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**By Electronic Filing**

November 27, 2013

Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge Street, 27<sup>th</sup> floor  
Toronto, ON M4P 1E4

Dear Ms Walli,

**Union Gas Limited ("Union")**  
**2012 Earnings Sharing & Disposition of Deferral Accounts**  
**Board File No.: EB-2013-0109**  
**Our File No.: 339583-000157**

After circulating the Written Argument of Canadian Manufacturers & Exporters ("CME") last night, we discovered that it contained a few typographical errors and that a portion of footnote 13 on page 10 was missing.

We have corrected these omissions in the corrected version of the Argument which is enclosed.

The typographical corrections that have been made are as follows:

- At page 3, lines 4 and 5, the phrase "proposals have" has been changed to read "proposal has";
- At page 8, line 3, a period has been added after the word "Agreement" and the letter "t" in the word "the" has been capitalized;
- At page 10, the following has been added to footnote 13:  
"and page 184, line 1 to page 186, line 23 along with Exhibit D7.18 showing the total consideration paid by the marketer for the assignment of FT Capacity from Union in case 4 at \$2.74/GJ, and in cases 5 and 6 at \$2.89/GJ. The consideration paid by Union to the marketer for the firm Exchange Service in each case at \$2.29/GJ."
- At page 19, paragraph 54, last line, the word "are" should read "is".

Yours very truly,

A handwritten signature in dark ink, appearing to read 'Peter Thompson', is written over a faint, larger signature that appears to be 'Alfred Wong'.

Peter C.P. Thompson, Q.C.

PCT/kt

Encl.

c. Karen Hockin (Union)  
Paul Clipsham (CME)  
All Interested Parties – EB-2013-0109

OTT01: 6036371: v1

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

**AND IN THE MATTER OF** an application filed 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.

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**ARGUMENT OF  
CANADIAN MANUFACTURERS & EXPORTERS ("CME")**

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**November 26, 2013**

(Corrected)

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## **I N D E X**

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**A. INTRODUCTION**

1. These submissions are made on behalf of Canadian Manufacturers & Exporters (“CME”) with respect to the relief requested by Union Gas Limited (“Union”) in this proceeding. The submissions relate to each of the topics addressed by Union in sections B to F of its Argument-in-Chief dated November 12, 2013.
2. The topic headings we have used to characterize the issues Union addressed in each of those sections are:
  - (a) The FT-RAM Related “Classification” and “Incentive” Issues – we submit that these words are a more appropriate description of the disputed issues pertaining to the 2012 FT-RAM Related optimization amounts;
  - (b) Response to Gas Supply Planning Directive;
  - (c) Demand Side Management (“DSM”);
  - (d) Deferral Clearing Variance Account Proposal; and
  - (e) Audited Utility Financial Statements.
3. Our submissions with respect to each of these topics follows.

**B. FT-RAM RELATED CLASSIFICATION AND INCENTIVE ISSUES****Background**

4. In 2012, Union realized \$36.641M<sup>1</sup> of upstream gas transportation “savings” compared to amounts embedded in 2012 rates. The embedded amounts are recovered from system gas and bundled T-service customers in the North served under the auspices of Union’s Rates 01, 10, 20 and 25, and from its system gas customers in the South served under the auspices of Rates M1, M2, M4, M5A and M10.<sup>2</sup>

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<sup>1</sup> See Exhibit D7.11

<sup>2</sup> See Exhibit D7.8 and Exhibit B, Tab 4, Schedule 1, Column (d) for the rate classes with numbers in brackets.

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5. Union classifies 9,881 of its customers as manufacturers. Of these, 261 are served under the auspices of contract Rates 20, 25 and 100 in the North, and contract Rates M4, M5, M7 and T1 in the South. The remaining 9,620 customers which Union classifies as manufacturers are served under the auspices of non-contract Rates 01 and 10 in the North, and Rates M1 and M2 in the South.<sup>3</sup>
  6. Based on the foregoing, some customers which Union classifies as manufacturers, albeit relatively small ones, are within the rate classes that pay the amounts embedded in rates for the transportation of gas to Union's system from points upstream.
  7. Adhering to the "upstream gas transportation cost reduction" classification of FT-RAM Related optimization amounts established by the Board in its EB-2012-0087 Decision and Order on Preliminary Issue dated November 19, 2012 (the "0087 Decision"), compared to Union's proposed "earnings subject to earnings sharing" classification and allocation, operates to benefit those small manufacturers who are system gas or bundled T-customers served under the auspices of Rates 01, 10, 20 and 25 in the North, and system gas customers served under the auspices of Rates M1, M2, M4, M5A and M10 in the South.<sup>4</sup>
  8. Conversely, Union's "earnings subject to earnings sharing" classification and allocation proposal for 2012 increases the incentive payment to Union's shareholder from \$3.664M, under the adherence to the 0087 Decision scenario, to \$20.911M<sup>5</sup>; and reduces the amount to be allocated to ratepayers, under the 0087 Decision scenario, from \$32.977M

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<sup>3</sup> See Exhibit J1.4 updated.

