uniongas
A Spectra Energy Company

November 7, 2013

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

RE: Union Gas Limited ("Union") - Undertakings
EB-2012-0451/EB-2012-0433/EB-2013-0074

As per prior communication from counsel, please find attached:

Attachment 1: Union's updates to undertaking responses J4.5, J4.6 and J9.2.
Attachment 2: Further information in relation to the Long Term Adjustment Account.

Yours truly,

[original signed by]

Karen Hockin
Manager, Regulatory Initiatives
Encl.

cc: Crawford Smith, Torys
All intervenors

Updated Gas Cost Savings, Economic Analysis Results and Related Bill Impact Information Based on the Settlement Agreement (previous undertakings J4.5, J4.6 and J9.2)

On October 31, 2013, Union and Enbridge filed the final signed Settlement Agreement, which included illustrative tolls. The content of the Agreement, tolls, and resulting gas costs savings remain consistent with Union's evidence, the Term Sheet and the testimony of the joint panel.

On August 23, 2013, Union filed updated evidence (Schedule 11 Addendum) revising total gas cost savings for TCPL approved Compliance Tolls. Union's resulting gas cost savings were estimated to be $15.4 million. During oral testimony, Union testified that the Term Sheet would not significantly change these gas cost savings because the differential between long haul and short haul transportation was expected to be maintained. "What we're trying to get to, though, is the cost differential, that $15.4 million, is the same, either as filed or with the settlement tolls." (Volume 4, Page 27 line 23 – Page 28 line 3).

Exhibit J4.5, filed September 20, 2013, provided estimated tolls on select paths assuming short haul tolls increased in a range of 45 – 55%. In addition, J4.5 estimated the impact to the previously calculated gas cost savings of $15.4 million by considering further TCPL toll impacts of conversions to short haul transportation. These impacts were projected to be $12.9 million (Case A, which assumed conversion impacts are recovered from EOT shippers), and $9.6 million (Case B, which assumed conversion impacts are recovered from all shippers). In addition, Exhibit J4.6 provided the updated project DCF (discounted cashflow) analysis for the estimated gas costs savings, resulting in project PI (profitability index) results of 1.13 and 1.01 respectively.

On October 9 and 10, 2013, the joint panel testified that they expected the final negotiated Settlement Agreement to provide tolls and toll differentials that would be consistent with the results filed in J4.5. "The expectation is that over the term of the settlement, over the 16 years, the differential will be the same, all things being kept equal" (Volume 9, page 99, lines 17-19). In addition, it was testified that the resulting gas cost savings would also not change with the Settlement Agreement. (Volume 8, page 2, lines 17-22).

1. Updated Tolls

The tolls contained in the Settlement Agreement are within the ranges Union provided in the original response to J4.5 and testified to by the joint panel. For example, in J4.5, the Parkway to Union EDA toll was estimated to be $0.36-$0.39/GJ (45-55% increase). The final Settlement toll in Appendix D, page 31, line 61 of the Agreement shows the Union Parkway Belt (Parkway) to Union EDA toll to be $0.3882/GJ, which is within the expected range. Likewise, the Empress to Union EDA toll was estimated to be $1.87-$1.98/GJ (45-55% range). The Final Settlement toll in Appendix D, page 2, line 16 is $1.9598/GJ, again within the range.

2. Updated Gas Cost Savings

Consistent with Union's testimony, there are no changes to Union's estimated gas cost savings over the 16 year term of the Settlement Agreement. This is also true when considering the LTAA, as described in Attachment 2. Over the entire term of the Agreement, all things being equal, average annual gas cost savings will remain as expected at $15.4M/year. However, due to differing amortization periods for costs allocated to short haul shippers (16 years) and long haul shippers (6 years), annual gas cost savings for the first 6 years of the agreement (2015-2020) will be higher than the remaining years (2021-2030). This difference in cashflow marginally improves Union's growth project's PI from 1.01 to 1.02, as detailed further below. Regardless of the change in cashflow, the average annual gas cost savings remain at $15.4M/year.

This amortization impact was described by Mr. Isherwood on the joint panel: "What's happening in the tolls…is it's being amortized over six years to long-haul, which is why long-haul has a higher unit cost increase than short-haul, but the bridging contribution for short-haul continues on for 16 years. So there really is a difference in the amortization period…but generally speaking, it would be about the same amount over the term of the agreement" (Volume 8, Page 118, lines 4-12).

3. Updated Case B

Exhibit J4.5 provided two cases to estimate the impact of further TCPL toll impacts of conversions to short haul transportation. Case A, which assumed the allocation of impacts would be borne by EOT shippers only, is no longer relevant. The Settlement Agreement (Appendix C, Page 3 lines 3-4) identifies that these impacts will be allocated to all shippers, which was the assumption used in J4.5 Case B.

