Ontario Energy Board

Commission de l'énergie de l'Ontario

EB-2012-0087

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

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

BEFORE: Ken Quesnelle
Presiding Member

Karen Taylor
Member

DECISION AND ORDER ON PRELIMINARY ISSUE
November 19, 2012

Introduction

Union Gas Limited ("Union") filed an application dated April 13, 2012 with the Ontario Energy Board (the "Board") under section 36 of the *Ontario Energy Board Act, 1998*, S.O. c.15, Schedule B, for an order of the Board amending or varying the rate or rates charged to customers as of October 1, 2012 in connection with the sharing of 2011 earnings under the incentive rate mechanism approved by the Board, as well as final disposition of 2011 year-end deferral account and other balances (the "Application"). The Application also requested approval for the disposition of the variance between the Demand Side Management ("DSM") budget included in 2012 rates and the revised budget approved by the Board in EB-2011-0327. The Board assigned file number EB-2012-0087 to the Application.

The Board issued a Notice of Application and Procedural Order No.1 on April 19, 2012 in which it adopted the intervenors in the EB-2011-0025 and EB-2011-0038

proceedings as intervenors in this proceeding. The Board also set out a timetable for the filing of interrogatories, responding to interrogatories, and for informing the Board regarding plans to file intervenor evidence.

In Procedural Order No. 2, dated June 27, 2012, the Board established a Technical Conference.

The Board directed intervenors to file letters scoping the issues for which they intended to seek better understanding at the Technical Conference. The Board also established that a Settlement Conference was to be held on August 28 and 29, 2012. On July 10, 2012, the Board issued a letter rescheduling the Settlement Conference to August 21 and 22, 2012.

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

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

The following parties made submissions on the Preliminary Issue: Board Staff, the Building Owners and Managers of Ontario ("BOMA"), the Consumers Council of Canada ("CCC"), the Canadian Manufacturers & Exporters ("CME"), Energy Probe, the Federation of Rental-housing Providers of Ontario ("FRPO"), the London Property Management Association ("LPMA"), and the School Energy Coalition ("SEC").

2011 Upstream Transportation Optimization Revenues

Over the term of the IRM plan, Union has optimized certain aspects of its upstream transportation portfolio. Intervenors and Union have taken different positions as to how these optimization-related activities should be treated in the context of the IRM

Framework. CME has argued that approximately $38.2 million (which includes an amount to December 31, 2010 of $16.2 million and an amount for 2011 of $22 million) has been treated inappropriately by Union since the commencement of the IRM plan.

CME stated that 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 $38.2 million to December 31, 2011, should be reimbursed. CME submitted that the $38.2 million amount consists of: (a) net over-payments to December 31, 2010 of $16.2 million; and (b) upstream transportation over-payments in 2011 of $22 million.[1]

Over the course of the IRM term, Union has been treating the upstream transportation optimization related revenues as utility earnings which are subject to earning sharing. Union argued that this treatment is appropriate for the following reasons.

Union submitted that this treatment is consistent with how these revenues have been treated by Union throughout the IRM term and, with the exception of deferral classification prior to IRM, by the Board historically. Union submitted that reclassifying the revenues as a gas cost reduction would be inconsistent with the past treatment by the Board and would effectively rewrite the terms of the IRM Framework agreed to by the parties and approved by the Board.[2]

Union stated that optimization is a market-based opportunity to extract value from the upstream supply portfolio held by Union to serve in-franchise bundled customers. Union stated that optimization occurs only when there are consequential market opportunities. Union submitted that it finds an opportunity to maximize the value associated with its upstream transportation portfolio, and it acts on that opportunity. Union stated that the opportunities to optimize are consequential in that they arise when a market opportunity presents itself for a variety of different reasons. These can include weather, market behaviour and also the services that are available in the marketplace and the demand from counterparties to acquire those services.

Union submitted that exchanges are a type of optimization activity. Union provided the following definition for exchanges.

[1] CME Argument, September 14, 2012 at p. 3.
[2] Oral Hearing Transcripts, EB-2012-0087 at pp. 3-4.

> An exchange is a contractual agreement where Party 'A' agrees to give physical gas to Party 'B' at one location and Party B agrees to give physical gas to Party 'A' at another location. Either Party 'A' or Party 'B' may agree to pay the other party for this service. An exchange can only happen between a point on Union's system and a point off of Union's system. The exchange must also happen on the same day at the same time.[3]

Union argued that the exchange related activities that parties have issue with, namely the FT-RAM related activities, are no different than any other exchange activities that Union has undertaken in the past. On that basis, Union argued that the FT-RAM related revenues should not be treated differently than revenues generated from other exchange activities.

Union noted that an amount of Storage & Transportation ("S&T") activity, including exchange activity, is included in base rates and is used to offset the revenue requirement. Union submitted that when it earns in excess of the amount built into base rates, that over-earnings has historically been granted deferral account treatment and is shared between Union's shareholder and its ratepayers. Union noted that it has been engaged in exchange activity since at least the early 1990s. More specifically, Union submitted that it has been engaged in exchange activity approved by the Board to optimize its upstream transportation portfolio and has had a deferral account in relation to that activity at least back to the early 1990s. Therefore, Union argued that the FT-RAM related exchange activities are properly characterized as S&T activity which would have, prior to the IRM term, been captured in the S&T related deferral accounts (specifically, Account No. 179-69).[4]

Union submitted that, in the EB-2007-0606 Settlement Agreement, parties agreed to the closure of the four S&T related deferral accounts on the basis that S&T margins built into rates be increased by $4.3 million. Union argued that the FT-RAM related revenues would have been captured in Account No. 179-69 during the IRM term had that account been in operation. Because the account was closed for the duration of the IRM term, the FT-RAM related revenues (and other transactional revenues) were treated as utility earnings during IRM. Union argued that treating the FT-RAM related revenues as utility

[3] RP-2003-0063 / EB-2003-0087, Ex. J20.10.
[4] Oral Hearing Transcripts, EB-2012-0087 at pp. 8-10.

earnings was the clear outcome of the IRM Settlement Agreement and is the appropriate treatment in the context of the IRM Framework.[5]

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

Union submitted that, in the EB-2008-02201 proceeding, it stated that it was not treating any benefit associated with the use of the DOS-MN as a Y-factor. Union also noted that it stated, in that proceeding, that any benefit from the use of DOS-MN over the term of the incentive regulation framework would be used to contribute to the S&T transactional margins already included in in-franchise delivery rates, and would form part of Union's utility earnings. Union also submitted that, in that proceeding, it stated that the DOS-MN service is part of Union's transportation portfolio that is available for optimization through S&T transactional activity. Union submitted that it stated that benefits resulting from transactions to optimize transportation capacity have historically been and will, in the future continue to be recognized as part of Union's regulated S&T transactional activity.[6]

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

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

[5] Ibid at pp. 10-15.
[6] Oral Hearing Transcripts, EB-2012-0087 at pp. 45-56.

