which Union was then engaging. It was an informed consent to a revision of the earnings sharing formula so as to avoid a review and possible off-ramp from the IRM Agreement.

[27] See CME Compendium, Tab 34, column 2, line 1.

68. Union's response to the interrogatory posed by Board Staff, found at Tab 28 of the CME Compendium, provided no details of the manner in which Union was engaging in FT-RAM activities. There was no discussion of the "combined" transactions that were being used to convert to profits millions of dollars of Upstream Gas Transportation Demand Charges paid for by ratepayers. No evidence was provided by Union pertaining to any periodic Gas Supply Plan changes that were being made to facilitate the "combined" transactions in which Union engaged. There was no reason for readers of the interrogatory response to suspect that the transportation and exchange transactions described in the interrogatory were anything other than the stand-alone Base Exchanges provided by Union to third parties with which ratepayers and the Board were familiar. The interrogatory response falls well short of disclosing all material facts pertaining to the FT-RAM activities in which Union was engaging. The interrogatory response is incapable of constituting an evidentiary base for a conclusion that ratepayers and the Board provided either an informed consent to, acquiesced in, or condoned Union's unilateral classifying the outcome of its FT-RAM activities as TS revenues rather than Upstream Transportation cost reductions.

(iii) The Current TCPL Case before the NEB

69. This was the first case in which details emerged pertaining to the FT-RAM activities in which Union had engaged. Excerpts from Union's interrogatories to TCPL in the TCPL Case are found in the CME Compendium at Tab 39. It was as a result of the pointed questions TCPL posed to Union in the TCPL proceeding and in this proceeding that ratepayers became aware of the amounts being realized by Union from its FT-RAM activities and the nature of transactions taking place.

(iv) EB-2011-0210 Case

70. This case is the only proceeding in which Union has provided sufficient information to enable the Board to make an informed analysis of whether the outcome of its FT-RAM

related activities can reasonably be classified as revenues derived by Union from its provision of TS exchanges to third parties. We respectfully suggest that, in the context of the applicable legal principles, an objective analysis of all of the relevant facts that are now known leads inevitably to the conclusion that the outcome of such actions is Upstream Transportation cost reductions and not TS revenues, as Union contends.

E. Detailed Analysis of Union's FT-RAM Activities

71. As already noted, the FT-RAM activities in which Union engages involve two types of "combined" transactions, namely, the Capacity Assignment and IT Optionality transactions already discussed. A detailed analysis of factors relevant to the classification of the outcomes of each of these "combined" transactions follows:

(i) Capacity Assignments

72. In the 0210 proceeding, counsel for Union argued that the step-by-step parsing of each of the "combined" transactions that we presented in argument is incorrect.[28] It is contended that the first step in the process is the "market" approaching Union to seek an exchange service that Union provides. We had suggested that the first step was a decision made by Union management to alter the Gas Supply Plan upon which rates have been based and to use a form of Upstream Transportation different from that reflected in its rates recovered from ratepayers in conjunction with active efforts by Union to find marketers willing to participate in the "combined" capacity assignments/marketer provided Transportation Exchange transaction.

73. We doubt very much that Union was a passive participant in the events that gave rise to "combined" transactions pursuant to which Union converts millions and millions of ratepayer funded FT demand charges to profits. However, for the purposes of our analysis, it really doesn't matter whether the marketer approaches Union or Union approaches the marketer. The fact is that before Union can assign its FT space to the

[28] EB-2011-0210 Reply Argument, Volume 16, September 4, 2012, p.70, line 21 to p.74, line 27.

marketer, it has to make a business decision to refrain from using that capacity. This decision is not a factor beyond Union's control.

74. Counsel for Union argues that the flow of funds analysis that we presented in argument in the 0210 proceeding is incorrect. In our presentation, we had assumed that the obligation that the marketer undertakes under the assignment to pay TCPL's full demand charge for the assigned capacity was something less than 100% of the demand charge value. This assumption was based on Union's evidence as to the value of assigned FT capacity. This evidence indicated that the assignee would assume between 76% and 85% of the full toll obligation.[29]

75. It appears that this assumption does not apply to the value to a marketer of the assigned FT capacity in a "combined" Capacity Assignment transaction. In argument, counsel for Union advised that, in such a transaction, the assignment to the marketer is for the full value of the FT demand charges.[30] For the purposes of our analysis, we accept this statement. We note that this statement appears to be different from evidence provided by Union during the Technical Conference where the witness appeared to be suggesting that, despite an assignment of FT capacity to the marketer, Union continues to pay the full amount of the FT demand charge to the marketer.[31] This makes no sense and we assume that the witness meant to say what Union's counsel said in argument.

