January 15, 2013

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

Re: EB-2012-0087– Union Gas Limited – 2011 Earnings Sharing & Disposition of Deferral Account and Other Balances – Reply Submission of Union Gas Limited

Dear Ms. Walli:

Please find enclosed two copies of the Reply Submission of Union Gas Limited for the above noted proceeding.

Yours truly,

[original signed by]

Karen Hockin
Manager, Regulatory Initiatives

cc: EB-2012-0087 Intervenors
Crawford Smith (Torys)
Alex Smith (Torys)

EB-2012-0087

ONTARIO ENERGY BOARD

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 of orders amending or varying the rate or rates charged to customers as of October 1, 2012;

REPLY ARGUMENT OF UNION GAS LIMITED

Overview

1. This is Union's Reply Argument, which should be read in conjunction with Union's Argument in Chief. This Reply Argument responds to those intervenors who oppose the deduction of compressor fuel and Unaccounted for Gas ("UFG") costs in calculating the net revenue to be recorded in Deferral Account 179-130 and quantifies the amount of those costs. The argument also addresses the wording of Account 179-130.

2. Union remains of the view that the proper amount of net revenue to be recorded in Deferral Account No. 179-130 is $18.947 million after deducting compressor fuel and UFG costs of $0.948 million incurred on Union's system necessary to generate the revenues arising from the FT-RAM related optimization transactions. This result flows from the accepted principle that revenues and costs associated with the transactions should be matched. Union's position is supported by Board Staff and LPMA.

3. On the contrary, failure to follow this principle, as suggested by some intervenors, would (1) result in ratepayers not paying the costs associated with the FT-RAM related optimization activity and (2) eliminate any incentive for Union to engage in the activity in the first place. For many of the exchanges that Union does, the 10% share of the net revenue would not cover the costs of the UFG and compressor fuel.

4. Finally, Union continues to support the wording proposed for Account 179-130 set out in Exhibit K2.1.

Key Principle Accepted

5. As submitted in its Argument in Chief, the revenues and costs associated with FT-RAM related optimization transactions should be matched in Account 179-130. Matching ensures that ratepayers receive the benefits of the FT-RAM related transactions as a gas cost reduction while paying for the costs necessary to realize those benefits. If revenues and costs are not matched, ratepayers will receive the benefits without paying a commensurate amount of the costs. This would eliminate any Board ordered incentive to Union to optimize its upstream transportation portfolio.

6. Prior to 2008, Union shared net transportation and exchange revenue with ratepayers through the disposition of Deferral Account 179-69. To arrive at the amount to be shared, Union matched costs and revenues by deducting the costs of compressor fuel and UFG incurred to provide the relevant transportation and exchange services. This had been Union's Board approved practice since 1993.[1]

7. Board Staff and intervenors agree with the matching principle. As Board Staff submits, "it is appropriate that <u>all</u> of the revenues and <u>all</u> of the costs (third-party, compressor fuel costs and UFG costs) related to the FT-RAM optimization transactions be reflected in … [Account 179-130]."[2]

Application of the Principle Results in the Deduction of Fuel and UFG Costs

8. Despite agreeing with the principle that revenues and costs should be matched, CME and, CCC fail in the application of that principle and oppose the deduction of compressor fuel and UFG costs. They make two related arguments:

(a) that Union has not incurred incremental compressor fuel and UFG costs associated with the FT-RAM related optimization transactions; and

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[1] Exhibit K2.3, FRPO q. 4

[2] Board Staff p. 3; CCC p. 1; CME p. 2; LPMA p. 2; FRPO p. 2; Energy Probe p. 5 (Energy Probe's ultimate position as to the proper amount to be recorded in the Account is difficult to discern as it agrees with LPMA and FRPO which take conflicting positions)

(b) that the amounts recovered from ratepayers in 2011 for compressor fuel and UFG exceeded Union's actual fuel and UFG costs.

9. Alone, FRPO argues that Union may have separated out the revenue collected through the FT-RAM transaction price for the fuel costs and booked those revenues as a reduction to its company-used gas costs. Board Staff has asked that Union specifically address this argument.

10. Each of the intervenor arguments are refuted below.

Fuel and UFG costs are incremental

11. At paragraph 13 of its argument, CME asserts that, "[t]hese charges [fuel and UFG in rates] cover all of the utility gas that Union brings to its system" under capacity assignments or FT-RAM related optimization transactions. To the same effect, CCC asserts that Union did not incur any compressor fuel or UFG costs.[3] Both statements are incorrect and contrary to the undisputed evidence.

