EB-2012-0087

Ontario Energy Board

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

AND IN THE MATTER OF an Application by Union Gas Ltd. for an order or orders approving the clearance or disposition of amounts recorded in certain deferral or variance accounts.

FRPO SUBMISSIONS

January 2, 2013

INTRODUCTION

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. In its decision on the Preliminary Issue, the Board ordered:

> *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.*[1]

As a result of the Board decision on the Preliminary Issue, Union was ordered to determine the amount of FT-RAM transactions that were used to reduce gas transportation costs and to propose how the benefits would be allocated to customers by November 26, 2012. In the package submitted on that date, Union proposed a reduction of the net revenues by an amount allocated for compressor fuel gas and Unaccounted for Gas (UFG). In subsequent discovery, through inquiry and cross-examination, Union has argued that this reduction was appropriate as it had been applied historically to determine net margins for the previous Transportation Exchange Services Deferral Account 179-69[2].

[1] EB-2012-0087 Decision and Order on the Preliminary Issue dated November 19, 2012, page 32.
[2]

Gas Transportation Cost Reductions Ought to be Accounted for at the Margin

The Preliminary Issue decision determined that the FT-RAM transactions were to viewed and accounted for as Gas Transportation Cost reductions. To effect the Board's order, in our view, these transactions should be classified and accounted for separately and distinctly from Union's traditional and current optimization transactions. We believe that all of the revenues and all of the costs should be booked in the new deferral account 179-130 to determine the resulting amount that would allocated to reduce transportation costs for customers who paid for the transport. Applying this proposition would result in Union reversing the transaction where the "fuel and unaccounted-for gas is recorded as a cost of gas expense"[3].

What needs to be recognized here is this transfer as described by Union witnesses is actually a transfer of a portion of the revenue from the transaction wherein the cost of fuel gas and UFG were negotiated into the price of the exchange. From the transcript, the following exchange clarifies that transaction revenue is being moved from the proceeds of these transactions to offset company-used gas costs:[4]

> MR. QUINN: That's helpful. So if you would do the same thing for number 2, other transportation services?
>
> MR. ISHERWOOD: I'm not sure what they would be. Do you have an example that...
>
> MR. QUINN: So an interruptible transport service, Dawn to Parkway.
>
> MR. ISHERWOOD: So that is typically like a C1 type of transaction.
>
> MR. QUINN: Yes.

[3] Transcript, Volume 2, December 21, 2012, page 32, lines 14-15
[4] Transcript, Volume 2, December 21, 2012, page 29, line 17 to page 31, line 18

MR. ISHERWOOD: Again, when we sell C1 transportation, it is normally short term. Typically the customer and Union will negotiate a price that includes fuel and UFG.

So we would then allocate those costs to fuel and UFG. And when the customer nominates the service in our pipeline system, they're nominating for the volume in the contract and not fuel in addition.

MR. QUINN: Okay.

MR. ISHERWOOD: C1 and exchange is basically exactly the same transaction, so two and three are identical.

MR. QUINN: If I could stop you there, sorry. I was looking at Ms. Elliott and I don't want us to jump around too much, but you -- I think maybe it is helpful if we go one at a time.

If you could flip back, I think it is just two pages, I think what I heard Mr. Isherwood say is that on another transportation service, like a C1 IT contract, the cost of fuel and the UFG would be negotiated in as a price, but then I thought I heard him say would then be stripped out and allocated back to fuel costs and UFG.

MR. ISHERWOOD: Sorry, let me clarify, because I may have misstated.

When we negotiate a price for an exchange or for C1 service, part of the value of that service -- call it 20 cents -- there would be a fuel component that would be a cost against the total revenue. When I say "fuel" I'm including UFG in that. So fuel and UFG are the same for -- are embedded in the same percent.

So if we sell a 20-cent exchange or C1, there may be five or six cents of fuel that is embedded as a cost, that we would then deduct off to get to a net revenue and margin number.

MR. QUINN: So you take in 20 cents of revenue and we will use five cents for simple math?

MR. ISHERWOOD: Sure.

MR. QUINN: 15 cents, then, comes back. Where did the five cents go? Where is it booked?

MS. ELLIOTT: So the full 20 cents in this example is booked as revenue, and the cost of fuel and UFG is booked as a cost of gas expense.

> So we would have 20 cents of revenue and we would have five cents of cost, and we would have a net margin of 15 cents.
>
> MR. QUINN: Where does the five cents go?
>
> MS. ELLIOTT: The five cents is the fuel and unaccounted-for gas is recorded as a cost of gas expense.
>
> We refer to it at times as company-used gas. So it is the total cost of compressor fuel and unaccounted-for gas on our system.

