

November 12, 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”) – EB-2013-0109 - 2012 Earnings Sharing and Disposition of Deferral Accounts and Other Balances

Enclosed please find Union’s Argument-in-Chief for the above noted proceeding.

If you have any questions with respect to the submission, please do not hesitate to contact me at 519-436-5334.

Yours truly,

[original signed by]

Vanessa Innis
Manager, Regulatory Initiatives

cc: Munir Madhavji, OEB
Crawford Smith, Torys
Mark Kitchen

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 or orders clearing certain non-commodity related deferral accounts and sharing utility earnings pursuant to a Board approved earnings sharing mechanism.

AND IN THE MATTER OF an Application by Union Gas Limited for an order approving a deferral account to capture variances between earnings sharing, deferral account and other balances approved for disposition and amounts actually refunded/recovered

**ARGUMENT IN CHIEF OF
UNION GAS LIMITED**

A. Overview

1. By application dated May 8, 2013 and later amended July 26, 2013 and November 4, 2013, Union Gas Limited's applied to the Ontario Energy Board for approval of the following requests:

- (1) approval of final balances for all 2012 deferral accounts and an order for final disposition of those balances;
- (2) approval of \$15.730 million as the customer portion of earnings sharing in 2012 and the proposed disposition of that amount to Union's customers; and,
- (3) approval to close Shared Savings Mechanism Account No. 179-115 effective January 1, 2013.

2. Union also applied to the Board for approval of a variance account to capture variances between earnings sharing, deferral account and other balances approved for disposition and amounts actually refunded to ratepayers or recovered (Account No. 179-132).

3. A Settlement Conference was held on August 1, 2013. Subsequently, a letter was filed by Union on its behalf and on behalf of intervenors indicating that in respect of certain deferral accounts there were no matters in dispute with respect to the balances in those accounts or the proposed method by which those balances would be cleared by Union.

4. On August 20, 2013 the Board issued Procedural Order No. 2 providing for an oral hearing in respect of those matters which remained in dispute. The hearing took place on October 22, 23 and 24, 2013.

5. The balance of this argument is addressed to the matters which are in dispute and is organized under the following issues:

- (1) Union's treatment of FT-RAM related exchange revenue;
- (2) Union's response to the Board's directive in relation to Union's gas supply plan and the "right size" of that plan;
- (3) Demand side management and Union's 2011 and 2012 results;
- (4) Union's request to establish Account No. 179-132; and
- (5) The Board's motion to review and vary in respect of the directive to prepare audited financial statements.

B. Treatment of FT-RAM Related Exchange Revenue

Proposed Treatment

6. Union is proposing to treat net FT-RAM revenue, also known as margin, as utility revenue subject to earnings sharing. In Union's submission, this treatment is consistent with the treatment of transportation exchange revenue by the Board for 2008, 2009 and 2010 and the terms of the IRM Settlement Agreements.¹

7. Union's proposed treatment differs from the EB-2012-0087 Decision in which 2011 FT-RAM revenue was classified as a gas cost reduction and recorded in the newly-created Upstream Transportation FT-RAM Optimization Deferral Account (Account 179-130). The balance in that

¹ The sale of transportation exchanges is one form of optimization activity. That activity is sometimes referred to herein as "S&T activity"

account was disposed of to sales service and Union North bundled direct purchase customers between April 1, 2013 and September 30, 2013.

8. For 2012, Union has included all net revenue from transportation exchanges, including FT-RAM-related transportation exchanges, in utility earnings subject to earnings sharing. The 2012 deferral account balances and 2012 earnings sharing calculation applying Union's proposed treatment of FT-RAM revenue is provided at Exhibit A, Tab 1, Appendix A, Schedule 1 and Exhibit A, Tab 2, Appendix B, Schedule 1, respectively.²

9. Union is proposing to treat 2012 net FT-RAM revenue as utility revenue subject to earnings sharing, in part, because:

- (1) A key premise of the Board's EB-2012-0087 Decision with respect to the treatment of net FT-RAM revenue was that Union's gas supply plan was driven, in part, by pre-planned optimization opportunities. On the contrary, as evidenced by the Sussex Report (Exhibit C, Tab 2), Union's gas supply plan is right-sized and does not consider opportunities for optimization. The upstream transportation assets underpinning Union's gas supply plan are contracted based on a set of gas supply principles that are consistent with those used in other jurisdictions in Canada and the United States (see also Exhibit B, Tab 3).³
- (2) Treating net FT-RAM revenue as a gas cost offset is (1) inconsistent with the historical treatment of transportation exchange revenue; and (2) represents a significant departure from the EB-2007-0606 and EB-2009-0101 IRM Settlement Agreements for Union's IRM for 2008-2012 approved by the Board (Exhibit B, Tab 1).
- (3) The Board's EB-2012-0055 Decision (Enbridge Gas Distribution 2011 Deferral Account Disposition Proceeding) conclusion that temporarily surplus upstream assets may be used to support transportation exchange revenue is consistent with

² The 2012 deferral account balances and 2012 earnings sharing calculation pursuant to the EB-2012-0087 treatment of FT-RAM revenue is provided at Exhibit A, Tab 1, Appendix B, Schedule 1 and Exhibit A, Tab 2, Appendix D, Schedule 19, respectively. The only difference between the two scenarios is the inclusion of FT-RAM revenue in 179-130.

³ See also, Tr. Vol. 2, pp. 79-89 and 127

how Union generates transportation exchange revenue (Exhibit B, Tab 1 and Tab 2).