12. In 2011, Union engaged in two types of optimization transactions: capacity assignments and FT-RAM related optimization transactions. As explained in Exhibit K2.3, optimization of the gas supply plan, under either form of transaction, had no impact on the quantity of compressor fuel and UFG necessary to serve Union's in-franchise customers. In this respect, the costs of compressor fuel and UFG on Union's system are not related to the gas supply plan. These costs are incurred to provide storage, transportation and distribution services within the franchise with the forecast of these costs based on the demand for these services on the system. How the gas arrives to Union's system has no impact on the costs.[4]

13. However, in respect of FT-RAM related transactions (as opposed to capacity assignments) Union incurred incremental fuel and UFG in connection with the sale of exchange services to ex-franchise customers. While the same quantity of Dawn-Parkway compressor fuel and UFG was incurred as a result of the optimization of the physical flow of gas, incremental fuel and UFG costs were then incurred to support the sale of the incremental FT-RAM

[3] CME p. 4, para 13, see also para 14. CCC p. 1

[4] Exhibit K2.3, CME q. 1, pp 1, 4-6

transportation exchange services giving rise to the revenues captured in Account 179-130. As explained by Union with reference to an example of a typical transaction:

> In the same month that Union generates the FT-RAM credits, Union enters into a new Dawn-Waddington transportation exchange service … to meet an incremental market need. To facilitate the Dawn to Waddington transportation exchange, Union purchases TCPL IT capacity Parkway to Waddington, using the remaining RAM credits to reduce the cost. To complete the path, Union also uses available Dawn-Parkway capacity, and it is this Dawn-Parkway flow that results **in additional fuel and UFG costs** that are recovered in the transportation exchange service revenue [as proposed by Union]. (Emphasis added.)[5]

14. As the Board will recall, the sale of an exchange by Union is necessary to provide a benefit. Without the sale, there would be no reduction in gas costs (i.e., no revenues to be captured in the Account). Only the incremental fuel and UFG costs associated with the exchange services have been recorded in Account 179-130.[6]

15. Moreover, none of these incremental costs were captured in Union's 2011 delivery rates. Rates approved in 2007 (the start of IRM) for in-franchise customers were designed to recover the forecast of $16.027 million of compressor fuel and $20.820 million of unaccounted for gas. Changes in cost of gas through to 2011 reduced the approved cost level recovered from in-franchise customers by $6.463 million for compressor fuel and $7.616 million for unaccounted for gas, to $9.564 million and $13.204 million respectively. Actual costs in 2011 for compressor fuel and unaccounted for gas attributed to in-franchise customers were below the approved forecast by $5.470 million and $11.812 million respectively. The favourable variance in these costs has been included in 2011 utility earnings subject to sharing. The variance was not caused by optimization of the gas supply plan.[7]

16. The compressor fuel and UFG forecast embedded in 2007 rates did not include any fuel or UFG related to the exchange services now subject to deferral. It is appropriate to include in

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[5] Exhibit K2.3, CME q. 1, p. 6

[6] Exhibit K2.3, CME q. 1, pp. 4-6

[7] J2.1, Exhibit K2.3, FRPO q. 1

Account 179-30 both the revenue and costs associated with providing FT-RAM related transportation exchange services as Union is proposing.[8]

17. The evidence relied on by CCC at p. 2 of its submission has been taken out of context with only a portion of the relevant response quoted. Contrary to CCC's argument, Union did not agree that it had not incurred incremental fuel and UFG costs in relation to the FT-RAM related exchanges. Union agreed that it was not "out of pocket" in relation to those incremental costs as they had been captured, with the revenues, as part of the exchange activity. That is, not as part of rates (see below). Union also indicated that what was now at issue was the matching of those incremental costs and revenues in the Account. The full response by Ms. Elliott is set out below:

> MS. ELLIOTT: We're not out of pocket the $948,000 of fuel. We, in fact, recovered that fuel in UFG costs from the C1 activity from -- in the revenue from the C1 activity.
>
> So we're talking about here matching the costs with the revenue subject to deferral. So the C1 exchange revenue from optimization activities has been pulled out of the revenue and subject to deferral.
>
> The costs being recovered by that revenue, or the $948,000, need to be matched against that revenue in the deferral calculation.[9]

Actual amounts Recovered is an irrelevant consideration

18. CME points to Union's actual compressor fuel and UFG costs to oppose inclusion of the incremental costs associated with the FT-RAM related activity.

19. In its argument, and in the manner in which it seeks to vary the proposed wording associated with Account 179-130, CME argues that the Board should determine whether Union has incurred actual costs incremental to the amount already recovered in rates for compressor fuel and UFG costs. By "incremental" CME means "greater than". In other words, CME argues that only if Union's actual compressor fuel and UFG costs were to rise above 2007 Board approved levels should costs associated with the FT-RAM related optimization activity be matched to the revenues related to that activity.

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[8] Exhibit J2.1. Exhibit K2.3 CME q. 1, pp. 7-8

[9] Tr Vol 2, p. 15, ln 25-28 and p. 16, ln 1-7

20. CME's argument does not follow from its own articulation of the purpose for the Account which it describes as capturing, "net FT demand charge savings that Union realized".[10] Given that the net savings could only be realized with the incurrence of the fuel and UFG at issue, these costs are part of the net savings and must be recognized in Account 179-130.

21. Ultimately, as described above, if CME's argument were accepted this would (1) result in in-franchise customers receiving the full benefit of the FT-RAM related transportation exchange revenue while Union bears a disproportionate share of the costs and (2) would eliminate the Board approved incentive for Union to engage in the activity in the first place. Union's incentive would be to engage in capacity assignments (which account for roughly half of the total optimization revenue and do not give rise to any incremental fuel or UFG) and not conduct any FT-RAM related optimization transactions in respect of which Union would not receive cost recovery.