<sup>4</sup> See Exhibit B, Tab 4, Schedule 1, column (e) and Exhibit D2.20, Attachment 1 at page 20 of Exhibit K1.2 for impacts on small, average and large Rate 20 customers in the North. For small, average and large Rate M4 and M5 customers in the South, see Exhibit B, Tab 4, Schedule 2, pages 1 and 2, column (f). There are, for example, 18 bundled direct purchase and 2 sales service customers served on Rate 20 in the North, some of whom will likely be small manufacturers. The annual benefit to these customers of adhering to the 0087 Decision is about \$46,000, \$180,000 and \$231,000 respectively.

<sup>5</sup> The \$20.911M is the \$36.641M at Exhibit A, Tab 1, Appendix B, page 2, line 7, column (b) minus the \$15.730M which is the amount Union proposes to share with ratepayers.

to \$15.730M. That materially reduced amount is allocated to 18 Rate Classes under Union's proposal, 9 of which do not pay the upstream gas transportation costs embedded in rates.<sup>6</sup> Compared to the adherence to the 0087 Decision scenario, Union's proposal has a negative effect on the customer classes who actually pay the upstream gas transportation costs embedded in rates, some of whom will be customers which Union classifies as manufacturers.

9. In all cases, including a case such as this where some manufacturers, regardless of their size, stand to gain and others stand to lose under the auspices of classification, allocation and incentive payment proposals which are matters in dispute, CME's mandate to its counsel is to advocate that the matters in dispute be determined on a principled basis which is compatible with the evidence and prior Board decisions.
10. The submissions which follow are made in accordance with this mandate.

Union's Evidence and Argument in this Proceeding

11. In its evidence and Argument, Union urges the Board to refrain from adhering to the classification, allocation and incentive payment determinations made in the 0087 Decision. It makes this submission on the grounds that it has presented an evidentiary record in this proceeding which is "different" and "more complete"<sup>7</sup> than the evidence presented in the EB-2012-0087 and EB-2011-0210 proceedings pertaining to FT-RAM Related optimization transactions.
12. The more detailed evidence which Union has presented in this proceeding relates to its Gas Supply Planning and the FT-RAM Related transactions in which it engages.

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<sup>6</sup> See Exhibit A, Tab 3, Appendix A, Schedule 1, page 1, line 23 for the rate classes to whom Union proposes to allocate the \$17.73M. They total 18 in number and are not confined to the members of the four (4) rate classes in the North and the five (5) rate classes in the South listed in para.7 of these submissions who pay the upstream gas transportation costs embedded in distribution rates.

<sup>7</sup> Union's Argument-in-Chief, para.11.

However, this well organized and well presented evidence adds little if anything of substance to a number of important issues which the Board considered and determined in the EB-2012-0087 proceeding.<sup>8</sup>

13. We submit that little if anything new has been said in this proceeding that was not said in the EB-2012-0087 and EB-2011-0210 proceedings with respect to the Board's response to Union's argument that its classification of the FT-RAM Related optimization amounts as "earnings subject to earnings sharing" under the IRM Agreement had been consented to by parties and approved by the Board in cases prior to 2011. As noted below, the Board rejected Union's argument to that effect.
14. The points of fact and argument upon which Union relies in paragraphs 13 to 32 of its Argument-in-Chief were made by Union in its Arguments-in-Chief and Reply Arguments in the EB-2012-0087 proceeding. There is little if anything new or different in these facts and arguments, and we do not intend to repeat the facts and arguments on the other side of the issue. They are a matter of record in the EB-2012-0087 proceeding.<sup>9</sup>
15. The Board, in the 0087 Decision, rejected Union's contention that the FT-RAM Related optimization amounts cannot be classified as upstream gas transportation cost reductions because of the circumstances that occurred in:
  - (a) the EB-2005-0520 proceeding to which Union refers in paragraphs 15 and 16 of its Argument-in-Chief;
  - (b) the EB-2007-0606 proceeding to which Union refers in paragraphs 17 to 21 of its Argument-in-Chief;

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<sup>8</sup> We urge the Board to review the Arguments presented in the EB-2012-0087 proceeding to better appreciate the considerable extent to which matters were covered by evidence and argument in that proceeding.