76. That said, the point we were attempting to make in our step-by-step analysis of this "combined" transaction is that the cost to the marketer for the assigned capacity and the benefit to Union of the FT assignment component of the transaction reflect amounts that should be captured in the Gas Supply Deferral Accounts if the transaction were treated as a stand-alone assignment transaction. We reiterate that an assignment of FT capacity by Union is not a TS exchange service. Where a marketer assumes the obligation to pay

[29] See CME Compendium, Tab 39, p.15 of 41.
[30] EB-2011-0210 Union Reply Argument, Volume 16, September 14, 2012, p.73, lines 19 to 23.
[31] See Technical Conference Transcript, August 21, 2012, p.1, line 9 to p.4, line 12, and p.52, lines 22 and 23.

the full amount rather than part of the amount of the demand charge obligation to TCPL, the FT demand charge amount being collected by Union in rates does not have to be spent. An FT demand charge amount collected in rates that does not have to be spent on transportation service gets recorded in a Gas Supply Deferral Account. This, we submit, cannot reasonably be disputed. The outcome of all FT assignment transactions should be treated consistently, regardless of whether they are stand-alone assignments or an assignment that is part of a "combined" transaction.

77. The further point that we were attempting to make in our step-by-step analysis is that while an exchange is a component of this type of "combined" transaction, it is not a Transportation Exchange provided by Union to a third party. Rather, it is a Transportation Exchange acquired by Union from the third party marketer. The exchange that forms part of this "combined" transaction is not an exchange that falls within the ambit of Union's rates or deferral accounts which are confined to exchanges provided by Union to third parties. Union's contention that it is a seller of exchange to the marketer is factually untenable.[32]

78. The additional point that we were attempting to emphasize is that the cost to Union and benefit to the marketer of providing Union with a Transportation Exchange, as a substitute for the FT service that Union had assigned away, is less than the cost to the marketer and the benefit to Union of the FT assignment. This, we submit, cannot reasonably be challenged. This is what Union's responses to interrogatories and undertakings state.[33] This aspect of the "combined" transaction is the purchase of substitute transportation and our point was that, as a purchase of substitute transportation, its cost should be recorded in a Gas Supply Deferral Account.

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[32] See Technical Conference Transcript at p.130, line 24 to p.134, line 10, where the witness insists on calling the marketer provided exchange component of the "combined" transaction a sale of an exchange by Union, even though it is clear that Union is acquiring the transportation exchange from the marketer.

[33] See for example CME Compendium, Tab 41, Exhibit JT2.13 and Tab 42, Exhibit J7.6. The only reasonable interpretation to make of these responses is that the value to Union of the assignment of FT to the marketer exceeds the cost to Union of the exchange service that Union acquires.

79. The assignment by Union of its FT contracts to a marketer and the concurrent acquisition by Union from that marketer of a transportation substitute for the FT service it has assigned are Gas Supply related transactions that should be recorded in Gas Supply Deferral Accounts.

80. The benefit that Union derives from assigning the FT transport reflected in its Gas Supply Plan for more than the cost of the substitute transport that it acquires should be appearing as a credit to ratepayers in the Gas Supply Deferral Accounts. It is not. Why? Because Union misdescribes the "combined" transaction as its "sale" of an exchange to the marketer for the net benefit that it derives from the "combined" transaction. As already noted, Union does not provide an exchange service to the marketer. Union acquires an exchange service from the marketer. The exchange services that Union can provide to third parties under the auspices of its C1 Rate Schedule do not form any part of the "combined" capacity assignment transaction. The C1 Rate Schedule and former Deferral Account 179-69 have no application to an exchange provided by a marketer to Union.

81. For all of these reasons, we reiterate that the outcome of a Capacity Assignment "combined" transaction cannot reasonably be classified as revenues derived from the sale by Union of a service falling within the ambit of its TS regime. The outcome of this "combined" transactions is, we submit, properly classified as an upstream gas cost reduction.