> view this is a fair approach that is consistent with the general architecture of the IRM plan and the Settlement Agreement.[7]

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

Union also argued that parties and the Board knew about FT-RAM as early as the EB-2009-0101 proceeding (Union's 2008 Earnings Sharing and Deferral Account disposition proceeding). Union noted that in that case, it over-earned and triggered a review of its IRM Plan as it exceeded its approved earnings by more than 300 basis points.[8] Board staff asked an interrogatory relating to the cause of the over-earnings.[9] Union's reply to that interrogatory included the following statement:

> Union also focused on further optimizing its upstream supply portfolio. Union was able to extract value from new services introduced by upstream transportation providers, in excess of what was achieved historically. An example of these new services includes TCPL's firm transport risk alleviation mechanism, FT RAM, storage transportation service risk alleviation mechanism, STS RAM, and Dawn overrun service must nominate DOS MN. These new services provided increased opportunities for transportation exchange transactions in the market. These opportunities were also influenced by favourable market conditions experienced in 2008.[10]

Union submitted that parties were aware that FT-RAM contributed to its over-earnings in 2008 (along with other transactional services) and at that time, interested parties could have argued for the reinstatement of the transactional margin related deferral accounts (i.e. Account No. 179-69) or could have argued for some other treatment of the FT-RAM related revenues. Instead, the parties agreed that the IRM Plan should remain intact and that amounts earned by Union over 300 basis points above Board approved earnings should be shared 90/10 to the benefit of ratepayers (which was an increase from the 50/50 sharing applicable to earnings over 200 basis points above Board

[7] EB-2008-0220, Decision and Order, January 29, 2009 at pp. 8-9.
[8] 300 basis points over approved earnings was the pre-determined threshold for triggering a review of Union's IRM Plan.
[9] Oral Hearing Transcripts, EB-2012-0087 at pp. 24-28.
[10] EB-2009-0101, Exhibit B, Tab 1, Schedule 4.

approved established in the original IRM plan).[11] As such, Union argued that parties and the Board were aware that FT-RAM related revenues were being treated as utility earnings (and not gas supply cost offsets) in EB-2009-0101 and accepted that treatment.

Union also argued that FT-RAM cannot be properly considered an offset to gas supply costs on the basis of the descriptions and historical usage of the gas supply related deferral accounts. Union submitted that the gas supply deferral accounts only record the changes in actual gas costs and changes in actual transportation costs. Union stated that they do not currently, and never have, captured revenues related to upstream transportation optimization activities.[12]

Board staff argued that the FT-RAM related revenues should have been treated as gas supply costs, on a principled basis, at the outset of the IRM term. However, given the Board's decisions on issues similar to the FT-RAM related issue, Board staff submitted that no change should be made to the treatment of these revenues during the IRM term. Board staff submitted that Union's treatment of these revenues was not unreasonable under the construct of the IRM Framework (and related past Board decisions) and Union should not be required to change the manner upon which these revenues are shared between ratepayers and shareholders at this time.[13]

All intervening parties that made submissions on the preliminary issues argued that the revenues generated from Union's FT-RAM related activities should be treated as gas cost reductions (as opposed to transactional service revenues) and as a result should flow to ratepayers. For example, LPMA stated that the fundamental question for the Board to resolve is whether the FT-RAM related activities undertaken by Union are revenue generating activities (which could then be classified as transactional services) or cost reduction activities (which should then be classified as a reduction in gas transportation costs).

LPMA submitted that these transactions result in Union continuing to deliver the gas to its franchise area for use by its system gas customers. LPMA noted that Union emphasized that the gas purchased always ends up being delivered to its system. The gas may be diverted from one area within Union's franchise to another, but ultimately

[11] Oral Hearing Transcripts, EB-2012-0087 at pp. 24-28.
[12] Oral Hearing Transcripts, EB-2012-0087 at pp. 16-20.
[13] Board Staff Argument, September 14, 2012, at p. 7.

the gas purchased for system gas customers is delivered to Union in its franchise area for use by those customers. In other words, Union is able to reduce the cost associated with the delivery of system gas to its franchise.

LPMA submitted that if Union is able to deliver gas to Ontario for consumption by system gas customers using utility assets that are paid for by those customers at less than forecast, the reduction in costs should be passed through to those customers. To do otherwise, encourages Union to contract on a planned basis to optimize (maximize) revenue generating activities to enhance shareholder return rather than to contract on a planned basis to optimize (minimize) the costs paid by system gas customers. LPMA submitted that these optimization activities are likely to be at odds with one another with the result that system gas customers are paying too much to get their gas delivered to Ontario and Union's shareholder benefitting by a similar amount.[14]

CME also argued that the FT-RAM activities that Union has been engaged in are reductions to the cost of gas transported to Union's customers.[15]

A number of parties provided arguments to refute Union's proposition that the FT-RAM related activities are no different than any other exchange activities that Union has undertaken in the past.

CCC argued that Union has an obligation to ensure that there is sufficient gas supply to meet the needs of its in-franchise customers. It submitted that arranging for sufficient gas supply requires arranging for sufficient transportation to ensure that the required gas gets to its customers. Transportation is, therefore, an integral component of Union's gas supply arrangements. Union's ratepayers pay for the gas supply arrangements. In that sense, the transportation component of the gas supply is a ratepayer asset.

CCC submitted that the costs of gas supply are a Y-factor under Union's IRM Framework. Therefore, gas supply costs are a pass-through item for Union's ratepayers.

CCC argued that the Board has long since recognized that, in arranging the transportation component of gas supply, there may be, from time to time, circumstances

[14] LPMA Argument, September 14, 2012 at p. 2.
[15] CME Argument, September 14, 2012 at p. 39.

where there is temporarily a surplus of transportation capacity. Those circumstances would not be planned, and would, for example, be attributable to temporary changes in market demand or weather. CCC submitted that, in those circumstances, the Board has allowed Union to enter into transactions to earn revenue from the surplus and that the revenue from the noted arrangements were classified as transactional services. CCC further submitted that these revenues were shared between Union and ratepayers, according to a formula that has been adjusted, from time to time, by the Board.