- (4) Base exchanges and FT-RAM exchanges are transportation services sold to customers pursuant to a Board Approved rate schedule. They are fundamentally the same in that they use upstream transportation assets that are temporarily surplus, only differing as a result of the value provided by TCPL's FT-RAM service (Exhibit B, Tab 2).
- (5) Treating 2012 transportation exchange revenues as a gas cost offset results in impermissible retroactive rate making.⁴

10. The evidence adduced by Union in this proceeding supports the proposed treatment. Unlike in prior proceedings in which the record was developed in an ad hoc manner, largely through interrogatories, the Board here has the benefit of comprehensive pre-filed evidence. That evidence sets out in detail the context and nature of Union's complex transportation exchange activity, and the reasons why FT-RAM margin is properly considered as utility revenues subject to sharing under the terms of the IRM Settlement Agreements.⁵

11. Union does not seek to vary the Board's decision in EB-2012-0087; rather, Union proposes a different treatment for FT-RAM related exchange revenues, based on a different, more complete evidentiary record, which responds directly to the Board's decision-making criteria. In this respect, Union's approach is consistent with EB-2013-0046 in which the Board indicated that its decision in relation to Enbridge's 2012 transactional services activity would be "based on the evidence that we have in front of us for this year, and not use last year as a precedential value for this year's proceeding."⁶

12. Finally, Union does not seek to vary the treatment of exchange revenues on a going forward basis. Those revenues are subject to agreement for 2014-2018. At issue is 2012 and the proper treatment of revenues for that year under the IRM Agreements (discussed below).

⁴ Union did appeal the EB-2012-0087 Decision. The decision of the Divisional Court is under reserve.

⁵ Tr. Volume 1, pp. 125-126

⁶ EB-2013-0046, Tr. Vol. 1, pp. 54-55

Background

13. Union has undertaken exchange activities since the early 1990s. The objective of these activities has always been to generate revenue by optimizing temporarily surplus transportation assets.

14. Historically, revenues arising from S&T activity have been shared with ratepayers in a variety of ways. Prior to 2008 and the IRM Settlement Agreements, forecast margins for S&T activity were directly credited to ratepayers through delivery rates (not gas supply commodity or transportation rates) and any positive variance to forecast was recorded in a deferral account to be shared between ratepayers and Union. The sharing of margins was intended to recognize, “Union’s role in developing opportunities and facilitating [revenue generating] arrangements.”⁷

15. **Elimination of the S&T Accounts.** Following the Board’s issuance of its Natural Gas Forum (“NGF”) Report Union proposed the elimination of S&T Transactional Deferral Accounts in its application for 2007 rates, EB-2005-0520. The issue was moved from EB-2005-0520 to EB-2005-0511, the Natural Gas Electricity Interface Review (“NGEIR”) which was an outcome of the NGF. Ultimately, the Board determined in NGEIR that elimination of the S&T deferral accounts that were not related to storage forbearance should be addressed in Union’s IRM application.

16. Union thus proposed eliminating Transportation & Exchange Services Account (179-69), Other S&T Services Account (179-73) and Other Direct Purchase Services Account (179-74) as part of its IRM in EB-2007-0606. As part of the overall Settlement Agreement in EB-2007-0606, parties agreed to eliminate these deferral accounts.⁸

IRM Agreements

17. **EB-2007-0606.** Union filed its application and evidence for its 2008-2012 IRM (EB-2007-0606) in May, 2007. Union proposed to use the rates determined in the 2007 Cost of

⁷ Exhibit B, Tab 1, p. 9

⁸ Exhibit B, Tab 1, pp. 9-12

Service proceeding as a base for the IRM, to which a Price Cap Index would be applied in each of the years 2008-2012.⁹

18. The parties agreed that, “the X factor and, indeed, the IR plan described in this Agreement, including any adjustments to base rates, are reasonable and fall within a reasonable range available on the evidence (page 6 of the Settlement Agreement).¹⁰

19. As part of the EB-2007-0606 Settlement Agreement, in addition to the annual pricing formula, parties also agreed to:

- (1) Eliminate four deferral accounts, including the Transportation and Exchange Services Deferral Account (179-69) (Section 5.1);
- (2) Establish an “Off-Ramp” review of the IRM in the event of a 300 basis point variance in weather normalized utility earnings above or below the amount calculated annually by the application of the Board’s Return on Equity formula (Section 9.1);
- (3) Implement an Earnings Sharing Mechanism (“ESM”) based on actual utility earnings, with 50/50 sharing of earnings above 200 basis points over the amount calculated annually by the application of the Board’s Return on Equity formula (Section 10.1);
- (4) Adjust the 2008 revenue requirement by \$4.3 million to reflect the elimination of deferral accounts above with the result that base rates through the IR term were reduced (Section 14.1) ; and
- (5) Maintain the existing Board approved gas supply deferral accounts without modification.¹¹

20. The nature of Union’s S&T activity fundamentally did not change as a result of the IRM Agreement. That is, Union continued to engage in the sale of transportation exchanges and other S&T activity as opportunities presented themselves and Union had available temporarily surplus

⁹ Exhibit B, Tab 1, p. 18

¹⁰ Exhibit B, Tab 1, p. 19

¹¹ Exhibit B, Tab 1, pp. 19-20

assets (discussed further below). Under the terms of Union's IRM, however, Union was incented with the elimination of the deferral account to focus on generating incremental transportation exchange revenue. This is exactly what Union did and as indicated by Union throughout the IR term was a significant contributor to earnings sharing which ultimately benefited ratepayers.¹²

21. In its Decision dated January 17, 2008, the Board approved the EB-2007-0606 Settlement Agreement. The Board determined that the Settlement Agreement was put forward by the major stakeholders and constituents with an interest in Union's rates and met the criteria set out in the NGF Report. In addition, the Board stated that the EB-2007-0606 Settlement Agreement represented "an important step forward in establishing long term rates stability in a manner that will promote maximum efficiencies for the benefit of both ratepayers and shareholders (pages 2-3 of the EB-2007-0606 Decision dated January 17, 2008)."¹³

22. **EB-2009-0101.** In April 2009, Union filed its application concerning the calculation of the 2008 earnings sharing amount, and a review of the IRM in EB-2009-0101. Union's application to dispose of 2008 non-commodity deferral account balances was filed separately in March 2009.