The average annual gas cost savings for Case B remains at $9.6M/year over the term of the Settlement Agreement. However, as described above, the gas cost savings for the first 6 years of the Agreement will be higher ($11.4M/year), offset by lower savings for the remainder of the term. The gas cost savings for the near term (2015-2020) are calculated as follows using the tolls provided in the Settlement Agreement:

- The annual average gas cost savings, prior to considering further TPCL toll impacts of conversions to short haul transportation is $19.1M/year.
- The Settlement Agreement defines that short haul tolls will increase by 55%. Of this, 35 basis points remains the estimated impact of moving the EOT to full cost of service. Therefore, the cost of recovering the revenue deficiency in the Prairies and NOL (driven largely by the conversion from long haul to short haul) is now 20 basis points. In J4.5, this was 15 basis points. For the short haul toll from Parkway to the Union EDA, a 55% increase represents 13.7 cents/GJ.
- 20 basis points would represent 5.0 cents/GJ for all shippers on the Mainline system. Assuming the conversion from long haul to short haul is the predominate driver of the 5.0 cents, Union has assumed that 4.0 cents is directly attributable to the conversion costs (there is also some general deficiencies that would be recovered as well, and is assumed to be the remainder of the surcharge).
- Union's total capacity on the TCPL system is approximately 530,000 GJ/d (includes long haul, short haul and STS).
- Therefore, the total cost for Union supply would be 4.0 cents x 530,000 x 365 days = $7.7 million.

Therefore, in this updated scenario, Union's annual gas cost savings would decrease from $19.1M to $11.4M for the first six years of the Settlement Agreement. This compares to $9.6M estimated for this case in the original J4.5. It is Union's expectation that by the end of the Settlement Agreement, the average annual gas cost savings will remain at $9.6M/year.

The updated project PI for Case B is 1.02, compared to 1.01 filed in the original response to J4.6. Since the average annual gas cost savings remain at $9.6M/year, the change in project economics is driven entirely by the change in cashflow.

Union believes this revised estimate of gas cost savings to be conservative. Current market differentials between Empress and Dawn are approximately $0.47/GJ (for 2013/2014); forward markets for 2015/2016 show the differential to be $0.60-$0.70/GJ. Union's gas cost savings estimates assumed a market differential of $0.92/GJ. Since lower Empress to Dawn differentials result in higher gas cost savings, it is Union's expectation that customers will benefit from gas cost reductions exceeding $15.4 million/year.

4. Bill Impacts

Union has also reviewed bill impact analysis as provided in J9.2 to update for the above figures.

In J9.2, based on gas cost savings of $9.6 million, the resulting bill impact for the average Rate 01 sales service residential customer would be a reduction of approximately $14.00 to $15.00 per year. When the gas cost savings are updated for the Settlement Agreement as noted above in Updated Case B, the resulting bill impact for the average Rate 01 sales service residential customer over the next 15 years would be a reduction of approximately $11.00 to $19.00 per year.

In J9.2, based on gas cost savings of $9.6 million, the resulting bill impact for the average Rate M1 sales service residential customer would be a reduction of approximately $0.40 per year. When the gas cost savings are updated for the Settlement Agreement as noted above in Updated Case B, the resulting bill impact for the average Rate M1 sales service residential customer would range over the next 15 years from approximately $0.00 to a reduction of $1.00 per year.

Explanation of the Long Term Adjustment Account ("LTAA")

1. Introduction

Pursuant to Procedural Order #12, on October 31, 2013, the applicants filed a copy of the TransCanada Pipeline Limited Mainline Settlement Agreement between TransCanada, Union, Enbridge and Gaz Métro (the "**Settlement Agreement**"). Subsequently, questions were raised by interveners in relation to the LTAA. This response addresses the background to the LTAA, its treatment under the National Energy Board (the "**NEB**") framework (i.e. prior to the Settlement) and during the term of the Settlement Agreement (January 1, 2015 to December 31, 2030).

2. Current Framework

The LTAA was established by the NEB in its RH-003-2011 Decision (the "**Decision**").[1] The LTAA was established in 2010 as part of a settlement agreement amongst shippers and TransCanada. The amortization of the LTAA has formed part of TransCanada tolls since 2010 that have been included in gas costs approved by the Ontario Energy Board. The purpose of the LTAA was to enhance the near-term competitiveness of the Mainline on the assumption that economic conditions would improve in future years and support recovery of amounts added to the balance in the LTAA.[2]