<sup>9</sup> See CME's Argument in the EB-2012-0087 proceeding to better appreciate the extent to which the chronology provided by Union in its Argument-in-Chief in this case was fully addressed in the EB-2012-0087 proceeding.

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- (c) the EB-2009-0101 proceeding to which Union refers in paragraphs 22 to 27 of its Argument-in-Chief; and
- (d) the benefits of the IRM Agreements to which Union refers in paragraphs 28 to 32 of its Argument-in-Chief.
16. The Board found that none of the arguments Union made on the basis of these circumstances had merit because of Union's failure to satisfy its disclosure obligation, as a Board regulated utility, to provide a sufficiently complete level of disclosure in the proceedings prior to 2011 pertaining to the extent of its involvement in FT-RAM Related optimization activities or its treatment of the resulting revenues. At pages 29 and 30 of the 0087 Decision, the Board stated as follows:

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

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

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

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



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

*In general, the Board is of the view that there is no expectation that the exact nature of the efficiency gains anticipated by a utility during an IRM period be identified or disclosed in advance. However, the question that is the subject of the Preliminary Issue in this proceeding and has unfolded in the context of Union's IRM Framework in this case is different.*

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

17. We submit that there is nothing in this case which could reasonably justify any changes to these findings. We submit that the 0087 Decision findings, that Union's classification and allocation of FT-RAM Related optimization amounts in years prior to 2011 was neither consented to nor approved by the Board or other affected stakeholders, are findings that remain valid.
18. In the context of the Board's findings with respect to the inadequacy of Union's disclosure in the prior proceedings, the Board's rejection, in the 0087 Decision, of Union's proposal to classify 2011 FT-RAM Related optimization amounts as "earnings subject to earnings sharing" is not "retroactive rate-making" as Union contends. Retroactive rate-making involves a decision by the Board to change an informed approval previously granted. The question of the appropriateness of Union's classification of these

amounts as “earnings subject to earnings sharing” arose for the first time in the 2011 Earnings Sharing Mechanism (“ESM”) proceeding. The issue was never considered or decided previously with the result that there was no retroactivity involved in considering and deciding the issue in that proceeding.

19. Moreover, as outlined in the Factum filed by Board counsel, Mr. Millar, in Union’s Divisional Court Appeal of the 0087 Decision, matters pertaining to the appropriateness or inappropriateness of Union’s classification of any 2011 earnings amounts fall squarely within the scope of the 2011 ESM proceeding. There was no retroactive rate-making involved in considering the issue in Union’s 2011 ESM proceeding and there is no retroactivity involved in considering the classification issue in Union’s 2012 ESM proceeding.
20. The Board’s rejection of Union’s Argument in the EB-2012-0087 proceeding, that approving a classification of FT-RAM Related optimization amounts as anything other than earnings subject to earnings sharing under the IRM Agreement, continues to be valid. It applies to support a finding that no impermissible retroactive rate-making is involved in considering in this case the appropriateness of Union’s classification of 2012 FT-RAM Related optimization amounts.<sup>10</sup>
21. Another important consequence of the Board’s finding in the 0087 Decision, that Union’s treatment of the FT-RAM Related optimization amounts as earnings subject to earnings sharing under the IRM Agreement was neither consented to nor approved by the Board or other stakeholders in proceedings prior to 2011, is that FT-RAM Related optimization amounts fall outside the ambit of the EB-2007-0606 IRM Settlement Agreement pertaining to the closure of the Transactional Services Deferral Account (“TSDA”). Put

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<sup>10</sup> See Union’s Argument-in-Chief, para. 9(5).

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another way, as a result of the Board's findings that neither the Board nor stakeholders knowingly approved or consented to FT-RAM optimization amounts being classified as earnings subject to earnings sharing under the IRM Agreement. The earnings sharing provisions of the IRM Agreement do not apply to ratepayers as a matter of contract with respect to either the 2011 or 2012 FT-RAM optimization amounts.

22. Union's proposal to classify the amounts as earnings subject to earnings sharing is a classification and allocation proposal to which ratepayers never contractually committed. As against ratepayers, the proposal has no contractual foundation. Union's proposal cannot be adopted on grounds that ratepayers agreed to it. Rather, its adoption must be justified on the basis that it is compatible with the concepts upon which the IRM Agreement is based and with the Board's precedent decisions pertaining to a determination of the incentive amount to be paid to utility shareholders for producing utility asset optimization benefits.
23. It is in this context that we believe that it is more appropriate to characterize Union's proposal as one which asks the Board to approve the payment of an incentive to Union's shareholder in the amount of about \$20.911M for producing FT-RAM Related optimization amounts in 2012 of \$36.641M, or an incentive percentage of about 57%. Union's proposal, when expressed as an incentive percentage of 57%, is about 5.7 times the percentage incentive of 10% established by the Board in its 0087 Decision.