22. In support of their position intervenors observe that Union bears the volume risk on compressor fuel and UFG. While generally true, this observation misses the point. Here, the Board is not being asked to consider or implement a volume true-up. Union will continue to bear volume risk in relation to fuel and UFG unrelated to FT-RAM related optimization activity and variances from Board approved levels will continue to be dealt with through earnings sharing. However, pursuant to its Decision and Order on the Preliminary Issue, the Board decided to exclude from utility earnings the net revenues associated with these optimization transactions. It is appropriate in these circumstances to exclude the costs associated with those transactions as well.

23. Union testified to the same effect in answer to a question from the Board. As Mr. Isherwood stated:

> The part we're asking for today is to the extent we're providing a service, whether it is C1 transportation or exchange service, that is using our system, then those volumes using our system do incur compressor fuel and do incur UFG.

[10] CME . para 8, p. 2

> So what we're asking for today, because the accounting has changed with the sharing now, what we're asking for today is that before we share, we calculate the net margin by subtracting off the fuel and UFG cost from the total revenue.[11]

24. FRPO expressly agrees with Union on this point. After stating that an argument could be made (as CME has done) that Union was at risk for fuel gas and UFG variances during IRM, FRPO concedes, "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…ensure there is an appropriate allocation of incremental costs incurred to generate the incremental net revenues."[12]

The Proposed Net Revenue Amount Includes All Optimization Revenue

25. In response to FRPO's argument and Board Staff's request, Union confirms that the net revenue amount of $22 million includes all revenues associated with Union's 2011 FT-RAM optimization activities. There are no amounts which were booked as part of company used gas which have not been included in the $22 million. FRPO is incorrect at pages 2 and 4 of its submission in suggesting that revenues were moved to offset company used gas or gas costs.

26. In this respect, the evidence is that all of the revenue (i.e. the "20 cents" referred to in cross-examination) has been captured in the $22 million while the costs (the "5 cents) is the amount to be netted against the revenue in the Account. As Ms. Elliott testified:

> 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.

And, in re-examination:

[11] At Tr. Vol 2, p. 41 line 3-12, Mr. Isherwood was also asked about Union's YCR/YCRR (Yearly Commodity Required/Yearly Commodity Revenue Required) calculation. That calculation is set out on Union's approved M12 rate schedule. It was first approved by the Board in 1975 (EBRO 309) and has been considered a number of times since. Pursuant to the M12 rate schedule customers have the option of providing their own fuel. There is also a year-end true-up mechanism for fuel. This is different from matching revenues and costs.

[12] FRPO p. 5

> Mr. Smith: Just one question. In Mr. Quinn's examination, members of the panel, you referred to an example – I believe it was you Mr. Isherwood or Ms. Elliott – of 20 cents of revenue and 5 cents of costs.
>
> Is it the 5 cents of costs conceptually that goes into the $948,000 or is it something else:
>
> Mr. Isherwood: The 5 cents is the cost to cover UFG and fuel on our system and that is part of the $948,000.[13]

The Proper Amount of UFG Costs to Deduct

27. In its argument, while substantially agreeing with Union as to the deduction of compressor fuel and UFG costs, LPMA argues the Union's actual 2011 UFG ratio, as opposed to the Board approved ratio, should be used by Union to derive the amount of UFG costs to deduct. The change proposed by LPMA results in a change of $210,000 to the amount to be deducted in Account 179-130 from $948,000 to $738,957.

28. In Union's view, it is appropriate to use the Board approved ratio as doing so is consistent with the pricing for M12 and C1 transportation services, both of which rely on the Board approved UFG ratio and actual fuel costs, just as Union has done in this case. Specifically, in the YCR/YCRR calculation, Union trues up for actual compressor fuel costs and uses the Board approved UFG, and this amount is included in rates. Using a different amount to calculate the related costs would create a mismatch. Any variance between actual UFG and the amount approved in rates is captured in the utility earnings calculation and is subject to sharing.

The Wording of Deferral Account No. 179-130

29. Union continues to support the wording proposed for Deferral Account No.179-130 set out in Exhibit K2.1. In the alternative, Union could support the wording proposed by LPMA which refers to "incremental compressor fuel and UFG costs directly attributable to the provision of FT-RAM optimization transportation services" on the understanding that "incremental" relates to incremental activity, as opposed to incremental to the fuel and UFG amounts recovered in rates. For the same reason and the reasons discussed above, Union strongly disagrees with the wording proposed by CME.

[13] Tr Vol. 2, p 31, ln 7-17 and p. 42, ln 11-18

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Torys LLP
Suite 3000
79 Wellington St. W.
Box 270, TD Centre
Toronto, Ontario
M5K 1N2 Canada
Fax: 416-865.7380

Crawford Smith (LSUC#: 42131S)
Tel: 416.865.8209

Alexander C.W. Smith (LSUC #: 57578L)
Tel: 416.865.8142

Counsel for Union Gas Limited

TO: Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, ON M4P 1E4

Tel: 416.481.1967

AND TO: All Intervenors (EB-2012-0087)