23. The EB-2009-0101 application addressed two major issues. The first was the calculation of 2008 earnings for the purposes of earning sharing itself, and the second was the need to review the IRM because Union's 2008 earnings exceeded the Return on Equity generated by the Board-approved formula by more than 300 basis points. This review was required by Section 9.1 of the EB-2007-0606 Settlement Agreement. Union filed evidence that showed its calculation of utility earnings and the earnings sharing amount. The amount Union proposed to share with ratepayers was \$15.2 million. In accordance with Section 10.1 of the EB-2007-0606 Settlement Agreement, this amount represented 50/50 sharing of the utility earnings in excess of 200 basis points above the amount calculated by the application of the Board's ROE formula. In addition, Union provided evidence that supported the continuation of the IRM.¹⁴

¹² Exhibit B, Tab 1, p. 20

¹³ Exhibit B, Tab 1, pp. 20-21

¹⁴ Exhibit B, Tab 1, pp. 23-24

24. Union's EB-2009-0101 evidence described the primary drivers of its financial results relative to 2007 Board Approved levels. The drivers included increased gas distribution revenues (both contract and general service), increased short-term transportation and exchange revenue and increased long-term transportation revenue, offset by increased tax expense. Union noted that increased short-term transportation and exchange revenues resulted from increased customer activity and service values due to colder than normal weather and new market opportunities. In addition, Union described how Union's approach to marketing of transactional services changed as a direct result of the implementation of Union's IRM and the elimination of the Transportation and Exchange Services deferral account. In response to an interrogatory asked specifically with respect to this evidence, Union referred explicitly to its use of FT-RAM to generate S&T revenue (EB-2009-0101, Exhibit B1.4).¹⁵

25. In the EB-2009-0101 Settlement Conference, parties agreed to amend Section 10.1 of the EB-2007-0606 Settlement Agreement in two ways:

- (1) A change to the earnings sharing calculation. Earnings between 200 and 300 basis points above the amount calculated annually by the application of the Board's Return on Equity formula would continue to be shared 50/50 between ratepayers and Union, while earnings in excess of 300 basis points would be shared 90/10 between ratepayers and Union.
- (2) A clarification of the revenues and expenses to be included as part of the earnings sharing calculation. Specifically, all revenues and expenses (operating or capital) that would be included in a cost of service application would be included in the earnings sharing calculation. The parties agreed to specific examples of what would and would not be allowed as adjustments to the earnings sharing calculation. Union's one-time adjustment for an unbilled revenue accrual was excluded from the calculation, while the use of actual unaccounted for gas volume was included in the calculation.¹⁶

¹⁵ Exhibit B, Tab 1, pp. 24-25

¹⁶ Exhibit B, Tab 1, p. 26

26. The effect of the EB-2009-0101 Settlement Agreement was an increase in the amount shared with ratepayers. The earnings sharing amount increased from \$15.2 million to \$34.2 million. Intervenors supported the amendments to the IRM Settlement Agreement as the amendments were seen to be fair, and even favourable to ratepayers (EB-2009-0101 Transcript, June 8, 2009).¹⁷

27. In approving the EB-2009-0101 Settlement Agreement, the Board stated the changes would, “not only reduce the regulatory cost but will allow greater certainty for all parties going forward” (EB-2009-0101 Oral Decision rendered June 8, 2009, page 88 of Transcript, lines 25-27).¹⁸

28. **Benefits of the IRM Agreements.** Ratepayers benefited directly from Union’s IRM, through a combination of flat delivery rates and earnings sharing during the five-year term. The secondary natural gas market in Ontario benefited as well.¹⁹

29. Throughout IRM rates increased by only 0.6% net of pass-through items over the five year term, relative to 2007 Board-approved rates. This meant that Union had to manage inflationary and economic pressures over the IRM term with a combination of cost related productivity initiatives and capitalizing on revenue-generating activities, such as transportation exchange revenue opportunities.²⁰

30. In addition to the base rate decreases (absent inflationary increases), ratepayers shared in Union’s success under the IRM through the ESM. For the period of 2008-2011, the earnings sharing amount shared with customers were \$47.5 million. Based on Union’s proposal in this proceeding, ratepayers will receive an additional earnings sharing amount of \$15.7 million.²¹

31. As part of the EB-2007-0606 Settlement Agreement, Union and stakeholders agreed to share earnings in excess of 200 basis points 50/50 between Union and ratepayers. As indicated

¹⁷ Exhibit B, Tab 1, pp. 27-28

¹⁸ Exhibit B, Tab 1, p. 28

¹⁹ Exhibit C, Tab 1, The Secondary Natural Gas Market in Ontario, prepared by Stephen Acker

²⁰ Exhibit B, Tab 1, pp. 28

²¹ Exhibit B, Tab 1, p. 31

above, the earnings sharing mechanism was amended in EB-2009-0101 such that earnings in excess of 300 basis points would be shared 90/10 in favour of ratepayers. In the years 2008-2010 the earnings sharing amount included the effects of net exchange revenue. That is, net exchange revenues contributed to Union's ability to meet, and exceed, the productivity factor, and all ratepayers benefited from Union generating this revenue, as it was included in the utility income subject to sharing. In this respect, and as reflected in Table 2 (Exhibit B, Tab 1), it is important to bear in mind that the productivity factor was set under very different conditions than prevailed during IRM.²²

32. The X-factor, the increased S&T margin in base rates and the earnings sharing components of the IRM ensured that ratepayers benefited from IRM during the term of the plan. In return, Union was to be provided the opportunity to generate productivity improvements, including revenue generating opportunities, during the IRM term. Union's incentive lay in achieving results beyond those which were already included in rates.²³

The FT-RAM Exchange Revenue at Issue

33. In 2012, Union realized net transportation exchange revenues of \$51.6 million, of which \$37.3 million is related to net FT-RAM revenue. This revenue is in excess of the margin included in delivery rates (\$6.9 million), and contributes towards Union's utility earnings that are proposed to be shared with ratepayers through the ESM.