#### The Issues

24. Based on the foregoing, we submit that the issues to be determined in this case, having regard to the more detailed evidence which Union has provided with respect to Gas Supply Planning and the range of FT-RAM Related optimization activities in which it engages, are as follows:

- 
- (a) Whether under the IRM Agreement, the amounts realized in 2012 of \$36.641M from FT-RAM Related activities is appropriately classified and allocated as upstream gas transportation cost reductions or whether some other classification and allocation is appropriate (the “Classification Issue”)?; and
- (b) What is the appropriate incentive to be paid to Union’s shareholder for having produced FT-RAM Related Optimization amounts in 2012 of \$36.641M (the “Incentive Payment Issue”)?

FT-RAM Related Optimization Transactions

25. The 2012 FT-RAM Related optimization activities consist of Capacity Release Exchanges and Union’s Own Use of FT-RAM Credits. Capacity Release Exchanges comprise about 85.25% or about \$31.236M of the 2012 FT-RAM Related optimization transactions. Union’s Own Use of FT-RAM Credits have comprised the other 14.75% of such transactions, having a value of about \$5.404M.<sup>11</sup>

(i) Capacity Release Exchanges

26. Capacity Release Exchanges are combined transactions. Union assigns its FT capacity to a marketer. As consideration, Union receives the benefit of that marketer paying the full TransCanada PipeLines (“TCPL”) FT toll to TransCanada and an additional payment because, with all of its attributes, including FT-RAM credits and diversions, the value to the marketer of the FT capacity is greater than TCPL’s regulated FT toll.
27. As part of the combined transaction, Union acquires the equivalent of a Firm Transportation exchange service from the marketer who takes Union’s utility gas from points upstream on Union’s system and delivers an equivalent amount of gas to the points

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<sup>11</sup> See Exhibit D7.12 – Capacity Release Exchanges total about \$31.8M of the \$37.3M or 85.25% of FT-RAM Related Transactions in 2012. The remaining 14.25% are transactions involving Union’s own use of IT credits.

on Union's system where that gas is then needed. The price the marketer charges for this service is the FT toll which Union would have paid to TCPL for firm FT service.<sup>12</sup>

28. While the invoicing and accounting for this combined transaction can be structured in a number of ways, we submit that the essence of the transaction is the assignment by Union of FT capacity at a value which exceeds its FT toll value and the acquisition by Union of firm utility gas transportation from a source different from that specified in the Gas Supply Plan at a price equivalent to the toll Union would pay to TCPL had it not assigned its FT service. If the combined or bundled Capacity Release Exchange is unbundled into a stand-alone assignment of unused FT capacity at a value exceeding its FT toll value and Union's purchase from the marketer of the alternate method of obtaining delivery of utility gas to the utility system, then the enhanced value of the assigned FT capacity would show up in a UDC deferral account as a credit to ratepayers.<sup>13</sup>

(ii) Union's Own Use of FT-RAM Credits

29. The other type of FT-RAM Related optimization transaction involves a decision by Union to refrain from using its FT capacity to carry utility gas to its system from points upstream and, instead, to use IT service which it purchases using the FT-RAM credits attributable to the unused FT capacity. IT service, instead of FT service, is the new mode

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<sup>12</sup> During the course of their cross-examination, Union witnesses agreed that the types of FT-RAM Related optimization transactions conducted in 2012 were the same types of transactions that were conducted in 2011 – see Transcript Volume 2, page 9, lines 18 to 22. Those questioning then followed pertaining to:

1. the proportions of Capacity Release Exchange transactions and Union's Own Use of IT transactions which occurred in 2012 – see Transcript Volume 2, page 9, lines 23 to page 11, line 13;
2. the features of Base Exchanges – see Transcript Volume 2, page 11, line 14 to page 15, line 10;
3. stand-alone capacity releases or assignments – see Transcript Volume 2, page 15, line 10 to page 18, line 18;
4. Capacity Release Exchanges – see Transcript Volume 2, page 18, line 19 to page 36, line 22.

We submit that the evidence provided during the course of this questioning supports our description of the nature of Capacity Release Exchange transactions.