CCC submitted that the essential characteristic of transactional services is that they are arrangements made to generate revenue from an unplanned, temporary surplus transportation capacity that Union may have, from time to time, as part of its gas supply arrangements. CCC submitted that transactional services are not an integral part of Union's gas supply arrangements.[16]

CME described how Union utilized the FT-RAM program to generate revenues as follows:

> Union has been optimizing components of its gas supply plan upon which its rates are based by creating unabsorbed demand charges ("UDC"), on a planned basis, and then either concurrently assigning or exchanging its FT transportation contracts for services on the TCPL Mainline to:
>
> i. monetize the FT-RAM credit value of its unused FT contracts;
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> ii. obtain cheaper means of delivering its Western Canadian gas supplies to their intended destination; and
>
> iii. treat the difference between the monetized FT-RAM credits funded by demand charges recovered from ratepayers in rates, and the costs of the cheaper transport as utility earnings, rather than as a reduction to Union's upstream transportation costs.[17]

CCC submitted that the FT-RAM program allowed Union to manage its gas supply arrangements in order to increase, very substantially, the revenue it could earn from some of its transportation arrangements.

[16] CCC Argument, September 14, 2012 at p. 2.
[17] CME Correspondence, August 3, 2012 at p. 2.

CCC submitted that Union's use of the FT-RAM service was not necessary in order to supply gas to its ratepayers. It argued that FT-RAM service was a service that allowed Union to alter its gas supply arrangements in order to increase the revenues available from the gas supply arrangements. CCC submitted that the FT-RAM program allowed Union to artificially manage the transportation arrangements by leaving pipe empty and flowing gas on a different path.

CCC submitted that transactional service opportunities arise in unplanned circumstances. CCC submitted that Union used the FT-RAM service as a tool to plan its transportation services and therefore FT-RAM is, in its essence, a part of Union's gas supply planning.

CCC submitted that Union's characterization of the FT-RAM transactions as exchange activities in not appropriate. CCC submitted that FT-RAM related transactions require two steps as follows:

> "Leaving the pipe empty is not an exchange. Buying the – or using the interruptible transportation ("IT") service on TransCanada from Empress to the NDA is not an exchange. But the exchange is then the part where we actually move a third party's gas from somewhere on Union's system to somewhere off our system, or likewise, off our system onto our system."…
>
> "The only reason we're doing that is because of FT RAM. If we didn't have FT RAM, there would be no economic incentive to do that transaction."[18]

CCC submitted that characterizing the FT-RAM related transactions as transactional services distorts the underlying reality that the FT-RAM arrangement is an artificial manipulation of the gas supply arrangements undertaken solely for the purpose of earning additional revenue. CCC submitted that the FT-RAM transaction is something fundamentally different than a traditional exchange arguing that the fact that there may be an exchange component to the arrangement does not change its essential nature.

CCC submitted that the evidence in the rebasing case, and in this proceeding, leads to the conclusion that the revenue earned from the FT-RAM arrangements is revenue earned not from transactional services but from gas supply arrangements. It is, therefore, properly characterized as a Y-factor, under the IRM framework, which makes it a pass-through item to be credited to Union's ratepayers.[19]

[18] Oral Hearing Transcripts, EB-2012-0087 at p. 44.
[19] CCC Argument, September 14, 2012 at pp. 3 - 4.

CME also, in its submission, described the difference between the FT-RAM related transactions and Union's traditional exchange activities. CME stated 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. CME submitted that stand-alone 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 transportation plan and purchased by Union to support the exchange transaction.[20] CME submitted that these types of transactions are base exchanges. CME argued that base exchanges are stand-alone transactions used to mitigate upstream transportation surpluses caused by factors beyond Union's control and that they are distinguishable from the combined transactions that Union used to support FT-RAM activities.

CME submitted that the combined transactions used to support FT-RAM activities are premised on decisions within Union's control to create surpluses so as to facilitate transportation switching that result in actual upstream transportation costs that are materially less than the amounts being collected in rates. CME submitted that it disagrees with Union's argument that there are no differences between what it referred to as base exchanges and the combined transactions that Union uses to support FT-RAM activities. CME argued that 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 transactional service regime.[21]

CME cited Union's evidence from RP-2003-0063 / EB-2003-0087 noting the following:

> 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.[22]

CME submitted that 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

[20] CME noted that 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.
[21] CME Argument, September 14, 2012 at p. 20.
[22] Ex. K1.1 at Tab 11.

is available to support transactional service activities is only the portion of those assets that is temporarily surplus because of factors beyond Union's control. CME submitted that the above cited evidence confirms the limited extent to which utility gas supply plan assets could be used to support transactional service activities.[23] CCC's and CME's positions and submissions, as discussed above, were either supported by or substantially the same as those of SEC, BOMA and others.

In its reply submission, Union submitted that the underlying premise to intervenor arguments is the assertion that the scope for upstream optimization is limited to instances where Union, as a result of unplanned changes in weather and market demand, has surplus transportation capacity. Union argued that there is no proper basis for the premise put forth by intervenors.

Union submitted that it has engaged in Board-approved upstream transportation optimization since at least the early 1990s, and that the sale of exchanges is simply one form of optimization. Union submitted that its ability to optimize its upstream transportation portfolio is affected by a range of factors that may include the attributes of the upstream transportation contracts, including the FT contracts held by Union. In this respect, Union submitted that it has a Board-approved practice of taking advantage of the attributes attached to TCPL FT contracts, and the value the market places on these attributes, to effect exchanges to the benefit of Union and ratepayers.

Union submitted that the passage cited by CME, from the RP-2003-0063 / EB-2003-0087 proceeding overlooks the balance of the evidence in that proceeding. Union submitted that in RP-2003-0063 / EB-2003-0087, it specifically discussed the assets available to support S&T activity as follows.

> Over the last few years, the level of S&T transactional revenue has been impacted by warmer weather and favourable market pricing conditions. In addition, certain TCPL services (e.g. FT make-up, AOS) that were approved and in place for 2002 only provided transactional revenue opportunities in 2002 and are no longer available. For 2003 and 2004, the Gas Supply Plan reflects a balanced or 'normal' asset utilization forecast.
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> The actual assets available for S&T transactional services will change on an ongoing basis dependent upon actual weather and market factors including the amount of direct purchase switching, T-Service switching, in-

[23] CME Argument, September 14, 2012 at p. 22.

> franchise growth, changes in customer use, market prices, and customer demand for S&T services. Union's forecast for S&T transactional services for 2003 and 2004 reflects normal market and operating conditions.[24]

Union argued that, as reflected above, there is nothing novel in Union taking advantage of market circumstances to optimize its upstream transportation portfolio. Union submitted that, as it previously indicated, actual assets available for S&T transactional services would depend, in part, on market factors (i.e., they were not limited to surpluses arising from weather or in-franchise demand). Union argued that there is nothing novel about exchange optimization utilizing FT-RAM as an attribute of FT contracts and that it has been engaged in exchange activity approved by the Board to optimize its upstream transportation portfolio since at least the early 1990s. Union argued that there is nothing inappropriate about Union seizing market-based opportunities to the benefit of Union and ratepayers.