34. The balance of the net transportation revenues, \$14.3 million, relates to the sale of non-FT-RAM related base exchanges. These exchanges are the same as the transportation exchanges that occurred historically prior to the existence of the FT-RAM service attribute, and prior to IRM.

35. Union was able to achieve the level of transportation exchange revenues due to a number of reasons:

- (1) Weather: The warmer than normal winter and warmer than normal summer of 2012 provided opportunities to provide transportation exchange services

²² Exhibit B, Tab 1, p. 31

²³ Exhibit B, Tab 1, p. 32

throughout each season. During the winter months, this resulted in additional temporarily surplus transportation available for transportation exchange services. During the summer months, this resulted in additional market demands for transportation exchange services.

- (2) Continued de-contracting on TCPL: De-contracting on TCPL resulted in increased TCPL tolls and increased participation of parties in the secondary market. This trend supported a corresponding increase in transportation exchange service value and revenue.
- (3) Sales Experience: As Union continued to gain experience with the changing market dynamics, transportation exchange services and FT-RAM, the overall transportation exchange service revenue results improved.
- (4) Market Experience: Participants in the secondary market also gained experience with how to use the FT-RAM program and related transportation exchange services to meet market opportunities. With this experience, customer generated requests for Union transportation exchange services increased.²⁴

The FT-RAM Exchange Transactions are S&T Activities

36. **Board Criteria.** In the EB-2012-0087 and EB-2012-0055 Decisions, the Board provided guidance related to the treatment of revenues associated with transportation exchange services. Specifically, in both the EB-2012-0087 and EB-2012-0055 Decisions, the Board indicated that the key distinction when determining if proceeds were to be treated as revenue versus a reduction to gas costs was whether the underlying transportation asset was “temporarily surplus” to system sales and bundled direct purchase customers’ needs. In the Board’s EB-2012-0087 Decision and Order on Preliminary Issue, the Board held:

In the Board’s view...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. [Emphasis added, Page 28,]

²⁴ Exhibit B, Tab 2, pp. 6-7. Further, as set in Table 2 (Exhibit B, Tab 1), between 2007 and 2012, the parties to exchange transactions nearly doubled and the number exchange transactions increased from 37 to 1,688.

37. Similarly, in Enbridge's EB-2012-0055 Decision and Order, page 6, the Board held:

The essential characteristic of transactional services is that they are arrangements made to generate revenue from unplanned, **temporarily surplus transportation capacity** that Enbridge may have, from time to time, as part of its gas supply arrangements. The portion of utility gas supply assets that is available to support transactional services activities is only the portion of those assets that are temporarily surplus because of factors beyond Enbridge's control (e.g. weather, market demand). [Emphasis added.]²⁵

38. The evidence in the application compares the Board's criteria to Union's 2012 transportation exchange service transactions, including those utilizing the FT-RAM program to determine if they met the Board's criteria of being underpinned by temporarily surplus upstream transportation assets. The evidence also considers whether the S&T activity was unplanned or not, and whether temporary surplus capacity was used to provide a service to an S&T Customer. If it was, and the purchase and delivery of gas supplies for system supply and direct purchase customers continued, then it is appropriate to treat any proceeds as utility revenue subject to earnings sharing. However, if the asset was used to reduce existing costs, such as Limited Balancing Agreement fees, then Union has proposed that it continue to be recorded as a gas cost reduction, just as it was prior to the Board's Decision in EB-2012-0087. Union treated the reduction of LBA costs as gas cost reductions throughout the 2008-2012 IRM term.

39. To summarize, Union applied the following criteria to determine if an FT-RAM transaction should be regarded as S&T revenue subject to earnings sharing or not:

- (1) Temporarily Surplus. The exchange activity was served by some quantity of the upstream transportation capacity, and/or a portion of its path distance that was not required on a temporary basis to meet market area demands. Temporarily surplus capacity varies depending on weather and market demands.
- (2) Unplanned. The activity was unplanned in the sense that it was not included in the gas supply plan. As described above (and further below), the gas supply plan is appropriately sized and does not contain excess transportation assets.

²⁵ Exhibit B, Tab 1, p. 36

- (3) Sold as service. The exchange activity was a service provided to third parties. Union is not permitted to bundle the sale of gas and transportation, meaning that the only way to extract value is through transportation exchange transactions involving temporary surplus capacity to third parties.²⁶

40. With respect to temporarily surplus assets it is important to recognize that this can, and should be, further subdivided into two types:

- (1) System Supply Balancing. Union does not require the gas supply and therefore the planned transportation capacity is surplus. In this case, Union does not purchase the supply and assigns the capacity to a third party. The net revenue from these assignments is accounted for in the Unabsorbed Demand Cost Deferral Account (179-108) for future disposition.
- (2) Portion of Transportation Path Distance Is Not Required. Market demands are lower than design day requirements, and a portion of the transportation path is surplus. For example, gas supply purchased at Empress needs only to move to Dawn in the summer rather than the full distance to Union EDA. The portion of the path between Dawn and Union EDA is temporarily surplus. Union monetizes the temporarily surplus capacity through the sale of transportation exchange services which include base exchanges, FT-RAM related exchanges and transportation assignments.²⁷

41. As discussed in Exhibit B, Tab 3 and Exhibit C, Tab 2, all upstream transportation assets in the gas supply plan serve the purpose of meeting design day market demands and annual customer requirements. Any surplus that is available to support transportation exchange service activity (whether daily, monthly or seasonal) is only available on a temporary basis. The temporary surplus arises as a result of factors outside of Union's control, such as weather and consumption levels. It is not available on a planned basis.

²⁶ Exhibit B, Tab 1, pp. 37-38 and Exhibit B, Tab 2

²⁷ Exhibit B, Tab 1, p. 38

42. **Union's 2012 FT-RAM exchanges transactions.** As described above, Union has applied the criteria developed by the Board to Union's 2012 FT-RAM exchanges transactions. The result of that application is reflected in Table 1 of Exhibit B, Tab 2. The Table shows how each of Union's exchange service transaction types has been evaluated against the three criteria. If the transaction was underpinned by upstream transportation capacity that was temporarily surplus, if the activity was not planned in the gas supply plan, and if the activity was the sale of a service to an S&T Customer, then the proceeds from that transaction are proposed to be treated as revenue.

43. All FT-RAM related transportation exchange services in 2012 were sold on a daily, monthly or seasonal basis. There were no annual transactions.²⁸

44. Each of the different categories of FT-RAM related transactions (Table 1, lines 4-7), and the rationale for treating them as revenue, is discussed further below.

45. *Transportation exchanges (FT-RAM related - Summer and Winter) (Table 1, Lines 4&5).* These transactions are completed when the market area does not require the full use of transportation capacity on that day (non-design day), and only a portion of the contracted path distance is required to meet annual requirements. The portion of the contract distance that is not required is temporarily surplus. For example, if not all of the Empress to Union EDA path is required, and the gas is transported to storage at Dawn, then Dawn to Union EDA is temporarily surplus. The value of this temporary surplus is monetized through FT-RAM credits. These surplus credits are not required by system supply and bundled direct purchase customers and can be used to provide transportation exchange services to S&T Customers. The ability to generate FT-RAM credits to support these transactions is dictated by market requirements and weather. For example, during the coldest winter days, this capacity is not surplus and the gas supply flows on a firm basis to the market area, meaning that no FT-RAM credits are generated. See further discussion at Section 12.1 and Case 3.²⁹

46. *Transportation Exchanges (Transportation Assignments Summer/Shoulder) (Line 6).* This item, described in Section 12.2, meets the criteria outlined by the Board. In this case, the

²⁸ Exhibit B, Tab 2, p. 13

²⁹ Exhibit B, Tab 2, pp. 11-12 and 51-58

service sold to the S&T Customer is a combination of a temporary release of Union's TCPL transportation capacity and the sale of a transportation exchange service. The temporarily surplus capacity results from the unlikely event that a design day will occur between March and the following November, and that a portion of the transportation path is not required. In the summer, this portion of the path is the distance between Dawn and the market area. The gas supply plan does not plan for the assignment of this capacity coupled with an exchange transaction. To do so would compromise the accepted gas supply planning principles, expose customers to operational and price risk, and may not result in a more cost effective option. Union proposes to treat the proceeds from summer assignment/transportation exchange service as revenue. Case 4 is an example of a summer transportation assignment.³⁰

47. *Transportation Exchange - Transportation Assignments - (Core Winter) (Line 7).*

Typically, transactions of this type would not meet the criteria of temporary surplus as outlined by the Board. In this scenario, as with the temporary assignments in the summer, the service sold is a combination of Transportation Assignment and transportation exchange service. While on most days during this period there may be transportation that is temporarily surplus to the utility needs, at the time of sale, Union cannot be certain that a design day will not occur. On days where there is a design day, then there is no temporary surplus asset. It is for this reason that Table 1 reflects an "X" in the relevant column.³¹

48. In 2012, however, the overwhelming majority of the optimization activity which took place under this category related to optimization of the TCPL Empress to Union CDA contract (unlike prior years which involved the EDA). As explained in the evidence, that contract serves a distinct purpose: while a South asset, on design day in Union North, the Union CDA contracted capacity is diverted upstream to serve Union North markets. As a result, there is, in fact, temporary surplus transportation capacity between Union North and the Union CDA. The risk that Union will be a "short" gas in the delivery area has been avoided because under the exchange, S&T arranges for the gas to be delivered during the winter exactly where it was

³⁰ Exhibit B, Tab 2, pp. 12 and 59-63

³¹ Exhibit B, Tab 2, pp. 13, 64-69 and 73-78; Tr. Vol. 1, pp. 131-133; Vol. 2, pp. 44- 47 and pp. 48-50

intended under the gas supply plan; that is, Union North. Cases 5 and 6 are examples of those types of transactions.³²

Conclusion regarding FT-RAM related exchanges

49. The fundamental nature of transportation exchange services sold by Union has not changed since the early 1990s. However, the market for transportation exchange services increased during the IRM term, driven by unforeseen changes in natural gas markets. These changes included changing gas supply flows across North America and rapid de-contracting on the TCPL system. The resultant increase in TCPL tolls drove significant growth of the secondary market for transportation and exchange services, and represented market opportunities for Union's S&T Group. Within the context of the IRM term, Union evaluated these opportunities, the associated risks, and the ability to capture market value. Union was able to use temporarily surplus upstream transportation capacities, the Dawn-Parkway transmission system, and purchased resources in order to meet the increased demand for transportation exchange services. There are (and were) no assets in the gas supply plan in excess of what was required to serve system sales and bundled direct purchase needs.

50. The introduction of the FT-RAM program did not change the types of transportation exchange services Union provided to the secondary market. It did, however, allow Union to monetize temporary surplus assets in the gas supply plan that otherwise would not be fully utilized. The FT-RAM program provided the secondary marketplace with economic transportation alternatives in response to decreasing firm contracting levels on TCPL, and increasing tolls. The increasing TCPL tolls result in increased value of FT-RAM credits. As a result, Union sold more transportation exchange services and generated more transportation exchange revenue than was anticipated at the outset of the IRM. Neither impact was foreseen by Union in 2007.

51. The dramatic increase in transportation exchange transactions sold by Union resulted in significant benefits for Union's ratepayers. Union's ratepayers benefitted directly from sharing transportation exchange revenue through a base delivery rate reduction and through earnings

³² Exhibit B, Tab 2, pp. 13, 64-69 and 73-78; Tr. Vol. 1, pp. 131-133; Vol. 2, pp. 44- 47 and pp. 48-50

sharing. In addition, the growth of a vibrant and active secondary market provided competitive gas supply options to all end-users in Ontario, including residential customers, industrial users and power producers. In Union's submission, its proposal to include FT-RAM revenue in utility earnings subject to earnings sharing supports the continued sharing of these benefits with ratepayers, while respecting the risk/reward balance inherent in the IRM Settlement Agreements.

C. Union's response to the gas supply directive

52. In EB-2011-0210, the Board approved Union's 2013 gas supply plan as filed. However, the Board expressed concerns with the gas supply planning process, planning methodology and resulting gas supply plan, in light of Union's optimization activities during the IR term. The Board questioned whether Union's optimization activities became a driver of the gas supply plan, rather than a consequence of it. In the result, the Board ordered Union to "file with the Board an expert, independent review of its gas supply plan, its gas supply planning process, and gas supply planning methodology."³³

53. In response to the directive, Union retained Sussex Economic Advisors. Consistent with the directive, the RFP which resulted in the Sussex retainer was provided to intervenors and Board staff for review and comment. The Sussex Report was subject to stakeholder consultation prior to interrogatories in this proceeding. Union's gas supply planning process is further described in detail in Exhibit B, Tab 3.³⁴

54. The Sussex Report addresses each of the eight gas supply planning related elements identified by the Board in its decision. At Union's request, the Sussex Report also considers the reasonableness of Union's approach to upstream transportation optimization.³⁵

55. The main conclusions from the Sussex Report include the following:

- Union's primary gas supply planning principles of reliability and cost are reasonable, similar to other LDCs, and are reflected in the gas supply plan.

³³ Exhibit B, Tab 5, p. 1.

³⁴ Exhibit B, Tab 5, pp. 1-7 and Exhibit C, Tab 2

³⁵ Exhibit C, Tab 2, pp. 7 and 39-41; Tr. Vol. 2, p. 183, ln 4-27

- Union's approach regarding design day demand forecasting (i.e., extreme cold weather conditions and a firm customer usage factor per degree day) is appropriate, similar to other LDCs, and reflected in the gas supply plan.
- The design day demand forecasting approach for Union North and Union South is consistent and aligned.
- Union's gas supply portfolios for Union North and Union South are reasonable and appropriately sized. The portfolios (and the plan overall) are right-sized in that they sufficient, but not excess assets to meet design day demands.
- Union's approach to decontracting/recontracting is comprised of data gathering, quantitative and qualitative analysis, and documentation. This approach is consistent with the contract evaluation approach used by other LDCs, is similar to the Union Incremental Transportation Contracting Analysis, and is reasonable.
- Finally, while there are various alternatives used by LDCs to extract value from gas supply portfolio assets, the current approach utilized by Union leverages the core competencies of the Gas Supply and Storage & Transmission groups, is consistent with other approaches used by LDCs (e.g., asset management arrangements), and is reasonable.³⁶

56. In respect of the final conclusion above, Sussex further testified that, while the organizational structure may vary, it is common for LDCs to engage in S&T activity on a daily, monthly or seasonal basis once an appropriately sized gas supply plan has been developed. Union's activities in this respect are entirely consistent with those of other LDCs across North America.³⁷

57. In Union's submission, it has responded appropriately to the Board's gas supply planning directive. To the extent there were questions at the hearing in relation to Union's response, these

³⁶ Exhibit C, Tab 2, pp. 1-2; Tr. Vol. 2, pp. 79-89

³⁷ Tr. Vol. 2, pp. 84-89

largely concerned Union South and the Empress to Union CDA contract, and arose from a misunderstanding of Union's South portfolio.

58. As explained in Exhibit J2.6, from a gas supply perspective, Union South is served through a combination of upstream transportation contracts (including Dawn supply purchases), Dawn storage, and transportation on the Union Dawn-Parkway system. The Dawn-Parkway System is designed to meet design day demands of Union South and all volumes for delivery at Parkway. Volumes going through Parkway include contracted obligations for ex-franchise (M12 customers) and either TCPL FT shorthaul or TCPL STS from Parkway to points in Union North to meet design day.

59. In order to effectively manage costs for Union South customers, upstream transportation contracts are sized to meet average day (annual) requirements; these contracts flow at, or very close to, 100% load factor on a planned basis. Dawn storage withdrawals and transportation on the Dawn-Parkway system is used in conjunction with the upstream transportation contracts (plus direct purchase supply received on Union's system) to meet design day requirements for Union South. The design day demand for Union South is 2,583 TJ/d. The supply, and related upstream transportation capacity, to meet this demand is found at Exhibit C, Tab 2, page 30, which reconciles how Union meets design day demands in Union South.

60. In determining gas supply and upstream transportation requirements for Union South, Union does not separate individual cities or city gate stations. Therefore, Union does not plan for, or contract for, Union CDA requirements independently in determining Union's gas supply arrangements for Union South. However, since the Union CDA is a TCPL delivery point, Union can and does contract for transportation capacity to this point that is used to serve part of Union South requirements as identified in the gas supply plan and the Sussex report. Union holds approximately 70 TJ/d of TCPL Empress to Union CDA upstream transportation capacity to meet Union South average day requirements. Union also holds TCPL capacity and secondary market capacity to move gas from the Dawn-Parkway system back to the Union CDA.

61. Union completes the gas supply plan on an integrated basis. That is, it considers Union North and Union South requirements on a combined basis in order to manage costs for all ratepayers. As described above, one example of this is the use of the Empress to Union CDA

contract to serve two purposes. In addition to meeting average day (annual) requirements for Union South as described above, the Empress to Union CDA contract of approximately 70 TJ/d is also used to meet Union North design day requirements. As described in Exhibit B, Tab 3, page 21 and Exhibit D8.40, the Empress to Union CDA contract is used to serve markets in Union NDA, WDA, and MDA on design day. On a design day, Union simply drops this gas off in the respective delivery areas in the North rather than shipping the gas to the Union CDA. The use of the Empress to Union CDA contract in this way reduces the assets that would otherwise be required to serve North design day demands. The North replaces these volumes at the Union CDA and pays for the related Dawn-Parkway and Parkway to Union CDA capacity. As Mr. Shorts testified: “It is an economical way for the North to be served that way, rather than contracting for Empress to the NDA capacity for the entire year”. If Union were to contract for Empress to the NDA capacity for the entire year instead of using the upstream diversion, the cost would be approximately \$30 million at current TCPL tolls.³⁸

62. Exhibit J2.6 also responds to questions in relation to capacity between Parkway Belt and the Union CDA. As reflected in the response, the contracted capacity is not surplus and does not reflect incremental supply. The contracts were executed by Union in response to a change in TCPL’s contracting requirements. Historically, TCPL had not required Union to contract for capacity it moved between Union Parkway Belt and Union CDA (the movement of gas is simply from one point in Union South to another point in Union South) nor had TCPL charged Union for that service. Once TCPL changed its requirements, Union contracted (November 2011) for the same volumes it had always moved free of contract (80 TJ/day).³⁹

63. In Union’s submission, as reflected in the Sussex Report and the evidence at the hearing, Union’s gas supply planning process, methodology, and plan reflects appropriate planning principles, consistent with those of other North American LDCs that are applied objectively and produce a gas supply plan that is right-sized.

³⁸ Tr. Vol. 2, pp. 45 and 48

³⁹ Exhibit J2.6; See also, Tr. Vol. 2, pp. 117-119

Union's Response to the Sussex Report Recommendation

64. The Sussex Report contains several recommendations. The principal recommendation relates to reporting: that Union should increase the level of documentation across departments with respect to the demand forecasting and gas supply planning processes. Union has reviewed all of Sussex's recommendations, accepts those recommendations and is in the process of implementation.⁴⁰

D. Demand Side Management – Custom Projects

65. The balances recorded in Union's various demand side management ("DSM") accounts are set out in Exhibit A, Tab 1. The balances were further updated on November 4, 2013.

66. As they relate to both 2011 and 2012, the balances reflect Union's audited results and a consensus between Union and the members of its Evaluation and Audit Committee (the "EAC").

67. The Shared Savings Mechanism Variance Account (179-115) has a zero balance related to the 2011 audit true-up for DSM activity in 2011. For 2012 there is no balance in the account. In EB-2011-0025 the Board approved a new DSM Incentive Deferral Account (179-126), which reflects 2012 activity. Accordingly, Union seeks approval to close Account No. 179-115.

68. SEC was the only party to conduct any examination in relation to DSM. The focus of its examination was Union's 2011 custom project portfolio. Custom projects are DSM opportunities that are unique to a customer location or application. The nature of custom projects did not change in 2011 in comparison to previous or subsequent years.⁴¹

69. Union's claimed 2011 DSM savings for custom projects underwent several reviews:

- (1) The projects and savings were reviewed internally by engineers employed by Union.
- (2) A sample of projects was selected by a third party, Navigant Consulting, following the sampling protocol established in 2008 in consultation with Union

⁴⁰ Exhibit B, Tab 5, pp. 6-7

⁴¹ Tr. Vol 3, p.10, line 25

and Enbridge's EACs. The sample frame was designed to achieve a 90:15 confidence level. There were 25 projects sampled for the commercial/industrial custom program, and 13 sampled for the large distribution contract custom program.

- (3) The selected projects were then verified by Michaels Energy ("Michaels") for commercial/industrial custom projects and by Diamond Engineering ("Diamond") for large distribution contract custom projects. Both Michaels and Diamond reviewed their findings internally within their own organizations, and had the results reviewed by an Ontario Professional Engineer.
- (4) Cascade Energy ("Cascade"), a subcontractor of the 2011 auditor EcoNorthwest, then independently reviewed the Michaels and Diamond reports and calculations. As part of this review, Cascade interviewed each of the verification consultants to clarify the results of the verification work and seek answers to any questions that arose during Cascades' review.
- (5) Prior to the finalization of the audited results, Union's EAC reviewed executive summaries of the Michaels and Diamond reports, along with the Audit Report by EcoNorthwest, which reflected Cascades' findings. The verified savings and audit recommendations are reflected in the final 2011 audited DSM figures.

70. SEC questions were directed at whether, absent the involvement of Union's DSM group, the customer would have undertaken the particular custom project on its own initiative.

71. While framed as relating to the proper "base case", in substance, SEC's questions relate to the approach to "free ridership". The Board, however, considered this issue in EB-2006-0021 (the first generic DSM proceeding) when it approved the framework applicable to Union's 2011 DSM activity. There, the Board specifically considered whether "free riders for custom projects [should] be determined on a portfolio average or on a project basis." In the result, the Board approved a portfolio average approach for determining free ridership for custom projects.⁴²

⁴² EB-2006-0021, Decision with Reasons (Phase 1), August 25, 2006, p.44.

72. Consistent with the Board's decision, Union applies a free ridership rate of 54% to the custom projects portfolio. As a result, Union's DSM results reflect only 46% of the savings associated with custom projects (Volume 3, page 92, lines 20-24). Union has used this free ridership rate since 2009, with support from its DSM consultative and its various EACs.

73. Union filed its 2012 DSM Annual Report, Audit Report and Audit Committee Summary Report with the Board on October 30, 2013 in compliance with the Board's Reporting and Record Keeping Requirement. As discussed above, the audited 2012 results are reflected in the evidence schedule updates filed on November 4, 2013. The updates resulted in a decrease in the Lost Revenue Adjustment Mechanism deferral account balance (Account 179-75) of \$69,000 and a decrease in the DSM Incentive deferral account balance (Account 179-126) of \$388,000. Union proposes that these updated deferral balances be disposed of in this proceeding.

E. New Deferral Clearing Variance Account No. 179-132

74. Deferral and variance accounts record the difference between actual and forecast results. The accounts eliminate forecast error, with the intention that actual results be disposed of as directed by the Board. As a matter of principle, it would be inconsistent with the very establishment of such accounts if Union, or ratepayers, were to gain or lose on the disposition of the actual amount recorded in an account.

75. Prior to 2012 any over- or under-refunding of deferral account balances was largely immaterial. In 2013, that changed.⁴³

76. Promptly on becoming aware of the significant over-refund due to variances from forecasted volumes in the disposition of 2010 deferral balances, Union applied to the Board for a variance account to address the potential over-refund of 2011 deferral balances.⁴⁴

77. Union chose the April to September 2013 period to prospectively dispose of the 2011 deferral amounts as quickly as possible after the Board's final Decision. Union's practice over the last several years has been to dispose of the amounts prospectively over six months.⁴⁵

⁴³ Exhibit A, Tab 1, p.40

⁴⁴ Tr. Vol 1, p. 33 and Exhibit A, Tab 1, page 41

78. The 2011 gas supply deferral account balances (Upstream Transportation FT-RAM Optimization deferral account (179-130) and UDC deferral account (179-108)) are the two major drivers of the over-refund of deferral account balances (Exhibit D2.1 Updated).

79. Union's proposal to establish a new deferral clearing variance account ensures that ratepayers receive actual, approved deferral balances passed through to them. With 2011 deferral balances, there is a significant difference between what was disposed of to ratepayers and what should have been disposed of. As Mr. Birmingham described at the hearing:

And just on that, Mr. Aiken, I know you'll be familiar with this, but in the context of the new incentive regulation settlement agreement -- and so this is EB-2013-0202 -- in section 7 there is a segment on deferral and variance accounts, and if I can just beg your indulgence for a second, on page 22 what it says there is:

It is understood and agreed that Union will administer the pass-through items of expenses and savings in a manner that is compatible with the principle that neither Union nor its ratepayers should gain or lose on such pass-through items.

And I think from our perspective that's always been the case. That's not a new principle. That is the very reason why deferral and variance accounts are put in place.⁴⁶

F. Audited Financial Statements for Union's Regulated Business

80. In its EB-2011-0210 Decision and Order (October 25, 2012, p.128), the Board directed Union to prepare and file separate audited financial statements for the portion of its business that is subject to rate regulation. The Board also ordered Union to collect the costs of preparing the statements in a new deferral account.

81. In Exhibit A, Tab 1, Addendum, Union provided an updated estimate of the costs to prepare these financial statements. Union filed the Addendum for information purposes only, because the costs increased from the previous estimate provided in EB-2011-0210. Union did not seek any relief from the Board with respect to the directive (Volume 1, page 54-55).

⁴⁵ Tr. Vol. 1, p. 32

⁴⁶ Tr. Vol. 1, pp. 41 and 43

82. As a result of the increase in the cost estimate to prepare audited financial statements for Union's regulated business, the Board, on its own motion, determined that it would initiate a review of the Board's directive (EB-2013-0109 Notice of Motion and Procedural Order No. 3). The Motion was filed on October 25, 2013.

83. As Union indicated in EB-2011-0210, the parties that advocated for separate audited financial statements failed to identify any information not already disclosed by Union in that proceeding or by Union in response to the Board's Reporting and Record Keeping Requirements that would be available as a result of the audited statements. It is unclear to Union what incremental information will be available to the Board and to intervenors as a result of the directive.

84. As required by its IRM Settlement Agreements (past and going forward), Union files with the Board an earnings sharing calculation supported by schedules that report utility earnings in which non-utility earnings are removed from corporate earnings. (See, for example, section 12.1 of the Settlement Agreement approved by the Board in EB-2013-0202.) Union believes that the above information addresses the requirements of the Board and parties in respect of the financial results related to utility operations. Certainly, further information is not required by Union to manage its utility operations. Union is required to prepare consolidated statements regardless of the result of the Motion. These are filed with the Board.⁴⁷

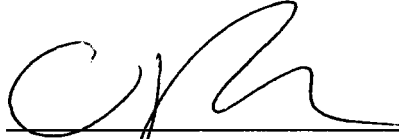
85. It is Union's intention to seek recovery of the costs related to the audited utility financial statements from ratepayers through the deferral account established in EB-2011-0210.⁴⁸

⁴⁷ Tr. Vol. 1, pp. 105 and 109

⁴⁸ Tr. Vol. 1, p. 105

86. Having regard to the Motion, Union has suspended work on the preparation of the financial statements in issue. This decision by Union is not expected to impede its ability to meet the June 30, 2014 deadline as outlined in the Board's directive.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

A handwritten signature in black ink, appearing to read 'Crawford Smith', written over a horizontal line.

Crawford Smith
Lawyers for Union Gas Limited