<sup>13</sup> See Transcript Volume 2, page 35, line 18 to page 36, line 20, and page 184, line 1 to page 186, line 23 along with Exhibit D7.18 showing the total consideration paid by the marketer for the assignment of FT Capacity from Union in case 4 at \$2.74/GJ, and in cases 5 and 6 at \$2.89/GJ. The consideration paid by Union to the marketer for the firm Exchange Service in each case at \$2.29/GJ.

of transportation used to transport utility gas to Union's system from points upstream. Not all of the FT-RAM credits are needed to acquire the IT service which is used as a substitute for the FT service embedded in rates for transporting Union's utility gas to its system from points upstream. The remaining FT-RAM credits are used to acquire IT to support Union's provision of exchanges to third parties. This combination of transactions produced about 14.75% of the total 2012 amounts of about \$36.641M or about \$5.405M of FT-RAM Related optimization "savings".<sup>14</sup>

30. Each of these types of FT-RAM Related optimization activities produce "savings" compared to the embedded costs of upstream transportation being recovered by Union in rates.

Transportation Switching is an Essential Component of FT-RAM Related Optimizations

31. An essential component of each of these types of FT-RAM Related optimization transactions is the use of a method to move Union's utility gas to its system from points upstream which differs from the method for moving that utility gas which is embedded in rates. We characterize this essential component of these FT-RAM Related optimization transactions "transportation switching". Notwithstanding the fact that Union does not agree with this characterization, we submit that it is appropriate.<sup>15</sup> The use of a transportation method which differs from the transportation method embedded in utility rates is reasonably characterized as utility gas transportation switching.

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<sup>14</sup> We rely upon and do not repeat here the detailed analysis of these two (2) types of combined transactions contained in CME's Argument in the EB-2012-0087 proceeding.

<sup>15</sup> Whether or not Union agrees with our use of the word "switching", the fact is that Union must decide to use a method different than that specified in the Gas Supply Plan to move utility gas to its system from points upstream to be able to engage in these "combined" optimization transactions. This decision to change the method to be used for transporting utility gas to Union's system from points upstream is an essential pre-requisite. The decision to make the change is a matter within Union's control.

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32. These submissions do not focus on whether FT-RAM Related optimization activities are “planned” or “unplanned”. In our view, the question of whether or not the FT-RAM Related optimization activities were pre-planned is not determinative of the Classification Issue. Rather, we submit that what is determinative is the answer to the question of whether a decision to change the method of transporting utility gas from that specified in the Gas Supply Plan is a necessary pre-cursor to producing the “savings” through the optimization activities.
33. Similarly, these submissions do not focus on whether the “surplus” used to support FT-RAM Related optimization activities is “temporary” or otherwise. Rather, their focus is on the cause of the “surplus” used to support the transactions and whether or not the cause is a matter within Union’s control. The “cause” of the surpluses used to support FT-RAM Related optimization is a decision to use a method different from that specified in the Gas Supply Plan to move utility gas to the distribution system from points upstream. The decision to make such a change is a matter within Union’s control and the decision constitutes a temporary change to gas transportation planning. Temporary changes to gas transportation planning fall within the ambit of the Y factor or flow-through items under the IRM Agreement.
34. In our view, transportation switching is the key factor in determining whether FT-RAM Related optimization amounts should be classified as “upstream gas transportation cost reductions” or as “utility revenues”. If “transportation switching” must take place in order for optimization benefits to be utilized, then the “upstream gas transportation cost reduction” classification for the savings realized should prevail.

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FT-RAM Related Optimizations are Not the Same as Base Exchanges

35. Union rationalizes its “utility revenues” classification proposal on the basis of an assertion that FT-RAM Related transactions are the same as Base Exchanges, and that, from a classification perspective, there is no difference between these types of transactions.
36. We have reviewed all of the evidence Union has provided in this case with respect to the range of FT-RAM Related activities in which Union engages and do not find therein any evidence to support the notion that there is no difference between Base Exchanges and FT-RAM Related optimization activities. We believe that these categories of upstream transportation optimization activities are different.
37. Base Exchanges are a service Union sells to a third party using upstream transportation it holds which is temporarily under-utilized because of factors such as weather or reduced demand. No decisions must be made to change the method for moving utility gas to Union’s system from points upstream before the benefits of a Base Exchange can be realized. No utility gas transportation switching is involved in a Base Exchange.
38. In contrast, an element essential to FT-RAM Related optimization activities is the use by the utility of a method other than the FT service embedded in the Gas Supply Plan and in rates to move utility gas from points upstream to the points on Union’s system where that gas is needed. All FT-RAM Related optimization activities require that a decision be made to change the method of gas transportation to be used to transport utility gas to Union’s system before the optimization benefits can be produced. It is this transportation switching which, in our view, inevitably gives rise to the upstream gas transportation cost reduction classification of the optimization amounts realized because transportation switching decisions are, in essence, periodic gas transportation planning changes, the



outcomes of which fall within the ambit of flow-through items of expense under the IRM Agreement.