Union argued that intervenors now seek to differentiate the upstream optimization activities undertaken by Union historically from those undertaken during IRM. However, Union submitted that they are fundamentally the same. Union submitted that efforts to link historic transactions to surplus assets or weather permitting circumstances are not grounded in the evidence. Union argued that the permissible scope of optimization is not delineated by the parameters suggested by intervenors, such as an unplanned temporary surplus of transportation capacity.

Union submitted that, fundamentally, the intervenors' argument misunderstands the difference between assets available on a planned basis and the use of assets on an actual basis having regard to market related factors that may emerge throughout the year. Union submitted that it does not plan to meet its customer needs through exchanges or other optimization activities, other than in rare instances. Union submitted that, pursuant to the gas supply plan, customer needs are met through the combination of firm upstream transportation contracts, Dawn sourced supply storage capacity and STS deliveries. Union submitted that it acquires only that capacity necessary to meet those demands, and no more. Union submitted that for this reason, it is entirely correct to say that on a planned basis there are few assets available for optimization. Union claimed that that is not to say, however, that where unplanned market opportunities present themselves, be they as a result of weather, customer demands, or market demand for transactional services (including services underpinned by services offered

[24] Ex. K1.1 at Tab 11.

by TCPL such as FT-RAM), Union does not seek to realize those opportunities for its own benefit and the benefit of ratepayers. Union submitted that it does so, and has done so for many years without issue, pursuant to the Board approved regulatory framework.

Union argued that its basic approach to optimization has not changed. What has changed is the number and profitability of market-based optimization opportunities under FT-RAM. Union submitted that this is due to significant changes in the market demand for transactional services, and is a positive development for both Union and ratepayers. Union argued that the resulting benefits for Union and ratepayers were captured because Union, responding to the incentives generated by the IRM framework, bore the cost and the risk of responding to available market-based opportunities. Union argued that, while the amounts generated exceeded previous optimization efforts, Union's approach to FT-RAM optimization was the same as Union's prior approach to optimization and consistent with the Board's regulatory framework.[25]

A number of parties disagreed with Union's argument that the Board and parties consented to the treatment of transactional revenues (including FT-RAM) during the IRM term.

CCC submitted that ratepayer representatives could only be said to have provided an informed consent to the characterization of Union's use of the FT-RAM service as transactional services if Union's use of the FT-RAM service, to manage the transportation arrangements, had been described to those ratepayer representatives. CCC argued that that description did not occur until the 2013 rebasing case (EB-2011-0210). Accordingly, CCC submitted that ratepayer representatives cannot be said to have consented to Union's characterization of its use of the FT-RAM service as a transactional service. CCC argued that it is not knowledge of the existence of the FT-RAM service that is relevant; it is knowledge of how Union used the service that is relevant.

CCC argued that whether ratepayer representatives provided an informed consent to Union's characterization of its use of the FT-RAM service as a transactional service is not determinative. CCC stated that the relevant consideration is whether the Board, in approving the settlement agreements, and therefore Union's IRM framework, or in the

[25] Union Reply Argument, September 24, 2012 at pp. 3 – 7.

subsequent rate applications, can be said to have approved, directly or by necessary implication, Union's characterization of its use of the FT-RAM service as a transactional service.

CCC submitted that Union relied on the Board's consideration of its use of TCPL's DOS-MN service, in EB-2008-0220, to make its argument that the Board consented to Union's characterization of its FT-RAM related revenues as transactional service revenues. CCC submitted that Union argued that the arrangements under DOS-MN were analogous to those under FT-RAM and so the Board must be taken, by necessary implication, to have approved FT-RAM arrangements as transactional services. CCC submitted that the Board could not be taken to have provided an informed approval without having had a detailed description, not of some analogous service, but of how the FT-RAM service was being used. CCC submitted that a detailed description of the FT-RAM program and how it was being used was not provided until the 2013 rebasing application (EB-2011-0210).

CCC argued that the existence of the IRM Framework provides the Board with a short form way of exercising its jurisdiction under Section 36 of the *Ontario Energy Board Act* to approve just and reasonable rates. CCC argued that the use of the IRM Framework does not dislodge the obligation of the Board to ensure that all of the components of the IRM Framework have been properly characterized and the revenues derived from the operation of those components properly allocated. CCC argued that to do that, the Board must have sufficient information on which to exercise its discretion.

CCC submitted that, prior to the 2013 rebasing case, the Board did not have sufficient information about how Union was using the FT-RAM service to allow Union to say that the Board had approved the characterization of those arrangements as transactional services (and therefore, approved of the allocation of revenue derived from those arrangements).

CCC submitted that revenues earned from the use of FT-RAM are significant, in the order of approximately $22 million in 2011 alone, and that the proper allocation of those revenues goes to the issue of the basic fairness of the IRM regime. CCC submitted that approvals should be based on a full and transparent description of what the Board is being asked to approve and not on conjecture.[26]

[26] CCC Argument, September 14, 2012 at p. 6.

SEC argued that the examples that Union provided of consent for its treatments of upstream transportation optimization revenues were all indirect, ambiguous, and lacking in disclosure of material facts. SEC submitted that none of the alleged consents can be properly characterized as fully informed consent, or anything close to that standard. SEC submitted that, at best, some of the examples cited by Union might be considered acquiescence without full knowledge of all the facts.[27] BOMA, FRPO and others provided similar arguments to the arguments of CCC and SEC described above.

In reply, Union argued that the intervenors' focus on the alleged inadequacy of Union's disclosure of the mechanics of Union's use of the FT-RAM program is misplaced. Union submitted that the intervenors' suggestion that Union has failed to adequately disclose its FT-RAM optimization activities inappropriately shifts the focus from the question of whether Union's FT-RAM optimization activities are consistent with the analytical framework of IRM. Union stated that the question is not whether Union's FT-RAM optimization activities were material and adequately disclosed, rather the question is whether Union's FT-RAM optimization activities are consistent with the IRM Framework, which Union argued that they are.

Union also reiterated its position, discussed previously, that intervenors and the Board were aware of Union's approach to optimization from proceedings before and during IRM, including EB-2008-0220 and EB-2009-0101.[28]

A number of parties made submissions counter to Union's argument that reclassifying the revenues as a gas cost reduction would be inconsistent with the past treatment by the Board and would effectively rewrite the terms of the IRM Framework agreed to by the parties and approved by the Board.