(ii) IT Optionality Under the FT Contracts

82. Counsel for Union also criticizes the step-by-step analysis we presented of the IT Optionality "combined" transaction Union uses in connection with its FT-RAM activities. Once again, for the purposes of our analysis, it matters not whether Step 1 is a party coming to Union seeking an exchange or Union actively soliciting parties to acquire

exchange services from Union. For the purposes of our analysis, we are prepared to assume that someone wanting to acquire exchange services from Union is Step 1.

83. As already discussed, under the TS regime covered by Union's C1 Rate Schedule and Deferral Account 179-69 prior to its closure, Union could respond to a request from a third party for an exchange service requiring Upstream Transportation support in one of two ways. If it had FT capacity falling within the ambit of its Gas Supply Plan that was temporarily idle because of factors beyond its control, then it could use that capacity to support its provision to the third party of the requested exchange service. However, if the Gas Supply Plan capacity was not temporarily idle because of factors beyond Union's control, and was needed to carry utility gas to Union's system, then it was unavailable to support exchange services. In that scenario, Union could acquire the necessary TCPL IT capacity needed to support the exchange transaction outside of the ambit of and as an increment to the Upstream Transportation component of its Gas Supply Plan.[34] Under Union's TS regime, the foregoing represents the extent to which utility Upstream Transportation falling within the ambit of the Gas Supply Plan can be used to support Union's provision of exchange services under the auspices of its TS regime. It is in the context of these limits of Union's TS regime that Union's use of the IT Optionality "combination" should be analyzed.

84. The precursor to Union's use of the IT Optionality available under its FT contracts is a decision taken by its management to refrain from using the FT service. This decision is not prompted by factors beyond Union's control. It is prompted by a decision to change the Gas Supply Plan related to the carriage of utility gas and to use IT and STS services available under the auspices of NEB approved toll schedules to move the utility gas to Union's system at a total cost that is materially less than the forecast FT demand

[34] See CME Compendium, Tab 40, Exhibit JT1.6 for the "Base Exchange" described therein and EB-2011-0210 Transcript Volume 7, p.117, line 20 to p.119, line 24.

charges being recovered from ratepayers. That the cost of using the IT Optionality "combined" transactions can be forecast is apparent from the fact that Union can and actually does forecast the amounts that it expects to realize from using this cheaper form of Upstream Transportation in 2012. Had the costs of actually moving utility gas to Union's system from points upstream been forecast and included in the Gas Supply Plan at the outset on an assumption that Union would actually use the IT Optionality under its FT contracts, then the amounts collected in rates would be materially less than the forecast FT demand charges that were used for rate-setting. If such a forecast of Upstream Transportation costs had been utilized for the purposes of rate-setting, then, to support the sale of an exchange service to a third party, Union would need to acquire IT service incremental to the service used to transport utility gas to Union's system under the modified Gas Supply Plan.

85. The same outcome should ensue when Union chooses to proceed with the IT Optionality "combined" transaction, whereby Union uses the value of IT Optionality, in excess of that needed to move utility gas to Union's system, to support its sale of an exchange to a third party.

86. No one is suggesting that the IT Optionality, in excess of the optionality needed to carry utility gas to Union's system, should "remain on the shelf" as argued by counsel for Union. Rather, what needs to be recognized is that Union holds the IT purchasing power that remains after it has satisfied utility transportation requirements, not in its own right, but as a trustee for the ratepayers who paid for it. This is because Union's TS regime does not apply and was never intended to apply to surplus Upstream Transportation capacity that Union creates by its own management decisions to substitute planned transportation service upon which rates have been based with a cheaper form of transport. Since Union holds the remaining IT Optionality in trust for ratepayers and not for its own account, when it receives revenues from the third party purchaser of the

exchange service, the amount received, up to the value of the purchasing power that was used and paid for by ratepayers to support the exchange transaction, is received by Union not in its own right but in its capacity as the trustee for ratepayers. As a trustee, Union cannot misappropriate that money. It must be held in trust for and eventually credited to ratepayers.

87. The concern is not that Union, in its capacity as trustee for ratepayers, has used the remaining IT Optionality to support the sale of an exchange service to a third party. The concern is that Union is not adhering to its fiduciary obligations, as trustee, to refrain from misappropriating the trust funds for its own use.