39. Capacity Release Exchanges and the other FT-RAM Related optimization activities are not analogous to Base Exchanges. Utility gas transportation switching gives rise to amounts properly classified as gas transportation cost reductions for the same reason that switching from one source of utility commodity embedded in rates to a cheaper source of such commodity would lead to a flow-through to ratepayers of any commodity cost reductions achieved as a result.
40. We accept that Union has provided more detailed evidence in this proceeding of its Gas Supply Planning. However, whether or not its Gas Supply Plan for 2012 was right-sized or over-sized is not determinative of the Classification Issue. As the Board stated in Enbridge Gas Distribution Inc.'s ("EGD") 2011 ESM proceeding, namely, EB-2012-0055:

***"Regardless of the Board's conclusion that Enbridge's capacity releases occur on an unplanned basis, the outcome of these transactions is that gas, which is required by Enbridge's customers, is delivered to these same customers at a reduced cost."***

41. Based on this analysis, the Board concluded, at page 14:

***"... it is clear to the Board that the revenues generated from capacity release transactions should be treated as gas cost reductions."***

42. A similar conclusion pertaining to the transportation switching effect of FT-RAM Related optimization activities in which Union engages has on the outcome of the "Classification Issue" was made by the Board in its 0087 Decision at page 26 where the Board stated:

***"The Board finds that the effect of this activity is that higher upstream transportation costs that are paid for by Union's***

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***customers, have been substituted with lower cost upstream transportation arrangements.”***

43. We submit that it is these findings with respect to the utility gas transportation switching element of the transactions which give rise to the upstream gas transportation cost reduction classification. It is the transportation switching aspect of the transactions that engages the flow-through items of expense concept expressed in the IRM Agreement.
44. Advance planning, invoicing practices, and the concepts of unlocking value are irrelevant to the Classification Issue. If the optimization amounts can only be realized because a prior transportation switching decision has been made, then the appropriate classification of the savings achieved is as upstream gas transportation cost reductions.
45. If we are correct that an essential component of FT-RAM Related optimization activities is utility gas transportation switching, then we submit that the upstream gas transportation cost reduction classification, which the Board established in the 0087 Decision, remains valid. That classification is supported by and compatible with the Y factor flow-through expense categories in the IRM Agreement and the principle embedded in the IRM Agreement that Union should not profit from reductions in items of flow-through expense.

Implications of a “Utility Revenues” Classification

46. We accept that, despite these submissions, the Board could find that 2012 FT-RAM Related optimization amounts should be classified as “utility revenues”, rather than as “upstream gas transportation cost reductions”. Even if the Board adopts a “utility revenues” classification, the Board must still consider the further questions of:
- (a) whether the portion of those revenues which Union proposes to allocate to its shareholder is appropriate; and

- (b) whether the allocation to ratepayers of the remaining amount is being made to the appropriate rate classes.

In connection with the first question, we ask whether there is any principled basis upon which Union's proposal to apply the earnings sharing formula under the IRM Agreement to determine the incentive amount that should be paid to its shareholder for producing the optimization revenues can be supported? We can see no principled basis for determining the incentive amount in the manner proposed by Union which adds the revenues attributable to optimization to utility over-earnings not attributable to FT-RAM Related optimization activities. It is mere happenstance that the amount to be allocated to Union's shareholder is in the order of \$21M. Had the utility not achieved any over-earnings in 2012, then the shareholder would realize almost 100% of the optimization amounts. Conversely, had the utility achieved over-earnings not attributable to FT-RAM Related optimization activities in an amount 300 basis points above the Board approved Return on Equity ("ROE"), then the share of the optimization amounts allocable to Union's shareholder would be 10%.<sup>16</sup>

47. We submit that this wide range of possible outcomes supports a conclusion that the method Union proposes to determine the portion of revenues to be allocated to its shareholder is inappropriate.
48. Regardless of whether or not the FT-RAM Related optimization amounts are classified as "upstream gas transportation cost reductions" or "utility revenues", the proportion thereof to be allocated to Union's shareholder for having produced the optimization amounts

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<sup>16</sup> See Transcript Volume 1, page 76, line 16 to page 78, line 11 – If there were no 2012 over-earnings of \$25,823, excluding the FT-RAM Related optimization amounts of about \$37M, then the \$37M of FT-RAM revenues, as utility earnings, would barely break through the 200 basis points dead-band. Conversely, if utility over-earnings excluding FT-RAM Related optimizations were \$56M, then the \$37M of FT-RAM optimization amounts would fall in the over 300 basis points tranche of the earnings sharing formula, 90% of which would be allocated to ratepayers.

should represent a reasonable incentive percentage. Put another way, the incentive Union's shareholder receives for having produced the FT-RAM Related optimization amounts should be the same regardless of the outcome of the classification debate. We submit that the earnings sharing formula is irrelevant to a determination of the level of incentive payment to Union's shareholder for having produced the optimization amounts which can be characterized as reasonable.