CCC submitted that the Board has never considered the revenues generated by Union through the use of the FT-RAM service and that the terms of the IRM Framework, agreed to by the parties and approved by the Board, require Union to treat gas supply, including transportation costs, as a pass-through item. CCC argued that the IRM Framework does not give Union the freedom to characterize, in any way it chooses, its transportation arrangements as transactional services. CCC argued that characterizing

[27] SEC Argument, September 14, 2012 at p. 5.
[28] Union Reply Argument, September 24, 2012 at pp. 7 - 13.

Union's upstream transportation arrangements is the statutory obligation of the Board in each application. CCC stated that it would be entirely consistent with the terms of Union's IRM Framework for the Board, in this proceeding, to characterize the revenues derived from Union's use of the FT-RAM service as gas supply, and not as a transactional service.

CCC submitted that it is open to the Board to find that the revenues derived from the use of the FT-RAM arrangements are not transactional service revenues but are gas supply revenues that should be credited to the ratepayers.[29] CCC's argument was supported by SEC and others.

In its reply argument, Union reiterated its position that the Board has dealt with the issue of Union's treatment of upstream transportation optimization during IRM (specifically in EB-2008-0220 and EB-2009-0101). Union submitted that its treatment of these revenues is in accordance with the IRM Framework and with past Board decisions on similar issues.[30]

With respect to Union's argument that FT-RAM cannot be properly considered to be offset to gas supply costs on the basis of the descriptions and historical usage of the gas supply related deferral accounts, CME noted that 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 related deferral accounts. The gas supply related deferral accounts and the balances to be recorded therein, CME argued, are intended to be and should be administered by the Board in accordance with their underlying intent, which is to ensure that neither shareholders nor ratepayers can gain or lose if the actual costs of upstream transportation needed for utility purposes varies from the amounts recovered in rates. CME submitted that the fundamental principle that upstream transportation costs are a pass-through item of expense should inform the interpretation of the scope of the accounts. CME argued that it is the principle that gives purpose to the accounts and not the reverse.

CME submitted that in combination, the gas supply deferral accounts are intended to capture the differences between the amounts recovered in Union's rates for upstream

[29] CCC Argument, September 14, 2012 at pp. 6-7.
[30] Union Reply Argument, September 24, 2012 at pp. 7 – 13.

transportation services and the amount Union actually pays for the services it uses to move utility gas to its system. CME further submitted that the TCPL Tolls and Fuels Deferral Account is a supplier specific deferral account. CME argued 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. CME submitted that the UDC Deferral Account is not TCPL specific and that it covers differences between forecast and actual demand charges Union incurs for upstream utility transportation. CME submitted 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.

CME submitted 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. CME argued that 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 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. CME argued that the cost consequences of TCPL load factor variances in the North can be recorded in this Deferral Account or in the UDC Variance Account and 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 related deferral accounts. CME submitted that the wording of the gas supply related deferral accounts cannot override the 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.[31] CME's submissions on this issue were supported by a number of parties.

In its reply argument, Union stated that reliance on the "fundamental principle" that upstream costs are a pass-through is not convincing. Union argued that the concept that upstream transportation costs are a pass-through does not exist in the abstract;

[31] CME Argument, September 14, 2012 at pp. 12 – 14.

rather, it is specifically defined by the Board approved gas supply deferral accounts. Union argued that the words used by the Board in the accounts prescribe what is passed through, and what is not. Union submitted that in other words, to the extent the gas supply deferral accounts are relevant; it is because they help define the permissible scope of optimization.

Union provided descriptions of the gas supply related deferral accounts in its reply argument. Union submitted that the revenues arising from Union's FT-RAM related upstream optimization activities do not fall within any of the gas supply deferral accounts. Specifically, the introduction of FT-RAM did not result in a change to the tolls charged by TCPL. Further, Union argued that to the extent tolls have changed during IRM, those changes have been passed through to ratepayers.[32]

BOMA, in its submission, provided a description of the purpose of the FT-RAM program. BOMA also provided a detailed history of TCPL's FT-RAM program and Union's role in certain NEB proceedings as a proponent of the FT-RAM program.

BOMA also submitted that TCPL has provided evidence that the elimination of the FT-RAM program would decrease its FT tolls. BOMA submitted that Union's ratepayers are paying higher tolls for FT service from TCPL as a result of the FT-RAM program while Union's shareholder is capturing most of the revenues generated through the FT-RAM transactions. BOMA argued that this outcome is not fair to ratepayers.[33]

In its reply argument, Union submitted that the proposition put forth by BOMA (i.e. Union's ratepayers have paid higher rates – as a result of higher TCPL tolls – due to the FT-RAM program), is not correct. Union argued that the benefit to ratepayers from earnings sharing exceeded the toll related impact of this level of discretionary revenues.[34]

FRPO, supported by a number of other parties, argued that independent of IRM, Union should not be allowed to profit by retaining excessive gas supply transportation contracts. FRPO argued that one of the first principles in designing an asset plan is to "right-size" the assets and contracts to meet the obligations of a utility. FRPO submitted

[32] Union Reply Argument, September 24, 2012 at pp. 13 - 14.
[33] BOMA Argument, September 14, 2012 at pp. 3 – 7.
[34] Union Reply Argument, September 24, 2012 at p. 16.

that, if done properly, the opportunities to optimize the assets are driven by weather variances or market changes.

FRPO submitted that in Union's rebasing proceeding (EB-2011-0210), Union described that it has a gas supply plan that meets two goals: the seasonal needs relating to the amount of gas that the company needs in Ontario and peak day needs to meet its system integrity requirements for the coldest day of the winter in its respective delivery areas. However, FRPO argued that during discovery, it became clear that while Union contracts for the gas to one location, it turns the contracts over to its capacity management division who assigns the contracts to third parties and as part of the agreement with the third party, Union requires the third party to deliver the gas to the delivery point where it is actually needed during the winter and to Dawn in the summer. FRPO argued that since the contracts assigned have delivery points that are further downstream than the designated delivery point, the third party is able to secure FT-RAM credits for the unutilized portion of the transportation path. FRPO argued that these transactions do not occur because of a change in market conditions or weather and submitted that these transactions occur months ahead of the start of the winter and that the term of the transactions are up to one year.

FRPO argued that while a case could be made that sending gas directly to Dawn in the summer appears prudent, there can be no principled argument for why ratepayers ought to be burdened with the additional cost of transport to a delivery area that is not consistent with the requirements for system integrity on a peak day. FRPO submitted that the capacity is clearly not needed for the location to which it is contracted or based upon Union's own principles of system integrity. FRPO argued that these planned diversions of gas from the contracted delivery point to the point designated in the assignment have resulted in a significant increase in profit enjoyed by the shareholder. FRPO submitted that those windfalls were generated with a significant cost to ratepayers and that a utility ought not be allowed to profit by retaining excessive gas supply transportation contracts for the purposes of converting that excess into shareholder profit by characterizing the transactions by their own definition as exchanges.[35]

In its reply argument, Union stated that FRPO's argument, set out above, is misconceived. Union submitted that the relevant context, as the Board's preliminary

[35] FRPO Argument, September 14, 2012 at pp. 2 – 4.

issue states explicitly, is the IRM Framework and the treatment of optimization revenues. Union argued that the prudence of Union's gas supply portfolio in 2011 is not at issue in this proceeding, nor could it be. Union submitted that its 2011 upstream transportation portfolio is the subject of final orders issued by the Board in connection with multiple QRAM proceedings. Union argued that the Board has no jurisdiction to engage in retroactive ratemaking to alter those previous orders of the Board.