The LTAA defers a fixed amount of Revenue Requirement each year between 2013 and 2017. A second account, the Toll Stabilization Account ("**TSA**"), tracks the actual year to year revenue deficiency or surplus (forecast Revenue Requirement and revenue vs. actual Revenue Requirement and revenue). If TransCanada's throughput forecast was realized, and the Revenue Requirement was as forecast, the TSA would see a deficiency created over the first few years with the TSA balance at December 31, 2017 being zero based on throughput recovery in the later years. The treatment of the TSA balance at the end of 2017 (assuming it is not zero) was left as an open question by the NEB in its Decision as provided below:

> "If there is a negative TSA balance when tolls are revisited, then the amount will be recoverable in future years, provided that the Mainline's fundamental risk has not materialized. If fundamental risk materializes, we do not intend that the TSA will be singled out or given special consideration for potential cost disallowance. Rather, we intend that if there is a consideration of cost disallowance, all aspects of the Mainline's revenue requirement or cost structure would be put in issue. If the TSA balance is positive when tolls are revisited, the Board will then determine if the appropriate method for disposing of that balance to the benefit of the shippers (for example, over a single year as a credit against the gross revenue requirement, or as a credit against the LTAA)."[3]

The opening balance in the LTAA was approximately $310 million. Under the current framework the LTAA would accumulate approximately $95 million per year over the five year term of the Decision. The LTAA balance (net of amortized amounts) is expected to be approximately $700 million at

[1] RH-003-2011 Decision, page 111.
[2] RH-003-2011 Decision, page 108.
[3] RH-003-2011 Decision, page 235.

December 31, 2017. The LTAA is reflected in the Mainline Revenue Requirement by amortizing costs based on the composite depreciation rate of the assets (i.e. long term recovery).[4]

3. Settlement Agreement Framework

The Settlement Agreement contemplates two adjustment accounts.[5] The first is the Bridging Amortization Account which will capture the forecast annual variances associated with establishing fixed tolls during the period January 1, 2015 to December 31, 2020[6] and the amortized portion of the Bridging Contribution for EOT short haul shippers from 2015 to 2030.[7]

The second is the LTAA which will initially include: i) the existing LTAA account balance as at December 31, 2014[8] (estimated to be $477M) plus ii) the TSA balance at December 31, 2014[9]. Under the Settlement, each year the LTAA may be adjusted to eliminate variances between actual and forecast Revenue Requirement and actual and forecast revenue from January 1, 2015 to December 31, 2020[10]. The Settlement Agreement remains consistent with the NEB Decision in that the recovery of the LTAA would be based on the composite depreciation rate of the assets. The segment of the Mainline with the shortest economic life is the NOL which will be fully depreciated by December 31, 2020. The segment of the Mainline with the longest economic life is the EOT which will be fully depreciated by December 31, 2050. The amortization of the LTAA will continue until the LTAA balance is zero.[11]

Therefore under the Settlement Agreement, the TSA will be eliminated and any annual differences between actual vs. forecast Revenue Requirement and revenue will be captured through the LTAA[12]. The LTAA from 2015 to 2020 will be amortized based on the composite depreciation rate of the three Mainline segments. Past 2020, the LTAA will be amortized based on the depreciation rate of the EOT assets.

The Settlement Agreement tolls are based on forecasted revenues in each year and therefore there are no net additions or subtractions to the LTAA forecast over the term of the Settlement Agreement. The Settlement Agreement provides the expected LTAA balance each year between 2015 and 2020.[13] The LTAA starts at $464 million in 2015 and declines to $386 million at December 31, 2020. The LTAA amortization costs are included in the Mainline Revenue Requirement.[14] The forecast annual Revenue Requirement associated with the LTAA declines from $15.8 million in 2015 to $15.6 million in 2020 and is on average $15.7 million from 2015 to 2020 (inclusive)[15]. The allocation between the segments of the

[4] RH-003-2011 Decision, page 233.
[5] Settlement Agreement, subsection 12.2.
[6] Settlement Agreement, subsection 12.4(a).
[7] Settlement Agreement, subsection 13.2(c)(iii) and 13.2(c)(iv).
[8] Settlement Agreement, subsection 12.3(a)(i).
[9] Settlement Agreement, subsection 12.3(a)(ii).
[10] Settlement Agreement, subsection 12.3(a)(iii).
[11] Settlement Agreement, subsection 12.3(c).
[12] Settlement Agreement, subsection 12.3(a)(iii).
[13] Settlement Agreement, Appendix A, page 2 of 2, line 15.
[14] Settlement Agreement, Appendix A, page 1 of 2, line 13.
[15] Settlement Agreement, Appendix C, pages 1 and 2 of 3, lines15.

Mainline is shown in Appendix C of the Settlement Agreement with the Revenue Requirement allocated amongst the Prairies Line, Northern Ontario Line ("NOL") and Eastern Ontario Triangle ("EOT") based on ratio of rate base.[16] This allocation changes over the term of the Settlement Agreement as all three segments are depreciating at different rates and the NOL continues to rapidly depreciate to zero by December 31, 2020. As well, as facilities are added to the EOT to accommodate market requests for transportation services, EOT rate base will increase. By 2020, the EOT allocation will be 60%[17] resulting in the LTAA amortization Revenue Requirement growing from $6.6 million to $9.4 million.[18] By 2021, the EOT will pick up even a higher portion of the cost allocation as the NOL has a zero net book value at this time.

It is important to note that all transportation services using the EOT are allocated the same Revenue Requirement for LTAA amortization costs. Therefore with the EOT assuming the entire balance of the LTAA as at December 31, 2020, the long haul contracts from Empress to the EOT and the short haul contracts from Parkway to the EOT would be allocated the same cost. That results in **<u>no change</u>** to the long haul to short haul toll differential. If the LTAA amortization costs are allocated otherwise, the toll differential between long haul and short haul transportation rates would increase and gas cost savings would increase marginally.

The Settlement Agreement allocates the balance of the LTAA to the EOT after December 31, 2020.[19] This allocation recognizes the balance between risk and reward on the Mainline going forward and was accepted by Union, Gaz Métro and Enbridge for the following reasons;

i) There is **<u>no impact</u>** to gas cost savings as a result of the LTAA being allocated to the EOT effective January 1, 2021. All long haul and short haul transportation services to the EOT would have identical toll impacts as the LTAA is recovered over the 2021-2050 period. If the balance in the LTAA at January 1, 2021 results in a $0.003/GJ toll impact, both the long haul and short haul tolls would change by the same amount. **<u>Therefore the toll differential between long haul and short haul tolls to the EOT would remain unchanged</u>**.

ii) As discussed in the Settlement Agreement, past 2020 the EOT will be fully segmented and EOT tolls will be wholly based on the EOT Revenue Requirement and throughput. By having the EOT accountable for the LTAA, the Prairies Line and NOL shippers will not be exposed to LTAA amortization costs from December 31, 2020 forward, which will reduce transportation cost risk and increase competitiveness in a portion of the Mainline that is not fully utilized. This will allow TransCanada and shippers using the Prairies Line and NOL to determine a toll structure on those sections of the Mainline without further legacy costs.

iii) For EOT shippers the commitment to assuming the LTAA balance at December 31, 2020 is approximately $6 million annually thereafter (in 2020 the Prairies Line and NOL would pay approximately $6 million of the annual LTAA amortization costs). Based on expected flows, and the

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[16] Settlement Agreement, Appendix C, Revenue Requirement by Segment Explanatory, page 2 of 3, lines 13-15.
[17] Settlement Agreement, Appendix C, pages 1 and 2 of 3, lines 19-21.
[18] NOL LTAA amortization Revenue Requirement will decrease from $4.4 million in 2015 to $1 million in 2020.
[19] Settlement Agreement, subsection 12.3(b).

composite depreciation rate, this would represent an increase of much less than 1% to EOT long haul and short haul tolls. Based on the depreciation rate for the EOT being less than the composite depreciation rate, annual amortization is expected to decrease, and the corresponding rate impact would be even lower.

The LTAA by design does not accumulate any credits or debits given that tolls are calculated to match forecast revenue to the forecast Revenue Requirement, on average, between 2015 and 2020. However there is earning sharing above the targeted ROE of 10.1% (up to 11.5%) and sharing of the loss below 9.3% to 8.7%. For TransCanada to reach an 11.5% ROE total revenue to the account of the shippers would be $255 million. This would reduce the balance of the LTAA. If TransCanada were to under-earn, the balance to the account of the shippers to arrive at 8.7% would be $75 million. This would result in the LTAA balance increasing. Overall, the LTAA balance can move in a positive or negative direction each year. As discussed below, however, Union and Enbridge believe that it is more likely than not that there will be reductions, rather than increases to the LTAA.

In conclusion, if the LTAA balance at the end of 2020 is as forecast, the impact of EOT shippers assuming the LTAA balance is less than 1% per year. In the event the LTAA balance is mitigated by excess net revenues during 2015 to 2020, EOT shippers receive the entire benefit of the reduced LTAA balance through lower rates. In the event the LTAA balance grows relative to forecast, EOT shippers would bear the consequences of the higher LTAA balance through higher rates, however in either instance, it is expected that the change in revenues relative to forecast would be driven by contracting practices and flows of EOT shippers. The Eastern LDCs expect that the tools provided to TransCanada with respect to discretionary revenues and the incentive mechanism create conditions where a reduction in the LTAA is more likely than an increase in the LTAA. In addition, the treatment of the LTAA does not impact the differential between long haul and short haul transportation tolls.