Although the original question was asked about the second category, Other Transportation Services, the Dawn to Parkway interruptible transportation was typical of a C1 exchange. As noted by Mr. Isherwood "C1 and exchange is basically exactly the same transaction, so two and three are identical."[5] Through understanding created in this exchange, it is clear that revenues from the FT-RAM supported exchanges are being booked to gas costs, as a "negative expense". Union then proposes to keep a historic practice of allocating fuel gas and UFG to these transactions as they would have for optimizations in the former Transportation Exchange account prior to its closure. To do so would result in the revenue collected for fuel gas and UFG as a negotiated part of the exchange serving to reduce gas costs thus increasing profits, while at the same time, the Upstream Transportation FT-RAM Optimization Deferral Account No. 179-130 would be allocated a cost for fuel gas and UFG. This is clearly a mismatch of revenues and costs.

[5] Transcript, Volume 2, December 21, 2012, page 30, lines 6-7. Two and three referring to Other Transportation Services and FT-RAM credit supported exchanges from Exhibit K2.3, FRPO Question 2.

An argument could be made that Union was at risk for fuel gas and UFG during the IRM period and that the 2011 variance between actual and recovery resulted in $26 million surplus to the company's benefit[6] . However, we respect that the decision on the Preliminary Issue has changed the way Union has historically viewed these transactions from traditional optimizations to gas cost reductions. In doing so, there ought to be a commensurate change in accounting to look at these transactions at the margin to ensure that there is an appropriate allocation of incremental costs incurred to generate the incremental net revenues. In this area, we agree with the Union's submissions in argument-in-chief:[7]

> Either the revenues and costs are captured in the deferral account, or, as they were previously, in earnings sharing, but it should not be the case that the revenues are in the deferral account, but the costs are in earnings sharing, which is the effect of that.

As the Union witnesses provided, the C1 rate is negotiated with an embedded price for fuel gas and UFG. These revenues created by the embedded cost for fuel gas and UFG are moved to the account for company-used gas[8] as part of the calculation of Net Revenues. In Union's proposal, there would then be an allocation of the cost of fuel gas and UFG. To be clear, these are allocations of cost as there is no nomination of fuel gas on Union's system[9].

In our view, in the appropriate matching of revenues and costs, these revenues for embedded fuel & UFG costs should have been kept with the revenue. If Union kept the revenues embedded to compensate for the Union system costs in the new deferral account, then it would be appropriate to allocate fuel gas and UFG as proposed but only if the incremental amount of revenue paid by

[6] Exhibit K2.3, CME Question 1, Attachment 1, line 9.
[7] Transcript, Volume 2, December 21, 2012, page 48, lines 22-26.
[8] Transcript, Volume 2, December 21, 2012, page 31, line 14-18.
[9] Transcript, Volume 2, December 21, 2012, page 28, line 8-22.

the counter-party stays in the deferral account so that there is a matching. Since there is no information on the record as to the value of C1 revenues transferred to cost of gas, the simple option is to deny the additional $948k. This approach could be taken in recognition of the fact that, in Union's proposed accounting, fuel gas and UFG have already been compensated for by the transfer to company-used gas of the "5 cents" embedded in the price of the service to the third party.

In the alternative, Union could be ordered to provide the amount of transferred to gas cost from FT-RAM supported exchanges and put that revenue back with the net revenues. At that point, an allocation of fuel gas and UFG could be booked to that account. In our view, that is the way Deferral Account 179-130 should operate in 2012 and a similar approach be used with Deferral Account 179-131 in 2013 and beyond.

Deferral Account Wording

In Union's Response to the Preliminary Issue on November 26, 2012, the following wording was proposed in relation to the revenue treatment for 179-130[10]:

> To record as a credit in Deferral Account No. 179-130 the ratepayer portion of net revenues related to FT-RAM optimization as ordered by the Board in EB-2012-0087. Net revenue is defined as FT-RAM optimization revenue less related third party and fuel costs to provide FT-RAM optimization transportation services.

[10] Exhibit K2.1, Appendix D

In our view, this wording ought to be more specific to describe the third party and fuel costs are deducted but revenues associated with embedded costs are kept in the deferral account. We would submit that wording such as "Net revenue is defined as FT-RAM optimization revenues with appropriate adjustments for the marginal costs of creating the revenue, e.g., allocation of company fuel as directed in EB-2012-0087".

Conclusion

FRPO commends the Board in providing effective opportunities for this Application to be heard and the record to be clarified. In this final step in ensuring an equitable approach to cost allocation, the additional steps have afforded an opportunity to understand how past approaches, in our view, need to be altered to effect a faithful execution of the Board's direction. We respectfully submit that Union ought to change its historic approach to accounting for the FT-RAM transactions to ensure there is an appropriate matching of costs and benefits. The expeditious approach would result in the denial of the allocation of costs for fuel gas and UFG. The most effective approach of reversing the streaming of revenues, embedded for fuel gas and UFG, away from the deferral account could be done in the alternative and we would submit be ordered for the 2012 disposition approach.

Costs

We respectfully submit that the Federation of Rental-housing Providers of Ontario has acted responsibly in its intervention in this matter and respectfully requests that it be awarded 100% of its reasonably incurred costs in connection with this matter.

All of which is respectfully submitted on behalf of FRPO,

Dwayne R. Quinn
Principal
DR QUINN & ASSOCIATES LTD