Union submitted that in any event, consistent with Union's prior Board approved practice, Union maintained in 2011 (and today) a balanced gas supply portfolio, designed to meet annual, seasonal and peak day in-franchise bundled customer needs (i.e. system supply and bundled direct purchase customers).[36]

CME, in its submission, provided a detailed analysis of the legal and regulatory framework applicable to Union's treatment of its upstream transportation optimization revenues. CME argued that it has been a fundamental principle of gas utility regulation in Ontario for many years that costs that a utility incurs to acquire upstream transportation from third parties to carry utility gas to its system are to be treated as a pass-through item of expense. CME stated that it does not matter whether it is utility "obligation to serve" considerations or other factors that constitute the underlying rationale for this fundamental principle. CME argued that 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 IRM Settlement Agreement to which Union is a party. CME stated that in its application, the principle discussed above 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.

CME submitted that by including this principle in its regulatory framework for the gas utilities it regulates, the Board 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. CME submitted that money collected from ratepayers for the upstream transportation of utility gas is to be used for the sole purpose of transporting utility gas to Union's system. CME argued that requiring ratepayers to pay for all costs actually paid for upstream transportation of utility gas, regardless of the amounts collected in rates,

[36] Union Reply Argument, September 24, 2012 at pp. 25 – 27.

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.

CME submitted that 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 overpayment amounts provided by ratepayers in trust for those ratepayers. CME submitted 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. CME argued that the Trustee/Beneficiary relationship is a well-established fiduciary relationship.

CME submitted that 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. More specifically, CME submitted that by agreeing in the IRM Settlement 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. CME submitted that the IRM Settlement Agreement reflects the establishment of an express trust and that the intention of the parties to create upstream transportation costs as a pass-through item of expense is clear. CME argued that the IRM Settlement 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. CME submitted that the Settlement 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.

CME also argued that a Trustee cannot use trust property for its own benefit. CME submitted that if a trustee wants to acquire or profit from trust property, without having to account for the benefits, then the Trustee requires the informed consent of beneficiaries. CME also provided a legal description as to what it submitted constitutes informed consent.[37] CME argued that the facts relied upon by Union fall well short of establishing the pre-requisite disclosure by Union of all material facts that the law

[37] CME Argument, September 14, 2012 at pp. 10 – 16.

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 transactional service revenues.[38]

CME concluded its argument by stating that 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. CME suggested that the Board direct Union to record the over-payment amounts to December 31, 2010, in such 2011 gas supply deferral accounts as the panel hearing determines to be appropriate. CME contends that these overpayments, which it believes to be in the amount of $16.2 million, should be reimbursed to ratepayers, along with over-payments for upstream transportation made in 2011 of $22 million. CME submitted that the reimbursement of those amounts should be to the ratepayer classes who paid the upstream transportation costs with the allocation of those amounts to ratepayers 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 in the next phase of this proceeding.[39]

In its reply argument, Union stated that CME's request for relief with respect to the upstream transportation optimization revenues prior to 2011 disregards the terms of the Preliminary Issue framed by the Board in Procedural Order No. 3. Union noted that the Preliminary Issue is limited to the optimization revenues in 2011. Therefore, Union submitted that the submissions by CME on amounts prior to 2011 are not properly before the Board and should be disregarded. Union submitted that in any case, the revenues for years prior to 2011 are subject to final rate orders from the Board and are not subject, at law, to adjustment.

With respect to CME's argument that there is an express trust relationship between Union and its ratepayers, Union submitted that this is not correct. Union stated that CME's proposition that trust law principles should be applied in the context of a regulated commercial relationship disregards basic principles of trust law and is not supported by any authority.

[38] Ibid. at p. 39.
[39] Ibid.

Union also argued that while it is required, and does, act in good faith to facilitate effective regulation by the Board, this requirement does not, as a matter of law, transform Union into a fiduciary of ratepayers. Union stated that the Supreme Court of Canada has held that the creation of fiduciary relationship requires an undertaking on part of the fiduciary to act as a fiduciary. Union submitted that there is no evidence that Union has undertaken to act as a fiduciary for ratepayers and it has not done so.[40]

Union concluded its reply argument by noting that it has treated its upstream transportation optimization revenues appropriately during the IRM term. Union stated that the IRM Framework has worked effectively and has achieved the objectives set out by the Board. Union stated that there is no evidence that any individual consumer views the results of IRM as other than positive. Union submitted that the various intervenor arguments on Union's treatment of upstream transportation optimization revenues are not based on principle, consistency or proper accounting. Union argued that the intervenor arguments are simply an attempt to retroactively renegotiate the terms of the IRM Settlement Agreement and recover regulated earnings to which they have no entitlement.[41]

Board Findings

For the reasons set out below, the Board finds that Union's 2011 gas supply related upstream transportation FT-RAM optimization revenues shall be classified and treated as gas supply cost reductions.

Union's IRM Framework was established pursuant to a consultation facilitated by the Board. The consultative process led to the filing of the Settlement Agreement in EB-2007-0606 which set out the features of the agreed upon framework for Union's IRM plan. The Board accepted the Settlement Agreement in its Decision and Order in EB-2007-0606. That Decision gave effect to Union's IRM Framework.[42]

The IRM Framework is a policy, the primary purpose of which is to set just and reasonable rates. The IRM Framework is also intended to produce positive regulatory outcomes, such as incenting improved productivity performance, providing certainty with respect to the regulatory process, and reducing the administrative costs associated with

[40] Union Reply Argument, September 24, 2012 at pp. 21 – 25.
[41] Ibid. at pp. 27 – 28.
[42] Decision and Order, EB-2007-0606, January 17, 2008.

economic regulation. The achievement of these positive outcomes does not diminish the importance or come at the expense of the primary mandate of the Board, that being the setting of just and reasonable rates.

At all times, the Board must be of the view that the rates arising from the IRM Framework are just and reasonable. The Board agrees with CCC, who stated in its argument[43] that the IRM Framework does not dislodge the obligation of the Board to ensure that all components of the IRM Framework have been properly characterized and the revenues derived from the operation of those components have been allocated properly.