88. The portion of the margin realized on the third party exchange transaction in which Union engages under the auspices of the IT Optionality "combined" transaction that equates to purchasing power of the IT Optionality that is used to support the exchange sale component of that transaction, are monies that Union holds in trust for ratepayers. The amount is derived from upstream gas costs recovered in rates that were not needed to support the transportation of utility gas to Union's system. Union's unilateral decision to treat these amounts that it holds in trust as TS revenues constitutes a misappropriation of funds it holds in trust for ratepayers.

89. The IT Optionality "combined" transaction can also be considered from the perspective of whether it is ratepayers or parties to the exchange transaction that are obliged to absorb the cost of using IT Optionality that lies outside the ambit of the changed Gas Supply Plan to support the exchange transaction. That "Base Exchange" scenario is identical to the Base Exchange transaction described in Exhibit JT1.6 filed at Tab 40 of the CME Compendium. The cost of using Upstream Transportation, incremental to that falling within the ambit of the Gas Supply Plan rests with the parties to the exchange transaction and not with ratepayers. This form of analysis leads to the same conclusion as the trust analysis described in the preceding paragraph.

90. Based on the foregoing, we suggest that an objective analysis of the facts pertaining to each of the "combined" transactions that Union uses in conducting its FT-RAM activities leads inevitably to the conclusion that the outcome of the activities is properly classified as gas costs reductions rather than TS revenues. Union's classification of the outcome of such activities as TS revenues is factually untenable.

F. Events Leading to the Framing of the Preliminary Issue

91. The correspondence and Procedural Orders leading to the framing of the Preliminary Issue are found at Tabs 32, 33, 34, 35 and 36 of the CME Compendium.

G. 0087 Technical Conference

92. At the Technical Conference held on August 21, 2012, Union introduced some information pertaining to the availability from TCPL in 2002 of FT makeup and AOS. No details of how these services were actually used by Union in 2002 were provided. Union witnesses indicated that they "would have" or "could have"[35] used these services at that time in its provision of TS to third parties. There was no evidence provided to show the extent to which the Board and interested parties were made aware of either the nature of these services or the manner in which they may have been used by Union.

93. That Union may have used these services in 2002 is of no relevance to the question of whether ratepayers and/or the Board provided an informed consent to, acquiesced in, or condoned Union's use of "combined" transactions to convert to profits millions of dollars of ratepayer funded Upstream Transportation costs. The mere fact that Union may have used FT makeup or AOS services available from TCPL ten (10) years ago is of no probative value with respect to Union's assertion that the Board was previously provided with sufficient information to support a finding that it provided an informed consent to,

[35] See Technical Conference Transcript at p.14, line 21; p.15, lines 1 and 6; p.16, line 22, and also p.37, lines 17 and 18 where the witnesses stated that "… we would have done a 'bit' in that year …".

condoned, and/or acquiesced Union's treatment of the outcome of its FT-RAM activities as TS revenues rather than Upstream Transportation gas cost reductions.

H. Union Reply Argument in EB-2011-0210 Case

94. As already noted, we disagree with Union's contention that there is no difference between Base Exchanges and the "combined" transactions in which Union engaged in connection with its FT-RAM activities.[36] There are material differences and they are discussed above in paragraph 41.

95. We reiterate that, in the context of the limited extent to which utility assets can be used to support TS activities, the definition of optimization that Union postulates is too broad. As already discussed, in a TS services context, optimization means actions taken by Union to sell TS services to third parties so as to mitigate the costs of surplus utility assets that are rendered idle as a result of events beyond Union's control.

96. Union's criticism of the definition of TS that we suggested lacks merit.[37] It misses the point that the Upstream Transportation utility resources available to support TS are very limited. In our definition, we attempted to describe the parameters of those limits which we suggest stem from the Board decisions that we have included in the CME Compendium, as well as evidence from Union in prior proceedings. Union appears to be proceeding from a premise that its TS services regime extends far beyond the limits that are prescribed by the prior Board decisions. We submit that this is an incorrect premise.