49. The principled basis for determining the appropriate incentive to be paid to Union's shareholder for engaging in such activities involves, amongst other things, a consideration of the Board's precedent decisions determining the appropriate percentage level for compensating Union's shareholder for optimization activities. In this connection, the Board's 0087 Decision addressed this issue on a principled basis by considering the range of possible incentive percentages by reference to prior Board decisions approving incentive payments ranging from 10% to 25%. In this connection, the Board stated as follows, at page 30:

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

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

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

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

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

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

50. We agree that Union should receive an incentive for producing 2012 FT-RAM Related optimization benefits within the range of 10% to 25% which the Board identified in its 0087 Decision.
51. In its Interrogatories and its questioning of Union witnesses, CME invited Union to present its 2012 FT-RAM optimization amounts classification and allocation proposals in an incentive payment context. Union refrained from presenting its proposal in this context.<sup>17</sup>
52. CME asked Union's expert to provide the Board with the benefit of his experience with respect to the level of incentive payments received by a utility which uses in-house resources paid for by ratepayers to conduct utility asset optimization transactions. In response, the witness stated that, in his experience, 10% was a very common incentive payment allowance to the utility shareholder for having engaged in such optimization transactions.<sup>18</sup>

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<sup>17</sup> See Exhibits D7.16 and D7.17, and Transcript Volume 2, page 3, line 7 to page 4, line 9.

<sup>18</sup> See Transcript Volume 2, page 176, line 4 to page 182, line 7. After determining Mr. Stevens' fairly extensive experience with matters pertaining to optimization at Transcript pages 176, line 4 to page 180, line 22, the witness was asked to provide the Board with the benefit of his expertise and with respect to the sharing of optimization revenues between ratepayers and the utility shareholder for a company like Union Gas which uses an in-house approach to utility asset optimization. At page 181, lines 8 to 12, the expert witness stated:

*"So in a broader sense, my typical experience has been that the revenue sharing mechanism to provide incentive to LDCs to remarket capacity has been in the 90/10 range, with some at 75/25."*

and again at lines 19 to 23:

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53. Union's expert witness confirmed the range of 10% to 25% and expressed the view that the 10% incentive allowance determined by the Board to be appropriate in the 0087 Decision is very common. In these circumstances, we submit that there is no principled basis for increasing the incentive allowance to the 57% level which Union is proposing. The range of reasonableness is between 10% and 25%.
54. With respect to the second question as to whether the allocation of the amount to ratepayers is being made to the appropriate rate classes, we can find no principled basis for allocating the ratepayers' share of the optimization amounts realized to classes of ratepayers who do not have costs embedded in their rates for upstream transportation. We can find no principled basis for supporting an allocation of optimization savings inextricably linked to what we call "transportation switching" decisions that must be made so that the optimization amounts can be realized to rate classes who pay no upstream transportation costs in their rates. Union's proposal to allocate the amounts to rate classes who pay no upstream transportation costs in their rates is inappropriate.

#### Conclusion

55. For these reasons, we can find no principled basis for supporting Union's proposal to reclassify the 2012 FT-RAM Related optimization amounts of \$36.641M as utility revenues, rather than as upstream gas transportation cost reductions. Similarly, we can find no principled basis for justifying an incentive payment to Union's shareholder in the amount of 57% of the optimization savings. The range of reasonableness is between 10% and 25% of the savings, or between \$3.664M and \$9.160M.

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*"No, my general experience, Mr. Thompson, is a utility is optimizing their assets, anything that they earn is shared 90/10, with 90 percent going back to the ratepayers and 10 percent going to the shareholder."*

56. Regardless of whether or not the net amount of \$32.976M remains classified as “upstream gas transportation cost reductions” or as “utility revenues”, this amount should be allocated to the 9 rate classes who paid the upstream gas transportation costs embedded in rates. We can find no principled basis for supporting an allocation of these savings to rate classes who pay no upstream gas transportation costs in their rates.

**C. GAS SUPPLY PLAN**

57. We defer to the submissions of Board staff and others who have far more expertise than we have in identifying whether there are any deficiencies, on a go-forward basis, in Union’s overall response to the Board’s directive requiring it to file with the Board an expert, independent review of its Gas Supply Plan, its gas supply planning process, and gas supply planning methodology.

**D. DEMAND SIDE MANAGEMENT (“DSM”)**

58. Mr. DeRose is a member of the Evaluation and Audit Committee (“EAC”) whose approvals are either explicitly or implicitly the subject of criticism in this proceeding. During that audit process, Mr. DeRose was not provided with the CPSV reports that are the basis of School Energy Coalition’s (“SEC”) concerns. For this reason, the issues raised by SEC were not considered by the EAC.
59. However, because Mr. DeRose is a member of the EAC, we feel it would inappropriate for us to make any submissions on the proposals being made to the Board to revise the EAC approved balances in the 2012 DSM Deferral Accounts.
60. We urge the Board to carefully consider and determine the issues which have been raised about the appropriateness of these EAC approved balances. In future proceedings, we will provide our views on the appropriateness or inappropriateness of the grounds upon which the balances in these deferral accounts are being criticized in this particular case.

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**E. DEFERRAL CLEARING VARIANCE ACCOUNT PROPOSAL**

61. We have had the benefit of reviewing a draft of Mr. Aiken's submissions on this issue. Conceptually, we agree with Union and Mr. Aiken that, as a matter of principle, neither Union's ratepayers nor its shareholder should materially gain or lose on the disposition of the actual amounts recorded in deferral accounts.
62. That said, we are sensitive to Mr. Aiken's concern that a proposal to introduce a deferral clearing variance account at the end of the five (5) year term of an IRM Agreement may be inappropriate. In our view, matters to be considered when evaluating a proposal to introduce such a true-up deferral account at the tail-end of a long-term IRM Plan include whether, in the early years of the plan, situations occurred which benefited Union's shareholder because deferral account balances were too high. When considering that question, the Board may wish to consider events that unfolded in the midst of Union's five (5) year IRM Plan pertaining to returns on incremental storage assets which Union was charging ratepayers through its operation of the storage deferral accounts, as well as events pertaining to FT-RAM Related optimization amounts, in years prior to 2011 which could have been flowed through to ratepayers sooner had the relevant events been discovered earlier.
63. Consideration such as these could prompt the Board to refrain from approving the account Union proposes. In the alternative, if such an account is to be approved, then it might be limited to over-refunds associated with the FT-RAM Related optimization deferral account.
64. We agree with Mr. Aiken that if the Board authorizes the account, then it might be limited to over-refunds associated with the FT-RAM Related optimization deferral account. Further, we agree with Mr. Aiken that if the Board authorizes the account, then



Union should be directed to include in the account any amounts that cannot be processed (credits or debits) as one-time adjustments related to contract customers that are no longer on the system.

**F. AUDITED UTILITY FINANCIAL STATEMENTS**

65. Board staff took the initiative in the EB-2011-0210 proceeding of requesting the Board to direct Union to be required to file separate audited Financial Statements for the regulated portion of the utility. In making this request, Board staff relied on, *inter alia*, the Board's directive requiring Ontario Power Generation Inc. ("OPG") to file such audited statements.<sup>19</sup>
66. CME supported Board staff's submissions, noting that separate financials for the regulated utility would assist parties in determining the proper allocations between rate-regulated and the non-rate-regulated storage business.
67. Included in its rationale for requiring Union to provide this information was the Board's belief that the information will assist in both assessing Union's revenue requirement in future Cost of Service proceedings, and in monitoring Union during the course of the IRM term.<sup>20</sup>
68. The evidence in this case indicates that estimates of the start-up costs which Union is incurring and will continue to incur to enable these audited regulated utility statements to be provided have increased exponentially over the high level estimates provided in the EB-2011-0210 proceeding. We support Mr. Aiken's analysis of this evidence in his submissions.

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<sup>19</sup> See EB-2011-0210 Decision and Order dated October 25, 2012, page 127.

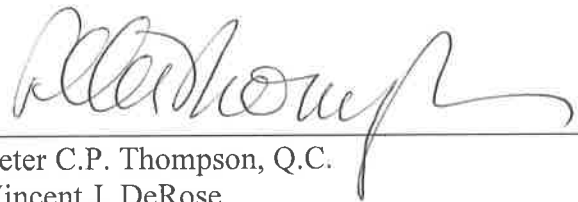
<sup>20</sup> See EB-2011-0210 Decision and Order dated October 25, 2012, page 128.

69. Mr. Aiken suggests that Union should be relieved from the directive. We neither support nor oppose that submission. In our view, the Board and its staff are the ones best able to determine whether the additional costs Union now expects to incur are reasonable, and if they are, whether the benefits the Board expects to derive from having these audited utility Financial Statements from year-to-year are likely to exceed the costs of their preparation.

**G. COSTS**

70. CME requests that it be awarded 100% of its reasonably incurred costs in connection with this matter.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 26<sup>th</sup> day of November 2013.



Peter C.P. Thompson, Q.C.  
Vincent J. DeRose  
Kim Dullet  
Counsel for CME