The Board is of the view that there is no tension between the objectives of the IRM Framework and its rate setting mandate. The Board makes findings during the IRM term based on the evidence properly put before it in the rate adjustment processes that are embedded in the IRM Framework. There is nothing inherent in the IRM Framework that requires the Board to depart from its normal approach to rate setting. The Board's discretion with regard to setting rates within the IRM term is exercised based on the facts placed before it and with due consideration of any new issues that have arisen. These are not new concepts.

The Board has an ongoing responsibility to determine whether activities undertaken during the IRM term are being characterized in accordance with the IRM Framework and have been characterized in a manner which results in just and reasonable rates.

It necessarily follows then, that the annual disposition of deferral accounts, earnings sharing and other accounts that are part of Union's IRM Framework is not merely a mechanical exercise. Rather, it is a process that is informed by evidence relating to the balances in those accounts and whether those balances reflect the appropriate application of the IRM Framework and the regulatory principles inherent in it.

The IRM Framework reflects a long-standing regulatory principle that the cost of gas and upstream transportation are treated as pass-through items. The Board points out that the following language was included in the Settlement Agreement on the IRM Framework.

[43] CCC Argument, September 14, 2012 at p. 6

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> The parties agree that identified Y factors will not be adjusted by the price cap index but will be passed through to rates.
>
> Items that will be treated as Y factors are:
>
> - Upstream gas costs
> - Upstream transportation costs
> - Incremental DSM costs (as determined in EB-2006-0021 and in any subsequent DSM proceeding) and volume reductions
> - Storage margin sharing changes (as determined in EB-2005-0551).[44]

As cited above, the Settlement Agreement specifically establishes that the cost of gas and upstream transportation are Y-factors and are treated as pass-through items.

The Board agrees with the submissions of parties, and in particular the argument provided by CME, that set out its understanding of how Union utilized the FT-RAM program to generate revenue. The evidence in this case supports CME's contention that Union generated revenue by creating unabsorbed demand charges or UDC on a planned basis and then either concurrently assigned or exchanged its FT contracts on the TCPL Mainline to monetize the FT-RAM credit value of the unused FT contracts.

The Board agrees with the submissions of parties that the utilization of TCPL's FT-RAM program by Union allows Union to manage its upstream transportation arrangements on a planned basis by leaving pipe empty and flowing gas on a different and cheaper path. The Board finds that the effect of this activity is that higher upstream transportation costs that are paid for by Union's customers, have been substituted with lower cost upstream transportation arrangements.

The Board finds that Union has used TCPL's FT-RAM program to create a profit from the upstream transportation portfolio and has treated this profit as utility earnings, subject only to the provisions of the earnings sharing mechanism.

The Board finds that this treatment is inconsistent with the Settlement Agreement on the IRM Framework and contrary to long standing regulatory principle inherent in the IRM Framework that the cost of gas and upstream transportation are to be treated as pass-

[44] EB-2007-0606, Settlement Agreement, Section 5.

through items, and therefore that Union cannot profit from the procurement of gas supply for its customers.

As such, the Board finds that Union's upstream transportation FT-RAM optimization revenues are gas cost reductions, and are properly considered Y-factor items in accordance with Union's IRM Framework. The Board directs Union to confirm that the net revenue amount related to FT-RAM optimization activities for 2011 is $22 million.

Union has argued that a finding to this effect will undo the IRM Framework. The Board does not agree. This determination is in no way a departure from the IRM Framework. The Board is simply re-classifying revenues based on evidence that has been filed with the Board, as part of Union's rebasing proceeding (EB-2011-0210) and incorporated by reference in this proceeding. This re-classification of revenues results in a treatment that is consistent with the IRM Framework and the regulatory principles inherent in it. As stated earlier, the Board considers the rate adjustment processes embedded in the IRM Framework to have the purpose of facilitating the type of review that has occurred here in this case.

The Board notes that Union has classified the revenues generated from its upstream transportation FT-RAM optimization activities as transactional service revenues because it believes that these activities are no different than its traditional transactional service activities. However, the Board finds that a review of the evidence filed by Union in previous proceedings to answer the question: "what are transactional services" does not lead to this conclusion.

In RP-2003-0063 / EB-2003-0087, Union's description of its transactional services, cited below, implies that the upstream transportation assets related to the gas supply plan that are optimized are only those assets that are surplus to the needs of the gas supply plan for reasons outside of Union's control.

> 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.[45]

The Board notes that, in the above passage, Union clearly states that upstream transportation assets are generally only available on an unplanned basis. The Board

[45] Ex. K1.1 at Tab 11.

also notes that Union provided the following additional evidence in RP-2003-0063 / EB-2003-0087:

> Over the last few years, the level of S&T transactional revenue has been impacted by warmer weather and favourable market pricing conditions. In addition, certain TCPL services (e.g. FT make-up, AOS) that were approved and in place for 2002 only provided transactional revenue opportunities in 2002 and are no longer available. For 2003 and 2004, the Gas Supply Plan reflects a balanced or 'normal' asset utilization forecast.
>
> The actual assets available for S&T transactional services will change on an ongoing basis dependent upon actual weather and market factors including the amount of direct purchase switching, T-Service switching, in-franchise growth, changes in customer use, market prices, and customer demand for S&T services. Union's forecast for S&T transactional services for 2003 and 2004 reflects normal market and operating conditions.[46]

Union provides the above citation in support of its argument that actual assets available for transactional services would depend (in part) on market factors and that the assets available would not be limited to surpluses arising from weather or in-franchise demand.

The Board finds that Union's evidence in the RP-2003-0063 / EB-2003-0087 proceeding, when taken as whole, does not support the conclusion that the planned optimization of gas supply related assets would be considered a transactional service. The evidence in the above noted proceeding explicitly speaks to the fact that with a balanced gas supply portfolio there will be few, if any, firm assets available to support transactional services on a future planned basis. In the Board's view, this statement speaks to the fact that the portion of utility gas supply assets that is available to support transactional service activities is only the portion of those assets that is temporarily surplus to the gas supply plan as a result of factors beyond Union's control. Therefore, a clear distinction can be made between Union's transactional services (including exchanges) and Union's FT-RAM related activities.

The Board does not agree that these optimization activities are sustainable efficiency improvements found during the IRM term as argued by Union. They are clearly reductions to upstream transportation costs that result in an overall reduction to the cost of achieving Union's gas supply plan, and are subject to pass-through treatment in the IRM Framework.

[46] Ibid.

Union takes the position that the FT-RAM related optimization activities cannot be properly considered to be an offset to gas supply costs on the basis of the descriptions and historical usage of the gas supply related deferral accounts. The Board does not accept this position.