97. The absence of any details of its FT-RAM activities at the time the 0606 Settlement Agreement was concluded and subsequently, when it was amended, is not a "red herring", as Union argues.[38] The Board cannot make the finding that Union seeks with respect to informed consent, acquiescence and/or condonation in the absence of such information. Separately and in combination, all of the events that took place in prior

[36] EB-2011-0210 Reply Argument, Transcript Volume 16, p.37, lines 12 to 15.
[37] EB-2011-0210 Reply Argument, Transcript Volume 16, p.77, line 7 to p.79, line 4.
[38] EB-2011-0210 Reply Argument, Transcript Volume 16, p.48, lines 11 to 17.

proceedings, upon which Union relies, are insufficient to support the finding it asks the Board to make.

98. Gas Supply Deferral Accounts should be operated and interpreted as described earlier in these submissions.

I. <u>EB-2011-0038 Case</u>

99. As already noted, in this case, Union, by its actions, acknowledged that Upstream Transportation amounts inappropriately withheld from ratepayers in prior years are to be credited to the deferral account for the year that forms the subject matter of the current Deferral Account Clearance proceeding.[39]

J. <u>Union's Argument-in-Chief in the 0087 Case</u>

100. Our position with respect to the points or argument made by Union in its Argument-in-Chief are covered by the contents of these submissions.

V. ISSUES

1. Is the outcome of the FT-RAM activities in which Union has engaged TS revenues, as Union contends, or Upstream Transportation cost reductions, as ratepayers contend?

2. If the latter, then has the Board heretofore authorized Union to keep as profits the forecast Upstream Transportation amounts recovered in rates in excess of amounts paid by Union to acquire Upstream Transportation for its utility gas?

3. How should a decision requiring Union to credit ratepayers with upstream gas costs over-payments be implemented?

[39] See CME Compendium, Tabs 50 and 51. Union recognized and proposed that over-payments made by ratepayers in 2007, 2008 and 2009 on account of Upstream Transportation should be credited to the appropriate Gas Supply Deferral Account in 2010.

VI. POINTS OF ARGUMENT

Issue 1: The outcome of the FT-RAM activities in which Union engage are Upstream Transportation cost reductions.

101. For the reasons described herein, Union's contention that the outcome of the FT-RAM activities in which it engaged are revenues derived from its sale to third parties of exchanges services falling within the ambit of its TS regime is a contention that is factually untenable. The outcome of the activities is properly classified as upstream gas cost reductions.

Issue 2: Neither intervenors nor the Board authorized Union to convert Upstream Transportation cost over-payments to profits.

102. The facts relied upon by Union fall well short of establishing the pre-requisite disclosure by Union of all material facts that the law requires to support a finding that ratepayers and the Board provided an informed consent to, acquiesced in or condoned Union's unilateral decision to classify the outcome of its FT-RAM activities as TS revenues. This case marks the first proceeding in which the Board and other parties have obtained sufficient information from Union to consider the classification issue.

Issue 3: All over-payments of Upstream Transportation costs should be reimbursed to ratepayers with matters pertaining to the implementation of that decision to be dealt with in the next phase of this proceeding.

103. For the reasons already outlined, the Board should find that all Upstream Transportation over-payments made by ratepayers to December 31, 2011, are to be held in trust by Union for reimbursement to the ratepayers who made those over-payments.

104. We suggest that the Board should direct Union to record over-payment amounts to December 31, 2010, in such 2011 Gas Supply Deferral Accounts as the panel hearing the next phase of these proceedings determines to be appropriate. These over-payments, which we believe to be in the amount of $16.2M, should be reimbursed to ratepayers, along with over-payments for Upstream Transportation made in 2011 of $22M. The reimbursement of those amounts should be to the ratepayers classes who

paid the Upstream Transportation costs with the allocation of those amounts to such ratepayers in Union's Northern and Southern operation areas and all other matters related to the reimbursement of those amounts, including their impact on the 2011 Earnings Sharing calculation, to be dealt with by the panel hearing the next phase of this proceeding.

VII. RELIEF REQUESTED

105. CME joins with other ratepayer representatives in urging the Board to determine the Preliminary Issue in a manner favourable to ratepayers. The particular directions that we suggest are as described above under Issue 3.

VIII. COSTS

106. CME requests that it be awarded 100% of its reasonably incurred costs in connection with matters pertaining to the Preliminary Issue. CME urges the Board to consider including an Interim Cost Award in its Decision with respect to the Preliminary Issue.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 14th day of September, 2012.

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