Absent a sufficient understanding about Union's FT-RAM optimization activities, it is not reasonable to assert that the Board or intervening parties could have assessed whether the structure of the gas supply related accounting orders was in accordance with the Settlement Agreement. The accounting orders were approved by the Board based on the evidence before the Board at that time and do not reflect the evidence that is now available to the Board in this proceeding. The Board therefore finds that the accounting orders, as structured, are inconsistent with Settlement Agreement which states that upstream transportation costs, not merely tolls, are a pass-through item.

Union has argued that the Board, and parties, were aware of and addressed the treatment Union applied to its upstream transportation activities during the IRM term. Union cited both the EB-2008-0220 and EB-2009-0101 proceedings in support of this argument. The Board does not agree with this assertion.

Union has not pointed to any previously filed evidence that fully explained how these revenues were being generated. The record on the Preliminary Issue has been almost entirely informed by evidence from Union's 2013 rebasing proceeding which has been incorporated by reference. The evidence describing the nature of Union's FT-RAM optimization activities in this proceeding far exceeds any that has been provided to the Board in the past.

The Board also notes Union's argument that it did not discuss in its evidence in EB-2007-0606 any of the ways in which it had optimized its transportation portfolio in the past or might do so in the future, and its argument that its intention during the IRM process that led to the Settlement Agreement was to put in place a framework for IRM, not to discuss how each of the parameters (including optimization or O&M productivity or any other issue) in the framework would be met going forward.

In general, the Board is of the view that there is no expectation that the exact nature of the efficiency gains anticipated by a utility during an IRM period be identified or disclosed in advance. However, the question that is the subject of the Preliminary Issue

in this proceeding and has unfolded in the context of Union's IRM Framework in this case is different.

The Board has found that the FT-RAM optimization activities associated with Union's upstream transportation services represent a departure from long-standing regulatory principle that the cost of gas and upstream transportation are treated as pass-throughs. The Board finds that Union must be mindful of the information asymmetry that exists between it and ratepayers. In particular, the Board finds that Union has an obligation to disclose departures or potential departures that it intends to make from regulatory principle inherent in the IRM Framework during the term of the IRM. The Board finds that the nature of Union's FT-RAM optimization activities and its treatment of the resulting revenue is an example of the type of departure that warrants a much higher level of disclosure than was produced in prior proceedings.

One of the remaining issues that must be addressed by the Board in this Decision on the Preliminary Issue is the amount of the estimated 2011 FT RAM net revenue of $22 million that should be credited to customers as an offset to gas supply costs. The determinations of the Board in this Decision suggest that all of the net revenue should accrue to ratepayers.

However, Union has said that absent an incentive, it may not have undertaken these activities. Further, the Board has not considered the issue of whether optimization of the gas supply plan is an integral part of prudent utility practice and should be undertaken by Union without the payment of an incentive.

Absent consideration of this issue by the Board, the Board is of the view that it is appropriate for Union to receive an incentive for having generated this net revenue in 2011. The Board has previously approved incentive payments ranging from 10% to 25%.

Prior to the commencement of Union's IRM Framework, Union received an incentive on transactional services equal to 25% of net revenue. The Board notes that this level of incentive payment was supported by parties at that time and found by the Board to be appropriate, in light of the effort required by Union to generate transactional services net revenue.

The NGEIR decision provided that Union would receive 10% of the net revenues associated with short-term storage and balancing activities. This incentive for short-term storage transactions continued through the IRM period and was again found to be appropriate by the Board for 2013 in EB-2011-0210.

In EB-2011-0210, the Board found that Union's optimization activities are to be considered part of gas supply and that 90% of all optimization net revenue, including net revenue associated with FT-RAM, shall accrue to ratepayers and 10% shall accrue to Union as an incentive to continue to undertake optimization activities on behalf of ratepayers.

Consistent with the treatment of Union's short-term storage transactions during the IRM period, the Board is of the view that it is appropriate for Union to receive a 10% incentive for having generated these net revenues in 2011. Ratepayers are thus entitled to 90% of the $22 million net revenue amount related to Union's 2011 FT-RAM activities in the form of an offset to gas supply costs.

Finally, in regard to CME's submission that the amount related to the gas supply-related upstream transportation optimization activity prior to 2011 also be addressed in conjunction with the Preliminary Issue, the Board is of the view that those amounts are beyond the scope of this proceeding. The scope of the Preliminary Issue was set out by the Board in Procedural Order No. 3, in which the Board stated that it would be determining whether Union treated the upstream transportation optimization revenues appropriately in 2011 under the auspices of Union's existing IRM framework. The Board is of the view that Union's application in EB-2012-0087 and the Preliminary Issue are solely concerned with the 2011 earnings sharing and final disposition of 2011 year-end deferral accounts, and the treatment of 2011 upstream transportation optimization, respectively.

Union shall file the following evidence to allow the Board to give effect to its findings in this Decision. The Board directs Union to confirm that the $22 million FT-RAM net revenue amount cited above by the Board in this Decision is the correct amount that shall flow to ratepayers as a gas cost reduction (minus a 10% incentive to Union). Union shall also inform the Board in what gas supply related deferral account(s) the amount will be recorded. In addition, Union shall file a draft accounting order for the deferral account(s) in which Union proposes to record these amounts. Union shall also inform the Board how the amounts that are to be recorded in the gas supply deferral accounts

related to its gas supply related upstream transportation optimization activities will be allocated to its customers. Finally, Union shall file an update to the earnings sharing calculation which removes the gas supply related upstream transportation FT-RAM net revenues and recalculates the amount to be shared with ratepayers.

THE BOARD ORDERS THAT:

1. Union's gas supply related upstream transportation FT-RAM optimization revenues shall be classified as gas cost reductions and be recorded in the appropriate gas supply deferral account(s). Union shall share 90% of the net revenue amount of $22 million for 2011, or the appropriate amount as provided by Union, with ratepayers.

2. Union shall file all the information requested by the Board in its Decision no later than November 26, 2012.

3. A Settlement Conference will be convened at 9:30 a.m. on November 27, 2012 with the objective of reaching a settlement among the parties on all outstanding issues in this proceeding. The Settlement Conference will be held in the Board's hearing room at 2300 Yonge Street, 25th Floor, Toronto, and may continue on November 29, 2012, if needed.

All filings to the Board must quote file number **EB-2012-0087**, be made through the Board's web portal at https://www.pes.ontarioenergyboard.ca/eservice, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Please use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.ontarioenergyboard.ca. If the web portal is not available you may email your document to the BoardSec@ontarioenergyboard.ca. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file seven paper copies. If you have submitted through the Board's web portal an e-mail is not required.

ISSUED at Toronto, November 19, 2012

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary